

MAKE-OR-BUY DECISIONS IN LEGAL SERVICES: A STRATEGIC PERSPECTIVE

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ABSTRACT

How do corporate legal departments and law firms make decisions about ‘making’ or ‘buying’ legal services? In what ways are their decisions governed by the usual criteria and factors identified in economic and managerial theories of the firm? And to what extent are lawyers’ make-or-buy decisions affected by professionalism and partnerships that govern the legal profession? This paper addresses these questions by generating five propositions arising out of various theories, concerning (1) the link between task modularity and organizational modularity, (2) knowledge interdependence complicating this link, (3) rent-seeking, property-rights, incentive-alignment, and decision-making adaptation motives for make-or-buy decisions, (4) the impact of managerial hierarchy on make-or-buy decision, and (5) the industry-level distribution of capabilities affecting value chain disintegration. The paper discusses some evidence in legal services in support of these propositions, and raise questions for further research.

'All law firms are outsourcing providers, but to date we don't behave like one.'

(Amanda Burton, Clifford Chance)

INTRODUCTION

This paper provides a framework for analyzing the make-or-buy decisions in legal services. To date, the study on the legal profession has directed its spot light on the evolving relationship between the law firm and its corporate client (Wilkins, 2009). Amongst other things, analysis in this tradition has highlighted the tension at which the above quotation hints, between the lawyer as a trusted advisor to the client and the lawyer as a mere provider of legal services. Fascinating though this is, it has detracted our attention away from examining the content of legal work, exactly what is kept in-house and what is bought.¹ This paper attempts to fill this analytical hole, by asking whether academic theories shed any light on explaining and predicting the ways in which corporate legal departments and law firms arrive at their make-or-buy decisions. I argue that they do, and that the theories are much improved if modified to capture the essential characteristics of legal work, the legal profession, and the managerial hierarchy of lawyers.

As a business school scholar trained in economics and sociology, my starting point is to review existing economic, engineering, and managerial theories of the firm. These

¹ An exception to this analytical focus is Regan MC, Heegan PT. 2010. Supply chains and porous boundaries: the disaggregation of legal services. *Fordham Law Review* **47**: 2138 - 2191.

theories are wide-ranging and provide guidance on criteria and factors to take into account when making the outsourcing/offshoring decision.² Following this literature review, I ask what modifications or elaborations are necessary in these ‘criteria and factors’ when applied to legal services. I argue that three modifications are necessary, arising from (a) the nature of legal services, (b) the nature of the legal profession, and (c) the nature of managerial hierarchy in law firms, including the partnership form.

Pressures for change in the legal services market and the legal profession predate the current economic downturn. The rise of ‘partners with power’ in large law firms (Nelson, 1988) and the in-house corporate counsel (Chayes *et al.*, 1985) is a phenomenon noted since the 1980s. In make-or-buy terms, this development has led to an interesting combination of management practices in legal services, not seen elsewhere.³ First, corporate clients have been bringing more work back in-house on both sides of the Atlantic.⁴ Second, corporate clients have adopted various methods to

² Outsourcing is about the firm boundary (make-or-buy) decision, whilst offshoring is about the location (onshore or offshore) decision. Traditionally, the two decisions get separate treatment in academic theories, with organization economists and management scholars taking a lead in analyzing firm boundaries, and economic geographers and international trade economists taking a lead in analyzing geographic locations. In practice, a firm may treat the two decisions separately, but it may well consider them simultaneously. Thus, the juxtaposition of the two decisions side-by-side is an essential part of theorizing for the twenty-first century phenomenon of globalization. This paper, however, gives primacy to the firm boundary decision, to simplify the discussion.

³ Not many other industries have experienced a phase in which the use of offshore outsourcing is accompanied by a move towards ‘make’ rather than ‘buy’. For example, in the assembly based industries (apparel, automobile, electronics, etc.), offshore outsourcing and the development of global value chains resulted from big strides towards ‘buying’ rather than ‘making’ in-house.

⁴ According to the annual ‘Managing Outside Counsel Survey’ conducted by the Association of Corporate Counsel (ACC) and Serengeti, the ratio of expenditure on outside counsel as compared to in-house counsel has shifted in favor of the latter (‘ACC Survey: Managing Outside Counsel’ in *The Metropolitan Corporate Counsel*, December 2008, p.25). The median ratio was 2.0 (i.e. for every dollar spent in-house, a legal department spent 2 dollars on outside counsel) in 2004, but it declined to 1.8 (2005), 1.6 (2006), 1.29 (2007), and 1.6 (2008) (www.serengetilaw.com, accessed on 9 November 2009).

increase their bargaining power, via convergence (i.e. reducing the number of law firms) and the introduction of competitive bidding and alternative billing arrangements to contain their legal fees. Third, some corporate clients and law firms have externalized work via the use of contract lawyers and offshore LPO providers. This is potentially a sustainable model. By making explicit the criteria in use for deciding what type of work is 'made' or 'bought', we will be in a better position to predict the future division of labor between corporate counsels, external attorneys, and other players in the industry.

Economic crises bring pre-existing pressures to a head, ushering in disruptive changes typically instigated by new entrepreneurial entrants in search of new market opportunities. This means that the make-or-buy decision, and the resulting division of labor, should be evaluated in light of new players with different strategies (and new business models), pushing and reshaping the boundary of the existing legal services market.

The value chain in the legal services market may be mapped out as follows (see Figure 1). The ultimate client in the market is the corporate legal department. It purchases legal services from law firms, which has its own make-or-buy decisions to make, including the use of contract lawyers. From the perspective of the legal department, there are four distinct paths to access offshore outsourcing. First, it can

Assuming constant price ratios (in the absence of any evidence that the billing rates of outside counsel fell relative to payments to in-house counsel), we conjecture that more work has been carried out in-house than out-of-house over time. Similar evidence exists in the UK. According to the Legal Week Intelligence Client Satisfaction Survey, the average proportion of legal work outsourced by FTSE companies fell from 51% to 42% over the five years 2004-2008 (Legal Week Intelligence (2008) *FTSE/Client Satisfaction Report*, November).

set up a captive offshore operation, as GE Plastics had done in India in 2001.⁵ Second, it can engage a law firm, which in turn sets up a captive offshore operation, as Clifford Chance has done in India. Third, it can use a law firm that sources from an independent offshore LPO provider. Fourth, a corporate client can bypass a law firm altogether, and outsource and offshore using a legal services firm, as Rio Tinto has done with CPA Global.⁶

- Insert Figure 1 about here -

How do firms end up choosing one route rather than another? What are the merits and demerits of each route from the perspective of legal departments and of law firms? What strategies are available to legal departments, law firms, and LPO providers to create and capture value in this increasingly global value chain for legal services? This study addresses these questions theoretically, with some empirical evidence. It is estimated that the LPO sector is worth no more than \$440 million, a mere 0.1% of the global legal services market (worth \$458 billion).⁷ How much more significant the LPO

⁵ *Corporate Counsel*, March 2003, p.78.

⁶ See 'Breaking New Ground' in *Legal Strategy Review*, Summer 2009. There appear to be considerable overlaps in work carried out by an LPO provider (mostly offshore), a legal services firm (onshore), and a legal advisory firm.

⁷ Datamonitor estimated that in 2007, the worldwide legal services revenue was \$458.2 billion, of which 60% was accounted for by US firms, 27% by European firms, and 11% by Asian-Pacific firms. This figure refers to the total revenues received by law firms for services rendered, and therefore excludes the in-house expenditure on legal services by corporations. Thus, the total legal spending was at least double this figure (see estimated ratios in footnote 2). The estimated size of the legal process outsourcing (LPO) market, at \$4 billion by 2015 (source: Forrester?), is a tiny drop in the ocean, comparable to the US trade surplus in legal services of \$5 billion in 2007 (Source: Datamonitor). ValueNotes projected in November 2009 that the LPO industry in India was \$320m in 2008 and expected to reach \$440m by 2010. This means that the US remains a much more significant 'offshoring base' for legal services than India!

and legal support services sector becomes, and how quickly, depend on answers to the above questions.

This paper makes three key contributions. First, I attempt to cast a wide net in reviewing existing theories of the firm, clarifying the links among different theories from economics, engineering, and management. Consequently, the make-or-buy decision is conceptualized as something that is influenced by, and impacts on, the nature of the internal managerial hierarchy and internal structure. Second, in reviewing existing evidence in legal services, the paper incorporates sociological perspectives in order to clarify how professionalism and the partnership form impact on the make-or-buy decision. Third, the paper raises theory-based questions for further research.

MAKE-OR-BUY DECISIONS: EXISTING THEORIES

This section reviews relevant bodies of literature that shed light on the make-or-buy decision, and the choice of paths to outsourcing. The review captures thinking in organization economics, engineering design, and branches of management studies, notably strategy. Although some of these theories have been widely cited, I have found it difficult to compare them for commonalities and differences, and to understand which combinations ‘work’ towards enhancing the explanatory power of the phenomenon at hand. I therefore begin by describing each theory informally, compare theories where appropriate, and attempt to develop my own integrative framework. Wherever possible, I refer to salient facts in legal services.

We have come a long way since the time when Ronald Coase posed the defining question in this field: which transactions are more efficiently conducted within a firm than in a market (Coase, 1937)? After a few decades when the field lay fallow and neoclassical economics held sway, transaction cost economics was arguably the key instigator to making the theory of the firm a big academic enterprise (Williamson, 1975, , 1985). TCE remains a paradigm that no-one can ignore for its predictive and prescriptive powers, not only in economics and management, but also in related social science disciplines including law and political sciences.

This paper recognizes this achievement. But it has chosen a different starting point, to fit the purpose at hand. The review of existing theories undertaken here advances from organization level, to firm level, to industry level to explain make-or-buy decisions. This has the advantage of distinguishing among different factors that affect the firm boundary decision, pertaining to the nature of tasks being carried out, the nature of managerial hierarchy, and technological and institutional aspects of industry evolution.

Organization-level Analysis

In considering the outsourcing decision, engineering design scholars focus on the allocation of tasks derived from the design of product architecture. The origin of this approach may be traced back to Herbert Simon's seminal work, which posits hierarchy and near-decomposability as two design principles for reducing complexity (Simon, 1962). In any production system, a complex set of tasks are carried out, from design and development, to manufacturing and distribution. The extent of information flows,

interactions, and feedbacks necessary to carry out the tasks may be represented by a design structure matrix (DSM). The design structure matrix (DSM) was originally a tool to assist engineers in effective product design and development (Baldwin *et al.*, 2000; Ulrich, 1995), but may have wider applications for different tasks in different settings (see also www.dsmweb.org).

As shown in Figure 2 (a), an 'X' is placed whenever there is information flow or other interaction between two components, persons, teams, or tasks. A number of methods are available to reduce interactions and feedbacks in a DSM. One such method is *clustering*, applied to component-based and team-based DSMs where the time sequence of the items entered in the rows and columns does not matter. The other is *partitioning*, in which time sequence does matter, so that task A must be completed before task B can begin. Both clustering and partitioning are methods for regrouping or reordering tasks, so as to enable complex systems to be decomposed into relatively independent 'chunks' or modules.

- Insert Figure 2 about here -

Baldwin and Clark (2006) provide an example of the use of DSM to improve information flows by reducing feedback loops. In 1994, an automaker sought to find a new plastic with high heat resistance for automobile interiors. Initially, there were a great number of interdependencies. The plastic supplier knew a lot about the properties of the plastic (how improving its heat resistance or shock absorption would affect its cost, for example), while the automaker knew how much heat the plastic would likely encounter in the automotive application. These interdependencies required several

iterations of consultation; the plastics-maker would develop a batch of plastics and send it to the automaker, who would ask for changes. But, eventually the two parties developed “design rules” (tests for heat resistance, for example) that allowed the two parties to work independently.⁸ To see this, compare Figures 2(a) and 2(b), taken from Baldwin and Clark (2006).

The partitioning of a set of tasks from other tasks, in this way, is the basis for theorizing about the effect of task structure on organization architecture (and ultimately the make-or-buy decision) (Galunic *et al.*, 2001; Sanchez *et al.*, 1996; Schilling, 2000). So, if tasks are decomposed into modules, then it becomes easier for these modules to be carried out by two separate organizational units (or organizational modules). Thus, resulting from the above discussion is the following proposition.

Proposition 1: Task modularity facilitates organizational modularity, by enabling task modules to be executed independently of each other.

In advancing this proposition, some caveats apply, arising from Herbert Simon’s two design principles, because each principle has merits and demerits. The first principle, hierarchy, refers to the structure in which tasks or components are grouped into a module, which may, in turn, be part of a higher-level sub-system, which is part of a whole system. Hierarchy economizes on coordination costs as it puts constraints on the

⁸ Legal work may be subjected to equivalent moves from a situation of lots of interactive consultation to developing ‘design rules’ to enable independent working. For example, if instructions on document review for litigation are not well articulated and written down by the lead lawyer, a lot of iterative discussion with junior associates conducting the review is likely to ensue. Such interaction can be minimized by articulating the instruction up front, which amounts to developing the ‘design rules’.

decision-making process of lower levels in an organization, resolving conflict between subsystems. However, hierarchical coordination may be too rigid and slow, undermining capacity for flexible responses to changing environments (Grant, 2005).

Near decomposability is the second design principle, and is characterized by strong interactions between the individual elements of a subsystem – a module -- but much weaker interactions between the modules. The resulting task structure not only helps attenuate bounded rationality problems, but also enables relatively autonomous adaptations, as the short-run behavior of individual modules is independent of system-wide considerations (Siggelkow *et al.*, 2003; Simon, 1962). Nevertheless, nearly decomposable structures may create knowledge silos that inhibit architectural innovation (Henderson *et al.*, 1990; Von Zedtwitz, 2003), resulting from communication barriers between functionally specialized organizational subunits (Sosa *et al.*, 2004; Tushman *et al.*, 1980). Moreover, because structures are nearly – but not completely – decomposable, inter-modular coordination remains necessary. Particularly in technologically complex or dynamic industries, modular interfaces require constant changes and refinements through trial and error.⁹ Thus, organizational modularity involves trade-offs, and ‘good’ organizational designs are a product of evolution rather than foresight. Thus, Proposition 1 may be less applicable in rapidly changing environments.

⁹ See Ethiraj and Levinthal (2004) on designing Intel chips, and Ernst (2005) on the process of revising design rules for semiconductors more generally.

Moreover, there is an important distinction to be made between the division of labor and the specialization in knowledge (Brusoni, 2005:1888). Individuals in an organization unit may know more than they make (Brusoni *et al.*, 2001), i.e. maintain knowledge related to activities that are not performed regularly (Takeishi, 2002; Tiwana *et al.*, 2007). This is because much knowledge is not product specific, and is subject to economies of scope (Grant, 1996). The knowledge boundaries of an organization unit may therefore stretch beyond their productive task boundaries.

The development of such knowledge interdependence and spillover constitutes a pragmatic constraint that limits organizational design efforts (Yayavaram *et al.*, 2008). In the literature on modularity in complex systems, the organization, as represented by a design structure matrix (DSM), is conceptualized as an information and/or material flow processing device (Baldwin *et al.*, 2003; March, 1994; Simon, 1947). It is therefore not surprising that the DSM framework gives little attention to the role of knowledge interdependence. In partitioned modular organization structure, information and materials flows between modules are based on no 'redundant' communication (Nonaka, 1990) and no underlying knowledge interdependence. We argue, by contrast, that knowledge interdependence may exist between, as well as within, organization units, providing an additional set of constraints on the design of formal organizational structure. This discussion leads to our second proposition.

Proposition 2: Knowledge interdependence between task modules undermines organizational modularity.

In shifting from the organization level to the firm level, it is important to recognize that organizational modularity is not a sufficient condition for outsourcing. For example, two product divisions may be able to work autonomously from each other, but this does not necessarily lead to the sale of one of the divisions to another firm. Building on the DSM approach, Baldwin and Clark (2006) developed an analytical framework called the task and transfer (T&T) network, in which a transfer is the flow of information, materials, and energy from one task (or chunk of tasks) to another. In this framework, a transfer becomes a market transaction when it can be standardized, counted, and valued. This framework, therefore, goes a long way to specifying under what circumstances partitioned tasks may be carried out by separate organizational entities. However, it cannot address whether these separate organizational units should be owned independently or by a single firm.¹⁰ We therefore turn to the issue of factors that affect the firm boundary decision more directly. Under what circumstances does organizational modularity lead to outsourcing and the redrawing of the firm boundary? In legal services, what would it take a General Electric or a Clifford Chance to switch from captive to outsourced offshoring?

Firm-level Analysis

Economists have long been concerned with developing formal ‘theories of the firm’. But unfortunately, despite some early attempts (e.g. a behavioral theory of the firm by

¹⁰ A good counter-example is the so-called modular consortium in the Brazilian automobile industry, which combines task modularity with asset integration. See Sako M. 2009b. Outsourcing of tasks and outsourcing of assets: evidence from automotive supplier parks in Brazil. In A Gawer (Ed.), *Platforms, Markets and Innovation*. Edward Elgar: Cheltham.

Cyert and March (1963)), a theory of the firm came to refer exclusively to a theory concerning the boundary of the firm. The firm boundary is identified by a legal entity, and economists focus on asset ownership patterns that lie behind the legal entity. So outsourcing, the decision to 'buy' rather than 'make', is about the redrawing of the boundary of the firm in the form of asset divestment. By separating out the theory of the boundary of the firm from the broader theory of the firm (which includes internal structure and managerial hierarchy), economists ignore the impact of the nature of managerial hierarchy on the boundary decision. This paper rectifies this deficiency by incorporating insights from management studies and business history.

Economists have produced a number of formal theories concerning the boundary of the firm. Gibbons classify existing theories into four categories: a 'rent-seeking' theory, a 'property-rights' theory, an 'incentive-system' theory, and an 'adaptation' theory (Gibbons, 2005). This is a useful schema to discuss determinants of the make-or-buy decision with transaction as a unit of analysis.

Transaction cost economics is a leading 'rent-seeking' theory, in which activities are internalized to preempt opportunistic behavior arising from asset specificity and uncertainty (Williamson, 1971, , 1991). Vertical integration (with dispute resolution via fiat) is assumed to stop the haggling over 'quasi-rent' that is created by a combination of specific assets and uncertainty.¹¹ In the property rights theory, parties decide to

¹¹ In legal services, specific assets are human rather than physical, and human asset specificity may be considerably high in law firms and legal departments that rely on internal promotion and stable employment.

integrate in order to make efficient investment *ex ante* (Grossman *et al.*, 1986). Integration confers the residual rights of control to the asset owner, but assumes a sole entrepreneur with no managers hiring drone employees who face no incentives.

This drone employee assumption is avoided in incentive-based theories, which treats the design of firm boundaries as a problem of aligning the agent's incentive to that of the principal (Holmstrom, 1999; Holmstrom *et al.*, 1991). In this framework, an agent can carry out multiple tasks. An agent may not own an asset (i.e. become an employee), then all incentives come from being paid on measured performance. Alternatively, the agent does own the asset (so becomes an 'independent contractor'), then he has two sources of incentive, one from a payment based on measured performance and the other from the asset's value after production occurs. In this sense, incentives offered to employees in firms are low-powered relative to the high-powered incentives offered to independent contractors in markets.

In the incentive-system theory, therefore, asset ownership can be an instrument to structure incentives in a multi-task environment, in which contracts are necessarily incomplete.¹² Let us assume that a supplier can undertake two sorts of actions that increase the expected value of the supplier's product. One type of action increases the expected value of the product to the customer, while the other increases its value in an alternative use, which may not be directly beneficial to the given customer. Neither of

¹² Contracts are incomplete when not all contingencies are fully specified. Contract incompleteness is prevalent in legal services due to the nature of the services provided, giving rise to the importance of incentive alignment.

these actions is contractible, meaning that the customer cannot pay the supplier based on the amount of the action taken. However, the customer can pay the supplier a bonus if the value of the product does indeed turn out to be high.

Vertical integration reduces the supplier's incentive to engage in the second type of action, whose only purpose is to increase the supplier's bargaining power (Baker *et al.*, 2002). However, vertical integration also reduces the supplier's incentive to engage in non-contractible actions that do benefit the customer. The reason is that under integration, the supplier loses the ability to threaten to sell the product on the open market, thus increasing the customer's incentive to renege on its promise to pay a bonus if product quality turns out to be high. Therefore, a non-integrated firm can more credibly promise a larger bonus than can an integrated firm. Thus, if the customer prefers a customer-specific product it will integrate (to avoid the supplier taking actions that enhance the alternative use value of the product). However, to the extent that there are non-contractible actions that increase the value of the product in both specific and general uses, the customer will NOT integrate, since it can credibly commit to pay a higher bonus to an outside supplier.

The incentive-system theory therefore provides a unified account of the costs and benefits of asset integration, just like the property rights theory. Furthermore, the incentive-system theory does better than the property-rights theory in assuming that employees face incentives. However, the incentive-system theory omits an aspect that is central to the rent-seeking and property-rights theories, namely the notion of control. Thus, in the incentive-system theory, whether the agent owns the asset affects his

incentives but not the span of control over his action space (Gibbons, 2005). The adaptation theory of the firm, Gibbons' fourth category, addresses this deficiency by asking whether integration or non-integration better facilitates 'adaptive, sequential decision-making' (Williamson, 1975). Thus, even without asset specificity, there may be situations that cannot be resolved using ex ante contracts or ex post negotiation. In the extreme case, the second-best solution is to concentrate authority in the hands of a 'boss' who makes decisions. This is what Williamson had in mind when he referred to 'fiat'. In reviewing these economic theories of the firm, we note the following conglomerate proposition.

Proposition 3: A firm makes its boundary decision by giving regard to its rent-seeking, property rights, incentive alignment, and adaptation considerations.

Economic theories therefore shed much light on the make-or-buy decision. But economists' tendency to ignore or simplify the nature of managerial authority has led to an assumption that the boundary decision is separable from the internal structure of the firm. This separability assumption misses the point of outsourcing, particularly when applied to the empirical context of business services including legal services. This is because business service outsourcing combines the two decisions: the make-or-buy decision concerning the corporate boundary, and the restructuring of the internal corporate hierarchy (Gospel *et al.*, 2010).

Corporations' organization structure can be a source of competitive advantage. As recounted by the business historian, Alfred Chandler, modern corporations have been restructuring to align structure to strategy (Chandler, 1962). In reality, it is easier said

than done for a global corporation to design and implement an appropriate multi-dimensional matrix structure to meet the competing demands of different products, corporate functions, customers, and countries (Galbraith, 2009). The creation of shared services and outsourcing are both part of this search for an appropriate organizational design, giving primacy to corporate functions over other considerations, often accompanying mergers and acquisitions (M&A). M&A create duplicated functions previously belonging to two separate corporate entities. Attempts at eliminating the waste of duplication trigger the creation of shared services. Such streamlining requires some central direction from the corporate headquarters. Without centralized control, the intended standardization and efficiency gains may not be forthcoming. Indeed, divisional autonomy is likely to get in the way of implementing standardized processes.¹³ Thus, existing corporate structure and managerial hierarchy affect the

¹³ The contrasting experiences at Procter & Gamble (P&G) and Unilever illustrate this point. Under A. G. Lafley's leadership, P&G created an internal global shared services unit in 1999 as part of the 'Organization 2005' restructuring initiative. It gave itself five years to pull all essential corporate functions – finance & accounting, human resources, and later IT – away from regional and divisional companies into a single Global Business Services (GBS) operation. Central direction from Cincinnati was essential in deploying SAP-based ERP systems throughout the company before such reorganization took place. By the time P&G's shared services were outsourced, their operations were drastically transformed and streamlined. By contrast, at Unilever, the Anglo-Dutch firm, characterized as a loose federation of national companies, strong country managers had little interest in global shared services. The human resource (HR) function did, however, consider outsourcing at the global level, and regarded the fragmentation of IT infrastructure as a hindrance in implementing it. With such cultural and technical barriers to creating in-house shared services, global HR outsourcing to Accenture was used as a trigger to transform HR processes, in a 'throw it over the fence' or 'lift and shift' approach, with an expectation of rapid cost reductions through scale economies, labor arbitrage, and increasing return on assets. Unilever could not have transformed without outsourcing, and outsourcing was an integral concomitant of transforming the organization. See Gospel H, Sako M. 2010. Unbundling of corporate functions: the evolution of shared services and outsourcing in human resource management. *Industrial and Corporate Change* **March**: 1-30

firm's choice between outsourcing and shared services, resulting in the following proposition.

Proposition 4: The nature of managerial hierarchy affects the firm's make-or-buy decision. The more centralized a firm's internal structure, the more likely it is to move to the creation of shared services and outsourcing.

Last, but not least, the make-or-buy decision itself affects the internal organization of the firm. This is an insight that Chandler articulated, when he examined how in the late nineteenth century, Duke Tobacco and Procter & Gamble cut out the middlemen to source their raw materials (raw tobacco and glycerin respectively). Disintermediation puts the onus on the purchasing department (as opposed to an external wholesaler or distributor) to manage independent suppliers, and thus requires an investment of resources and personnel for the department to take on new tasks. As such, disintermediation is a form of vertical integration (Helper *et al.*, 2010).

Industry-level Analysis

External factors sometimes outweigh issues internal to the firm as a determinant of a firm's make-or-buy decision. Here, we focus on shifts in the distribution of capabilities in the industry as a result of technological change or the availability of new locations for talent.

Management scholars have employed the concept of organizational and dynamic capabilities to analyze firm boundaries (Eisenhardt *et al.*, 2000; Jacobides *et al.*, 2005b; Teece *et al.*, 1997). Early theorizing on resources and capabilities tended to focus on

analysis at the firm level (Barney, 1991; Penrose, 1959; Wernerfelt, 1984). More recently, however, the level of analysis has shifted to the industry, and in particular to the distribution of capabilities in the industry to explain vertical disintegration and the development of global value chains (Gereffi *et al.*, 2005).

In particular, greater heterogeneity in the distribution of capabilities within an industry leads to vertical disintegration as firms gain from trade and specialization (Jacobides, 2005; Jacobides *et al.*, 2005a). When firms identify superior capabilities outside their boundaries, they have an incentive to ‘buy’ rather than ‘make’, even if transaction costs are high. This is because higher transaction costs in the market are compensated for by lower production costs of a superior performing firm in the value chain (Jacobides *et al.*, 2005b). Such disturbance in the existing distribution of capabilities may occur as a result of technological change, availability of new locations for talent, or entry by new industry participants.

New market entry triggers the reassessment of incumbent firms’ own capabilities relative to those of new entrants. For example, a new supplier that produces a component at a significantly lower cost may induce an incumbent firm to access it via market contracting. Hence, when new players emerge, additional firm boundary design alternatives are unlocked for incumbents. In service industries where reputation and status matter as proxies for service quality, firms may also give regard to shifts in the distribution of reputation and status in the market. Thus, our fifth proposition is as follows.

Proposition 5: The distribution of capabilities (and reputation) in an industry affects the make-or-buy decision. In particular, the more capable (and reputable) suppliers are available in the market, the more likely the firm is to buy rather than make.

- Insert Table 1 about here -

Summary

Table 1 provides a summary of all the theories reviewed in this section and the five propositions that arose from those theories. Linking the organization-level, firm-level, and industry-level determinants of the make-or-buy decision, an integrative framework focuses on corporate strategy which is about creating and capturing value. At the organization level, task modularity facilitates, and knowledge interdependence hinders, organization modularity. We tread carefully by not conflating organizational architecture design and firm boundary design. The latter, firm boundary, is defined by asset ownership patterns. The integrative framework here complemented economic theories that focus exclusively on explaining firm boundary with management theories about the impact of managerial authority on make-or-buy decisions.

In the end, task modularity is neither necessary nor sufficient for outsourcing (asset disintegration). For instance, we may have task modularity but integrated asset ownership. This may be due to interdependent knowledge underlying the partitioned task sets (Proposition 2), or due to the absence of capable external suppliers (Proposition 5). Conversely, outsourcing may occur even when tasks are

interdependent and non-modular between two firms, if the two firms have differential capabilities and rely on relational contracts.

MAKE-OR-BUY DECISIONS IN LEGAL SERVICES: EVIDENCE AND ISSUES

In this section, we apply the integrative strategic framework developed above to legal services. In particular, we investigate the extent to which each of our propositions survives or falters in light of prior work and anecdotal evidence (including from a few dozen interviews I carried out with law firms and legal process outsourcing (LPO) providers). It is hoped that this preliminary discussion will refine the plan for more systematic empirical research.

The Nature of Legal Services

What is the nature of tasks underlying the delivery of legal services? This is the first question looking for an answer in addressing Propositions 1 and 2 that link task modularity to organization modularity.

Legal work, just like other knowledge-intensive professional work, is generally considered difficult to standardize. This is because practicing law is a craft, bespoke and uniquely customized to the needs of each client. However, as Richard Susskind eloquently argues, ‘a market demand for increasing *commoditization* of legal services’ has rendered much of legal services to follow a path from bespoke, to standardized, systematized, packaged, and commoditized stages (Susskind, 2008). A technology

perspective of ‘service as product’ is evident in Susskind’s definition of a commoditized legal service as ‘an IT-based offering that is undifferentiated in the marketplace’ (i.e. in the minds of the recipients and not the providers of the service) (p.32). Building on Susskind’s work, what we need is a sober analysis of *how* legal work is decomposed into constituent tasks, and *who* decides what is an optimal degree of decomposition. We begin with tackling the first issue of ‘how’.

The Design Structure Matrix (DSM) may be a useful tool for analyzing legal work decomposition and work flows. I have never seen a DSM drawn for legal tasks. But major legal process outsourcing (LPO) providers and innovative legal services firms have applied process management to legal work, starting with identifying steps (or activities) and process flows from one step to the next. Process mapping enables ‘continuous improvement’ by considering the elimination of wastes, in the form of duplication of steps, complex workflows, waiting, or rectification of defects (Womack *et al.*, 1990). For example, NovusLaw found in a time-and-motion study of litigation document reviews, that each document was touched 14 times, starting with a first-level review by a partner-level contract lawyer, proceeding to privilege reviews by senior associates, and hand-offs to paralegals.¹⁴ These tasks of reviewing, tagging, and logging documents may be reordered and repackaged into partitioned task modules, using a Design Structure Matrix.

¹⁴ Raymond E. Bayley (2009) ‘Three litigation management strategies’, *Executive Counsel*, 6(5), November/December.

In litigation support, a task module may consist of the entire e-discovery work. With high volume, it might be optimal to have a number of teams (organization modules) working in parallel. There is more than one way of dividing the work to minimize interaction between the teams. One way is to provide each team with a batch of work, with the teams doing the same range of tasks. Another way is to make each team specialize (e.g. one team doing objective coding only, and the other subjective coding only), but in such a way as to make the hand-off from one team to another as simple and clear-cut as possible. Well-defined interface is an essential characteristic of both product modularity (Ulrich, 1995) and organizational modularity (Sako, 2003; Sanchez *et al.*, 1996). Within each module, tasks may be 'routine' or non-routine.

A number of implications follow from this discussion on work decomposition, pointing to the need for further research. These are familiar points in manufacturing but are just as applicable in legal services. First, the application of principles dating back to Fredrick Taylor's Scientific Management in the 1910s leads to efficiency improvements through standardization, the elimination of wastes, learning-by-doing, and economies of scale that result from repeatability of tasks. Just as manufactories emerged in the wake of a transition from craft production to mass production, lawyers will be sourcing and working with 'legal engineers' and legal support workers in information factories. What we do not know is *the location from which, and the speed with which, such competition based on scale and process efficiency will arise.*

Second, work decomposition improves functional quality but raises other concerns for quality. The standardization of tasks, the elimination of wasteful steps, and the

improvement in workflows to minimize waiting contribute to improving functional quality. Rigorous quality control, by applying lean Six Sigma techniques, reduces defects (George, 2003). However, work decomposition may lead to inferior quality through the fragmentation of work. Coordinating workflows require supervision, monitoring, and quality checks. More fundamentally, tasks may be separable but underlying knowledge may not be.

Legal research is a good case in point. At one end of the spectrum, a 50-state survey on a particular issue is easily separable in both task and knowledge as a standalone project. At the other end of the spectrum lies case law research that depends on cumulative prior knowledge of precedents and case interpretation as well as an understanding of the whole case for which research is undertaken. Introducing organizational modularity in this latter case is likely to undermine the quality of legal work. In short, as an extension to Proposition 2, abstract legal research might be outsourced, but legal research that depends on precedent and case interpretation will not be.

Third, the more legal work becomes decomposed, the greater the proportion of decomposed tasks that can be carried out by non-lawyers (Sako, 2009a). These non-lawyers may be paralegals or just graduates with good literacy (and possibly numeracy) skills. It takes a fully qualified car mechanic to repair any part of the automobile, but (almost) anyone may be taught to replace a punctured tire without knowing anything about the car. Similarly, if tasks are well defined, some believe that document preparation in litigation support and corporate transactional work does not require legal

knowledge. This means that with work decomposition, the proportion of workers in legal services market who are qualified lawyers will decline over time. According to one estimate, as much as 70 % to 80% of legal tasks do not require lawyers, as they are 'legal work but not lawyer work'.¹⁵

To summarize, although the speed and extent may be debated, no-one disputes that there is scope for transforming legal work by decomposing it into task modules, and that work decomposition in turn facilitates organizational modules some of which may be outsourced and/or offshored. This will not happen, however, unless there are both demand and supply for this sort of transformation to take place. We therefore turn to corporate legal departments and law firms, and analyze what degree of work decomposition lawyers within each type of organization regard as optimal, as a precursor to a make-or-buy decision.

Make-or-buy Decisions by Corporate Legal Departments

What kind of legal work is kept in-house and what kind of work is outsourced by corporate legal departments? We review the received wisdom, based on past research and media coverage of developments at major corporations. This account, however, leaves a number of intriguing questions unanswered (raised below in this sub-section).

As noted in the Introduction, there is evidence that corporate clients have brought more work back in-house in recent years, in the United States and in Britain. Some

¹⁵ Bruce MacEwen (2008) 'A conversation with Ray Bayley of NovusLaw', www.AdamSmithEsq.com, June 11, 2008.

external attorneys in law firms used to provide general service, which in-house lawyers came to internalize over time. But given the trend towards work decomposition and task modularity, bringing work back in-house cannot be attributed to the changing nature of legal work itself. Indeed, the reasons behind this trend lies at the firm level, and two factors are normally mentioned, namely the rise in power and status of the inside lawyers (Chayes *et al.*, 1985) and the rise of the financial conception of control in the corporation (Fligstein, 1990). The inside lawyer's role in the corporation is not fixed but evolves with the needs of business. As the role evolves, we need to figure out how inside lawyers fit into the corporate-wide managerial hierarchy, and analyze in what ways inside lawyers exert voice in the make-or-buy decisions for legal services.

In the United States, large modern corporations came to be run by managers who endorsed the financial conception of control (Fligstein, 1990). In this conception, a corporation is a bundle of diversified investments requiring close monitoring of financial performance. The financial markets deregulation of the 1990s reinforced this managerial ideology. Business needs in this climate led to an increasing amount of legal work with greater reliance on legal expertise in corporate governance, financing, and transactions. At the same time, management began to emphasize short-term stock returns for shareholders and tight cost control applied to all corporate functions including the legal department.

Although cause and effect are difficult to trace, the rise of the in-house counsel occurred in conjunction with the rise of the shareholder value ideology in modern corporations (Nelson *et al.*, 2000). The general counsel typically had been a lawyer who

did not quite make his mark as partner. By the 1980s, however, the general counsel became more powerful, building his power base by co-opting two relatively new functions: compliance and the management of outside attorneys (Chayes *et al.*, 1985). First, compliance work may be characterized as 'preventive or anticipatory legal services', involving anticipating possible legal problems in corporate transactions. This was also an entrée into the inside counsel's involvement in the broader strategic planning process. Second, the general counsel took a lead in the make-or-buy decision for legal services, closely monitoring and managing outside attorneys. They became 'hired guns' to provide matters of 'exotic specialty' (requiring specialized technical expertise) or matters with large capacity fluctuation (e.g. in litigation). The general counsel typically gave detailed 'instruction with little scope for originality or independent judgment' by external attorneys (Chayes *et al.*, 1985).

At the same time, the rise of the financial conception of control led major corporations such as Dupont and General Electric to improve internal legal processes by applying lean Six Sigma techniques. Given this head start that corporations had in their efficiency drive, routine and repetitive tasks could be done more cheaply in-house than out-of-house. However, unlike law firms, corporate legal departments tended not to employ junior associates who could undertake this sort of work. Corporations therefore started to turn to contract lawyers onshore, and to offshore starting with captive operations.

Last but not least, the financial conception of control led some powerful corporate counsels to assume the role of 'business partner' (inside lawyers as full members of the

business team taking legal decisions in the context of business decisions) and ‘lawyer-statesman’ guarding the company’s reputation.¹⁶ Moreover, some inside lawyers become entrepreneurial, in the sense of regarding law as a source of profit and corporate growth, an instrument to be used aggressively in the marketplace (Nelson *et al.*, 2000). In a downturn, general counsels are also expected to be entrepreneurial, proactive, and the ultimate guardians of risk management in ‘legally astute’ companies (Bagley, 2008). The need for substantive business knowledge about the specific corporation in which inside lawyers work explains the preference for ‘make’ rather than ‘buy’ for this sort of blended legal-business advice.

Whilst this account is persuasive on one level, a number of things remain puzzling. With respect to Proposition 2, inside lawyers’ claim that ‘making’ is advantageous over ‘buying’ when it concerns blended legal-business advice rests on the interdependence of legal knowledge and business knowledge specific to a corporation. However, as inside lawyers become part of the top management team, what is the extra edge that lawyers as professionals have over other types of professionals giving business advice? A ‘system of professions’ perspective, in which contiguous professions vie for shifting jurisdictional boundaries, may shed light on this question (Abbott, 1988).

With respect to Proposition 3, a trend towards ‘make’ rather than ‘buy’ may be a sheer function of the cheaper cost of legal service delivery in hierarchy rather than in external market dominated by large law firms. Nevertheless, it would be good to be

¹⁶ Ben W. Heineman, Jr. (2006) ‘In the Beginning’, *Corporate Counsel*, April.

able to identify empirically the economic theory factors at play. For example, how significant is the rent-seeking motive for sourcing legal services in-house, based on firm-specific human assets of inside lawyers? In what ways is the mix of legal work (compliance, corporate transaction, litigation, intellectual property, etc.) affecting the need to align incentives in a low-powered rather than a high-powered manner? Has the greater demand for compliance and 'anticipatory legal services' created greater reliance on 'making' rather than 'buying' due to the need for 'adaptive, sequential decision making'?

Proposition 4 points to the importance of studying the nature of internal structure and managerial hierarchy. How centralized or decentralized is the in-house legal departments in a multi-divisional global corporation? How integrated are inside lawyers into the managerial hierarchy? For instance, to whom does the general counsel report to, and do inside lawyers face solid or dotted reporting lines to business unit managers? We expect that the more centralized the corporate counsel organization, the more likely that the firm is to take a shared services approach to legal services, identifying corporate-wide opportunities for process efficiency and cost savings. Also, we expect that the more integrated inside lawyers are in the managerial hierarchy, the more likely they are to consider such efficiency improvements and outsourcing as part of such move.

Sorting out these strands empirically would shed light on how inside lawyers exercise their voice in corporate make-or-buy decisions for legal services. One research design

might be to compare inside lawyers in corporations of different national origins facing different conceptions of control, financial or otherwise.

Make-or-buy Decisions by Law Firms

What is the impact of the legal profession and the partnership form on the make-or-buy decision in law firms? First, the nature of legal expertise and professional values put a brake on the decomposition of legal work (Propositions 1 and 2). Second, the nature of managerial hierarchy in partnerships may obstruct centralized outsourcing decisions (Proposition 4). Third, the way partners and associates are rewarded creates disincentives for outsourcing and offshoring (Proposition 3). I will discuss these in turn.

Traditionally, many lawyers find it hard to pass along to non-lawyers legal work that historically was within the purview of fully qualified lawyers. The distrust of non-professionals is inherent in all types of professionalism, which combines technical expertise and shared ethical values. An expert possesses a stock of esoteric knowledge that is not widely shared. An expert becomes a professional when he/she becomes organized into a profession, possessing the following four properties besides expertise: an ethical code, cohesion, collegial enforcement of standards, and autonomy (Adler *et al.*, 2006). Professional experts tend to be conservative, resistant to new ideas for a good set of reasons. First, clients and other experts may interpret experts' need to learn as evidence of deficient knowledge. Second, many experts get paid by the hour, and explicit learning reduces the time available for billable services. Third, expertise implies specialization, which reduces versatility and limits flexibility. Fourth, experts' niches are partial monopolies, and like other monopolists, experts hold favorable positions that

confer high incomes and social status, which come under threat with social or technological changes. Fifth, expertise entails perceptual filters that keep experts from noticing these changes especially outside their domains (Starbuck 1992).

The conservatism, resistance to change, and distrust of non-professionals explain the legal profession's tendency to dismiss work decomposition. The legal services value chain may be broken down into three blocks, namely knowledge and information management (KIM), consultative advice and representation (CAR), and client relationship management (CRM) (see Figure 3). Some lawyers dispute the possibility or wisdom of modularizing their work in this way but for different reasons, some due to the underlying knowledge interdependence between task modules, others because they distrust the competence and ethics of non-lawyers.

- Insert Figure 3 about here -

However, the inherent pull towards keeping the profession whole, which mitigates against work decomposition, is countered by a dynamic of greater knowledge specialization within the profession. Professionals have made incremental changes in their own professions over time, in response to large social forces, both endogenous and exogenous to the professions. In particular, with the tremendous growth in the knowledge base required of a profession, there has been an inevitable drive towards greater differentiation and specialization (Scott, 2008). Scott illustrates this with the growth of specialist physicians with hyphenated titles, and the parallel growth of contiguous occupations (e.g. chiropractors, pharmacists, etc.). Here lies an endogenous

reason for greater division of labor in professional work. The legal profession is not immune to this force for greater specialization.

Next, law firms are organized as partnerships, emphasizing 'collegiality, peer evaluation, autonomy, informality, and flexibility of structures' (Hinings *et al.*, 1999). This implies a rejection of market-based institutional logic, even as the professional partnership model has given way gradually to a managed professional business form (Hinings *et al.*, 1999). In this latter form, the logic of individual autonomy and collegial control is being replaced by a greater reliance on hierarchical control by managers who give priority to strategic planning and marketing (Scott, 2008). In this transformation, claimants to professional status have given up using the 'social trusteeship model' (in which they make civic-minded moral appeals to clients) in favor of emphasizing the value of technical expertise.

Nelson's analysis of law firms with varying degrees of bureaucratic management practices is instructive here (Nelson, 1988). In his meticulous sociological analysis, Nelson put forward two conclusions which are relevant: first, that 'professional codes provide almost no specific guidance on how a law firm should be organized' (p.79), and second, that the large law firm has the trappings of power and prestige but lacks autonomy from clients (p.259).

A distinguishing characteristic of professional organizations is the relative lack of rules. Professional practice depends on the discretion and judgment of individual professionals. Nelson found evidence against the claim that organizational policies are arrived at through collegial consensus by partners of equal power. Instead, a

managerial hierarchy with decision-making authority emerges within a law firm, with the hierarchy structured according to the power of the client-responsible partners. Thus, in law partnerships, policies on outsourcing (if they are deemed to be strategically important enough) are likely to be formulated, not by consensus, but by ‘partners with power’ whose power base rests on their ability to find and maintain important clients.

Extending Nelson’s line of argument, the more a law firm is a loose confederation of partners (or teams of partners) with largely independent client bases, the more likely that the law firm’s make-or-buy decision reflects the wishes of each client. Here lies the view that law firms are not proactively endorsing outsourcing, but are merely reacting to the wishes of their clients who are more price sensitive and unwilling to pay high hourly rates for associates at the base of the pyramid (See Table 2 for some examples of law firm outsourcing/offshoring in the news).¹⁷ This is an important modification to Proposition 4, which focuses on the impact of the nature of managerial hierarchy on the make-or-buy decision. The partnership form *per se* appears to have some but no decisive impact on the level at which make-or-buy decisions are taken. It is more the power structure within the partnership that appears to matter. To the extent that partnerships cannot resort to centralized decision-making of the type that is available to corporate CEOs, decisions to restructure the law firm, including outsourcing and offshoring decisions, may face more hurdles and take longer.

- Insert Table 2 about here -

¹⁷ Slaughter and May is on record saying that they are considering offshore outsourcing at the request of a specific client.

Last but not least, partners and associates in law firms are not incentivized to make outsourcing decisions on the basis of efficiency gains as a criterion. The billable hour is a disincentive to seeking efficiency. It is also a disincentive to outsourcing/offshoring. In relation to Proposition 3 (incentive-system theory), further research may be warranted on alternative billing arrangements as applied to different types of legal work. Theory suggests that incentive alignment via bonus payments works best when work is non-contractible, with providers owning assets that have productive alternative use value.

DISCUSSION, CONCLUSIONS, AND POSSIBLE FUTURES

This paper set out a strategic perspective in analyzing the make-or-buy decisions in legal services. Strategy is about how a particular entity, be it a lawyer, a law firm, or a corporation, creates and captures value (rather than giving it away to someone else). This strategic perspective refocuses our analytical lens away from transaction (or relationship) towards the firm (or an entrepreneur) as a unit of analysis. The approach enables the study of a firm's make-or-buy decision in a landscape with not only incumbents but also new entrepreneurial entrants occupying different segments of the value chain.

The paper advanced five propositions from economics, engineering, and management theories. The paper then discussed these propositions in the context of past scholarly work in the sociology of professions and some anecdotal evidence about legal services, corporate legal departments, and law firms. How do the economic and

management theories of the firm stand up against the inclusion of professionalism and partnership as mediating factors? The interim conclusion is that the propositions stand up very well when applied to legal services.

Some theoretical simplifications were made in the paper. In particular, there was no discussion of multi-sourcing (Susskind, 2008), concurrent sourcing (i.e. make-and-buy practices) (Parmigiani, 2007), flexible permeable boundaries (Jacobides *et al.*, 2006), and the consequent blurring of the boundaries between the inside and the outside (Wilkins, 2009). Moreover, the paper did not touch on the nature of embedded ties (Uzzi *et al.*, 2004) and relational contracts in attorney-client relationships that affect the extent of make-or-buy. Whilst recognizing all these possibilities, this paper focused on analyzing sharp boundaries between the inside and the outside of the firm, in order to (a) get down to the level of detail of legal task decomposition, and to (b) treat the firm or entrepreneur as unit of analysis so as to focus on strategy – i.e. value creation and capture.

The next obvious step is to conduct empirical work in order to test these theories and propositions in a more systematic matter. A key research question therefore remains: how do lawyers, law firms, and legal departments create and capture value? The make-or-buy decision in the context of the entire value chain is not just about trading with known incumbents, but also about identifying new opportunities for dis-intermediation and re-intermediation. So, under what circumstances would the law firm be dis-intermediated? Under what circumstances would the in-house legal department be dis-intermediated?

In many ways, the empirical context is unraveling as we study the phenomenon of legal service outsourcing and offshoring. How can we study something that is about to happen or has not yet happened? Luckily, we have some methodologies to study such things, including comparisons with other industries and professions that appear to be 'ahead of the game'. Another method is to use scenario planning techniques to articulate a range of strategies under each of the identified possible futures in the global legal services market.

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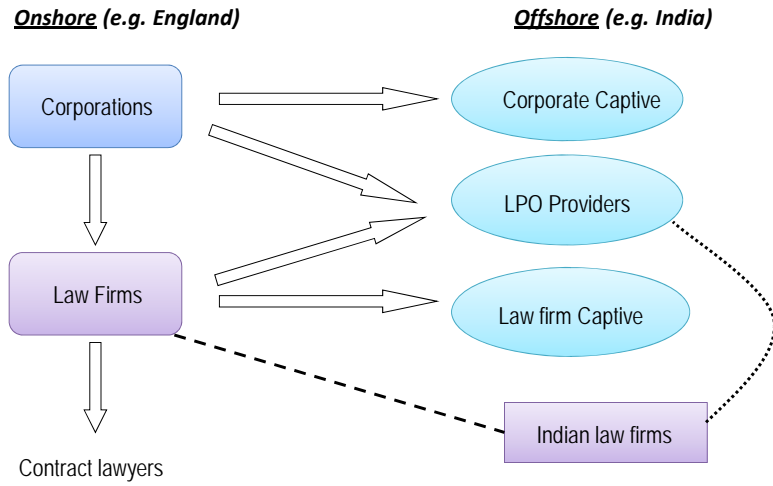


Figure 1: Possible routes to outsourcing and offshoring

Make or Buy Decisions in Legal Services

	Engineering Plastics Company	Auto Company
Engineering Plastics Product and Process Design	. x x x x x x x x	
	x . x x x x x x x x	x x
	x x . x x x x x x x	x x x
	x x x . x x x x x x	x x x x
	x x x x . x x x x x	x x x x x
	x x x x x . x x x x	x x x x x x
	x x x x x x . x x x	x x x x x x x
	x x x x x x x . x x	x x x x x x x x
	x x x x x x x x . x	x x x x x x x x x
	x x x x x x x x x .	x x x x x x x x x x
Automotive Company Product and Process Design		. x x x x x x x x
	x x x x x x x x x	x . x x x x x x x
	x x x x x x x x x	x x . x x x x x x x
	x x x x x x x x x	x x . x x x x x x x
	x x x x x x x x x	x x . x x x x x x x
	x x x x x x x x x	x x . x x x x x x x
	x x x x x x x x x	x x . x x x x x x x
	x x x x x x x x x	x x . x x x x x x x
	x x x x x x x x x	x x . x x x x x x x
	x x x x x x x x x	x x . x x x x x x x

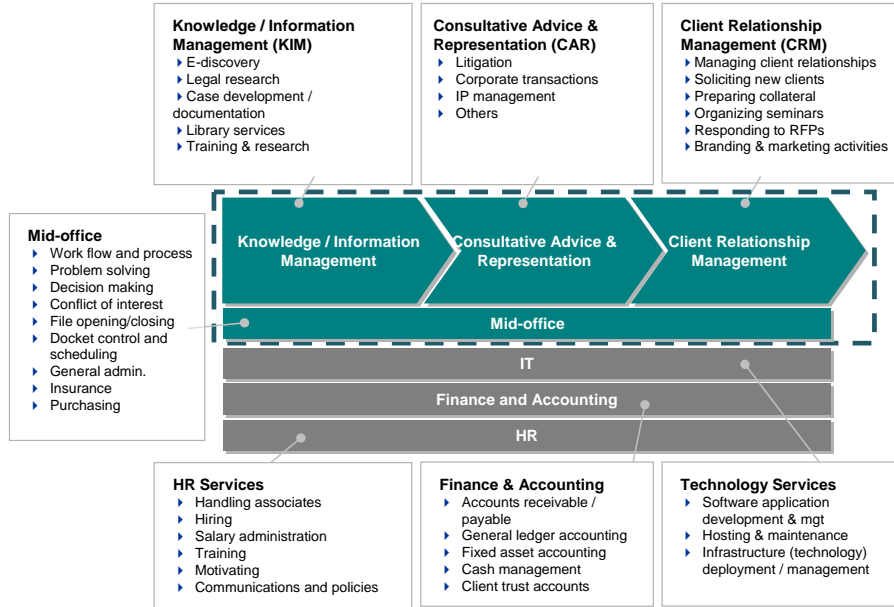
Figure 2 (a): Initial Task and Transfer Matrix for the Plastic Compound Design

	Specification and Agreement	Engineering Plastics Company	Auto Company
Specification and Agreement (8 Specs & Tests)	. x x x x x x x x		
	x . x x x x x x x		
	x x . x x x x x x		
	x x x . x x x x x		
	x x x x . x x x x		
	x x x x x . x x x		
	x x x x x x . x x		
	x x x x x x x . x		
Engineering Plastics Product and Process Design		. x x x x x x x x	
		x . x x x x x x x	
		x x . x x x x x x	
		x x x . x x x x x	
		x x x x . x x x x	
		x x x x x . x x x	
		x x x x x x . x x	
		x x x x x x x . x	
Automotive Company Product and Process Design			. x x x x x x x x
			x . x x x x x x x
			x x . x x x x x x
			x x . x x x x x x
			x x . x x x x x x
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			x x . x x x x x x
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Source: Baldwin and Clark (2006)

Figure 2(b): Partitioned Matrix after Tests were Developed

Make or Buy Decisions in Legal Services



Primary services in a law-firm value-chain

Figure 3: The Value Chain of a Law Firm

Table 1: Summary of Make-or-Buy Theories and Propositions

Level of analysis	Factors influencing the make-or-buy decision	Propositions
Organizational-level	<p>Task structure (partitioned, clustered, stability)</p> <p>Organizational modularity</p> <p>Knowledge interdependence</p>	<p>Task modularity facilitates organizational modularity, by enabling task modules to be executed independently of each other.</p> <p>Knowledge interdependence between task modules undermines organizational modularity.</p>
Firm-level	<p>Rent seeking</p> <p>Property rights</p> <p>Incentive alignment</p> <p>Adaptation in decision-making</p> <p>Managerial hierarchy</p>	<p>A firm makes its boundary decision by giving regard to its rent-seeking, property rights, incentive alignment, and adaptation considerations. Firms make rather than buy whenever:</p> <ul style="list-style-type: none"> - Asset specificity and uncertainty are high in a transaction - Ex ante efficient investment decisions are easier to make via exercising control - Principal can incentivize agent with low-powered incentives - Exercise of fiat is essential in adaptive sequential decision-making <p>The nature of managerial hierarchy affects the make-or-buy decision. The more centralized a firm's internal structure, the more likely it is to move to the creation of shared services and outsourcing.</p>
Industry-level	Distribution of capabilities	The more capable suppliers are available, the more likely the firm is to buy rather than make.

Table 2: Outsourcing and Offshoring by Law Firms

Firm	What	Who, Where, Comments
Allen & Overy	Litigation document review	Transaction specific outsourcing to Integreon in New York, US and Mumbai, India. 30-50% cost saving.
Clarke Willmott	Support functions	Secretarial (typing) work at its Birmingham office to Exigent in South Africa.
Clifford Chance	Document review and due diligence. Support function: IT and document production.	Legal services offshored to CC wholly-owned subsidiary in Gurgaon, India. Support function is delivered with Integreon from the same location.
Eversheds	Support - document production	UK-wide secretarial work to be outsourced offshore to Exigent.
Linklaters	Support - finance, leisure, accounting	Looking to outsource an onshore picture administration centre and knowledge process outsourcing
Lovells	Litigation document review. Real estate document production	Transaction specific. Exigent in South Africa. Unnamed provider in India.
Osborne Clarke	Non-strategic support functions	Onshore - £1m saved annually. Plans to extend
Pinsent Masons	Secretarial work, Document review and due diligence	Estimated 50% saving on low level legal work. Dedicated team of qualified lawyers employed by Exigent in Cape Town.
Simmons & Simmons	Document review, due diligence and research	Dedicated outsourced team of 5 lawyers employed by ?? in Mumbai.
Slaughter and May	Document review and due diligence	Triggered by request from specific client.

Source: Modified using Luke McLeod-Roberts 'A&O signs outsourcing deal with LPO provider Integreon, *The Lawyer*, 18 November 2009.