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# OFFSHORING OF HIGHLY SKILLED OCCUPATIONS: THE CASE OF THE LAW INDUSTRY



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Since the 1990s, a large number of white-collar jobs have moved from the US to developing country locations, particularly India. The boom in such offshoring started in the 1990s, encompassing clerical “back-office” jobs and lower level software jobs that spawned the “Business Process Outsourcing” (BPO) industry in India. Early offshorers included American Express and GE Capital, who set up their “back-offices” in India, handling routine clerical work such as billing, document preparation, accounting and so forth. During the 2000s, and especially after the 2008 financial crisis, we have seen an increase in the offshoring of highly skilled jobs in professional fields such as engineering, law, and accounting.

We know very little about the incidence, scope, and prevalence of the offshoring of highly skilled jobs. There is no readymade database or trade statistics regarding the movement of these jobs from the advanced industrial countries to developing ones despite considerable interest from policy makers. The best estimate of the potential of offshoring comes from Princeton economist Alan Blinder (2006). Using a conservative estimate of the “offshorability” of US jobs, he estimates that roughly 29% of US jobs can be offshored, and even more importantly, there is no correlation between offshoreability and skills: in other words, even highly skilled jobs can be offshored.

Blinder’s work challenges conventional wisdom regarding the offshoring of highly skilled jobs. Some have argued that professional work is less susceptible to offshoring because it involves tacit knowledge, non-routine problem solving, and “lateral and critical thinking” (Sako 2013). Highly skilled occupations, such as that of lawyers, are difficult to be offshored, given their high status, the high degree of “occupational closure” (the ability to control entry into the profession through education and/or occupational licensing requirements), and “market closure” (since only lawyers trained in the US can practice law or own law firms in the US; Abel 1997). None of these claims have been empirically tested.

The very few empirical studies of offshoring of professional occupations vary in their conclusions. Morgan (2006) suggests that the offshoring of engineering services has caused median salaries for US engineers to remain constant between 1995 and 2005. Pounder (2006) studied offshoring of both accountants and radiology work, but found no evidence of job declines for accountants while offshoring of radiology work shrunk the job market for diagnostic radiologists relative to that of interventional radiologists. Offshoring of legal work has not been studied before.

This policy brief concerns the offshoring of lawyers’ jobs from the US to India. Since the financial crisis, an increasing number of US law firms and corporate legal departments have offshored legal work to India, and this phenomenon has spawned a new industry in India, called the Legal Process Outsourcing (LPO) industry. Specifically, we examine the nature and incidence of legal jobs that are offshored, and how this has affected the labor markets for lawyers in both the US and India.

## THE NATURE OF LEGAL PROCESS OFFSHORING

Since the 1990s, US law firms and corporate legal departments used LPO firms in India for labor-intensive routinized legal tasks such as legal transcription, legal coding and indexing, document review, and electronic discovery. While many Indian firms continue to do these tasks, India based (and globally owned) LPO firms have steadily moved up the “value chain” of legal work by offering advanced services such as contract drafting and review, negotiation support, and due diligence services for corporate merger and acquisition deals.

LPO work today can be categorized into three categories corresponding to the work done by first-year, second-year, and third-year associates in large law firms in the US<sup>1</sup> and there has been growth in all three categories. At the lowest end are the *back-office business*

<sup>1</sup> Others prefer alternative categorizations. Lacity & Willcocks (2012) for example talk of ten towers (also referred to as industry “verticals” in India) across which firms specialize.

services, (e.g. accounting, payroll, IT and software systems application and maintenance), many of which were first offshored during the boom in India's BPO in the late 1990s and early 2000s (Kuruville & Ranganathan 2008). The second category, *litigation support services*, includes much of the labor-intensive legal work, such as legal transcription, document conversion, legal coding and indexing, and document review and discovery. Many of these activities are done by first-year associates in large US law firms and paralegals in smaller firms. Typically, document review work by first-year associates in large US firms is billed to clients at rates above \$200 an hour, while the same can be done in India for \$10 per hour.<sup>2</sup>

The third category consists of the rapidly growing *higher value-added services*, including general legal research services, patent assessment, patent portfolio management, statutory and case law research, due diligence services such as technical, legal and financial analysis of companies for mergers and acquisitions, and contract drafting and review. Typically these tasks are carried out by second- and third-year associates at large US law firms. We found that Indian based LPO firms such as SDD Global and Lexadigm were doing the research for briefs and motions in US courts, and their attorneys were trained for multi-jurisdictional research. For example, Lexadigm has drafted its first brief before the US Supreme Court involving a tax dispute related to the fifth amendment due process clause. Lexadigm and Intellivate specialize in the higher value-added arenas like appellate briefs and patent applications (Sechooler, 2008). Several India based LPO firms assist US social security attorneys in filing cases, and do research for filing *de novo* appeals before Administrative Law Judges. LPO firms also assist bankruptcy attorneys in preparing complaints, and are making rapid advances in medico-legal support.<sup>3</sup>

As firms move up rapidly the value chain, they engage in more "nearshoring or onshoring," similar to the experience of Indian software and BPO firms (Kuruville & Ranganathan 2008). In the words of Bull and Furlong (2011, p. 2), "LPO firms are moving up the value chain with surprising speed: taking on the work of second, third and fourth-year lawyers." SDD Global<sup>4</sup> and Pangea<sup>3</sup> (now Thompson Reuters) have recently opened more offices in the US and hire American lawyers at lower salaries.

Clearly, a global value chain has emerged in the law industry. To govern this value chain, US law firms/corporate legal departments have introduced detailed service-level agreements (SLAs) with their India based LPOs. SLAs detail and dictate a range of work standards and some employment practices at LPOs in order to meet the strict confidentiality requirements suggested by the American Bar Association. Some SLAs specify how Indian lawyers

are to be recruited, trained, supervised and evaluated. This is a unique method of regulation of global value chains, which has been exhaustively described in Gereffi, Humphrey & Sturgeon (2005) and Lakhani, Kuruville & Avgar (2015).

## THE INCIDENCE OF OFFSHORING OF LEGAL WORK

As noted, there are only estimates regarding the offshoring of legal jobs from the US. In 2011, Deloitte estimated that the legal process outsourcing market would have a 26% compound annual growth rate, reaching 1,109 million US Dollars by 2015. An alternative estimate of the size and growth of the LPO market can be gleaned from India, which receives the bulk of LPO work. Based on annual reports of Indian LPO companies, the National Association of Software and Services Companies (NASSCOM) reported that the LPO revenues have increased from \$640 million in 2010 to \$857 million in 2011 and to \$1.12 billion in 2012, resulting in a 30% annual average growth rate. NASSCOM was not alone in projecting the fast growth of the LPO market. Lacity & Willcocks (2012) notes an average annual growth rate between 35% and 40% with some firms experiencing 100% annual growth between 2006 and 2010. Consultants such as Global Market Insights projected the total US market for LPOs to reach about 3 billion dollars in 2016 (the bulk of which would go to India); between 2016-2024, the LPO market is expected to grow at an annual rate of 35%.

More firms and employees are working in India-based LPO firms than ever before. The *number* of LPO firms in India has grown from 40 in 2005 to 128 in 2010 (Lacity & Wilcocks 2012), while our count in 2014 yielded 171 firms. The LPO industry employed 7,500 Indian lawyers in 2006, but this number grew to 15,400 in 2010 and 32,000 by 2012 (NASSCOM). NASSCOM's 2013 annual report projected India's LPO industry to hire 80,000 employees by 2015; this estimate was consistent with the projection of 79,000 employees for the same year by the American Bar Association (2011).

To sum up, these disparate data sources paint a consistent picture of the rapidly growing LPO industry. US corporate legal departments and US law firms dominate LPO to India. In 2010, 72% of the total revenues of the Indian LPO industry was accounted for by US firms, followed by the UK (which accounted for 19%), with the remaining balance spread across Australia, Japan, and the Middle East (NASSCOM, 2011). In the next section, we examine how the emergence of this global value chain of legal work between US client firms and first tier suppliers (Indian LPO firms) has affected both countries' labor markets for lawyers.

<sup>2</sup> The General Counsel of GE was quoted in the Legal Intelligencer: "You don't need a 500\$ an hour associate to do document review."

<sup>3</sup> A well-publicized story regarding the successful motion filed by an India based LPO firm to dismiss the defamation case against Sacha Baron-Cohen in the California courts (in connection with "Da Ali G" show) has also raised the profile of LPO firms in the US (SmithDehnINDIA).

<sup>4</sup> Now owned by a US law Firm, SmithDehn.

## THE EFFECT OF LEGAL PROCESS OFFSHORING ON THE AMERICAN LABOR MARKET FOR LAWYERS

**The US Law Firm Employment System.** Before examining the effect of offshoring on the US labor market for lawyers, it is necessary to understand the contours of the employment system for lawyers in large US law firms. The employment model in large US law firms, called the “Cravath” system after the founding partner of the firm Cravath, Swaine and Moore LLP, is a classic example of a closed internal labor market (Wholey, 1985). Key elements of this model include hiring of elite law school graduates, paying them the highest industry salaries, and training them intensively through a six year period, followed by an “up or out” tournament where only the best associates were promoted to partners (Sherer & Lee, 2002). Salary for these cohorts of young associates generally moved in “lockstep” whereby the promotion percentage was fixed. These “rules” of the internal labor market were relatively transparent to all. Because the intellectual capital of its lawyers is what establishes a law firm’s reputation, revenue and profitability, Cravath’s model of human capital development became an industry standard and was widely copied (slavishly<sup>5</sup> in the opinion of some critics) by most large firms (Galanter & Palay, 1991; Gilson & Mnookin, 1989; Henderson, 2008). This model was reinforced by the practice of “billing by

the hour” (Ribstein, 2010), a mechanism for evaluating lawyer’s performance as well as convincing the client how much time was spent on their behalf. Another key aspect of this employment model was leverage (the ratio of associates to equity partners)<sup>6</sup>. As partners in the large firms garnered more work, they began to have one or more associates working for them. Galanter & Palay (1991, p. 103) stated that “firms will tend to grow (at least) exponentially” if “each firm’s promotion percentage remains reasonably constant” and leverage ratios remain the same. This resulted in the “pyramid shape” (our emphasis) or the “inverted funnel” shape of the typical large law firm over the last three decades (Galanter & Henderson, 2008).

The 1990s witnessed some adaptation to the Cravath system, driven by increased demand and intense competition for elite law graduates. The lateral hiring of partners, hiring of non-partner track associates at lower pay, and expanded use of contract lawyers were also growing (Sherer & Lee, 2002). Many firms changed their compensation strategies from “lockstep” to rewarding high performing partners and associates differently from the rest (Henderson, 2008). Along with the growth of non-lawyer “auxiliaries” like marketing directors, these changes led Galanter & Henderson (2008, p. 38) to conclude that “the large law firm has gradually transitioned from the classic promotion to partner tournament model characterized

**Table 1 · Starting Salaries for Law Graduates**

Class of year	Median individual starting salary	Annual percentage change for median salaries	Mean individual salary	Annual percentage change for mean salaries
1990	40,000	+6.7	44,290	+5.2
1995	40,000	+8.1	45,590	+3.3
1998*	45,000	+9.8	53,172	+8.5
1999*	49,000	+8.9	59,133	+11.2
2000	51,900	+5.9	67,048	+13.4
2004	55,000	0.0	71,105	+1.6
2005	60,000	+9.1	72,730	+2.3
2006*	62,000	+3.3	79,338	+9.1
2007	65,750	+6.0	86,396	+8.9
2008	72,000	+9.5	92,009	+6.5
2009*	72,000	0.0	93,454	+1.6
2010*	63,000	-12.5	84,111	-10.0
2011*	60,000	-4.8	78,653	-6.5
2012*	61,245	+2.1	80,798	+2.7
2013	62,467	+1.9	82,408	+1.9

Sources. NALP (1990–2013). \*NALP (2007–2015).

<sup>5</sup> A quote ascribed to a Proskauer Rose Partner, by Henderson (2008). Galanter & Henderson place the origin of the Cravath model in the early 1920s, while Sherer & Lee suggest it is the late 1880s. Meyer & Rowan (1977), referring to how widely adopted this model was amongst large law firms, note that it has become an institutional myth.

<sup>6</sup> In the top 25% of the 100 largest firms, leverage ranged from 4.96 to 8.49 while the bottom 25% of the AMLAW 100 firms leverage rates ranging from 1.89 to 3.55. My interviews with law firms suggest that many use a rule of thumb of three (associates generating three times their cost).

by a stable and reliable set of rules that limited the options of both associates and partners, to a more ‘elastic’ mode. A key consequence was the change from the ‘funnel shaped’ or *pyramid* form to a ‘pitted fruit form’ with a firm ‘core’ of owner partners, and a fleshy ‘body’ of all types of partner and non-partner track employees” (ibid., p.38).

**Post 2008 Changes.** The financial crisis and offshoring accelerated the weakening of the “internal labor market model” of US large law firms. Firms have increasingly adopted “eat what you kill” compensation strategies for partners, lockstep plateaus, and full merit pay for associates.<sup>7</sup> In addition, as large firms attempted to increase profits per partner, they tightened compensation for associates as evidenced by the sharp declines in salaries for first year associates since 2009 in Table 1. Simultaneously, firms substituted hiring of entry-level associates with more lateral hiring (evident in the growth of two-tier partnerships particularly in larger law firms) and more outsourcing and offshoring of legal work.

Layoffs of lawyers, law firm bankruptcies and hiring cutbacks have challenged the traditional sense of employment stability under the Cravath system. During the last decade, at least 12 very large law firms with more than 1,000 partners have collapsed entirely (Scheiber, 2013). Between 12,000 and 14,000 lawyers were laid off during the downturn (Edwards, 2013). Hiring cutbacks continue and in the opinion of many of our interviewees, are the “new normal.”<sup>8</sup> All the available evidence (Altman Weil, Lexis-Nexis, Robert Half surveys) suggest that law firms expect to hire more lateral associates (such as non-

partner track attorneys) from 2014 onwards, rather than recruiting at entry level. It is therefore not surprising that Table 2 shows decline in the percentage of law graduates who work in law firms generally, beginning in 2009.

Another key development has been a departure from the established practice of “Billing by the hour.” Billing practices today show increasing diversity including “value billing” (tying overall fees for representation to outcomes), flat rates for work done during the year, fixed fee for each job completed, or “success fee” (based partially on performance and outcome or blended discounted fee)<sup>9</sup>. In view of these changes in the employment practices, Henderson (2008) argues that the “logical system” of rules that buttressed the internal labor market of US big law firms were disappearing.

Legal industry observers argue that the financial crisis was a watershed in the rapid growth of LPO, and this offshoring subsequently propelled aforementioned changes in employment practices. On the growth of LPO to India, David Wilkins, Director of Harvard Law Schools’ program on the Legal Profession, suggested: “This is not a blip, this is a big historical moment” (Timmons, 2010). In an interview with Forbes, Professor Larry Ribstein at the University of Illinois College of Law remarked: “Law firms downsized rapidly as their biggest clients no longer had bottomless pockets to pay them (2011). New law graduates, the canaries in the coal mine, found their jobs disappearing. They might have hoped that the jobs would return with the economy. But by then, it was too late: “The jobs were going to India.” Figures on declining share of entry level associate in the firm’s overall billing hours per client substantiate these expert views. A trade

**Table 2 · Employment Trends in the US Law Industry, 2001-2012 (%)**

Year	Employed	Jobs requiring the bar exam	Other professional positions	Non-professional positions	Not working	Continuing studies	Jobs in law firms
2001	90.0	75.9	5.5	1.5	7.6	2.4	57.8
2002	89.0	75.3	5.8	1.6	8.5	2.5	58.1
2003	88.9	73.7	5.7	1.6	8.4	2.7	57.8
2004	88.9	73.2	5.3	1.4	8.6	2.5	56.2
2005	89.6	74.4	5.1	1.4	8.2	2.2	55.8
2006	90.7	75.3	5.1	1.3	7.0	2.2	55.8
2007	91.9	76.9	5.1	1.3	5.8	2.3	55.5
2008	89.9	74.7	4.9	1.3	7.7	2.4	56.2
2009	88.3	70.8	5.4	1.8	8.7	3.1	55.9
2010	87.6	68.4	5.6	1.9	9.4	2.0	50.9
2011	85.6	65.4	5.3	1.9	12.1	3.0	49.5
2012	84.7	64.4	4.9	1.8	13.2	2.1	50.7
2013	—	64.4	4.7	1.6	12.9	1.8	51.1

Source: NALP (2013).

<sup>7</sup> Interviews with three US law firms.

<sup>8</sup> Interviews with Law Firm Administrator in NYC.

<sup>9</sup> Interviews 12,14, and 17, all law firms.

publication called the Real Rate Report shows that the entry level associate hours billed as a percentage of total lawyer hours billed per client was 7% in 2009, but declined to only 2.9% in 2011 (Wolters Kluwer, 2014). The 2014 version of this report reveals a 60% drop in the ratio of hours billed by first year associates over the past five years. These numbers are strong indicators of the effect of offshoring on the decline of entry-level positions for large US law firms.

Why did offshoring increase so rapidly after the crisis? We do not have conclusive answers but identify contributory factors. The search for lower costs is one reason, and Indian labor costs are between 10% and 20% of US labor costs. But the labor cost arbitration is not the only reason as it is possible to contract out work at almost similar costs in the US. Our interviews with Robert Half (a firm that provides temporary legal employees) suggest that during the downturn, its Philadelphia office was supplying project attorneys at \$20 an hour, only marginally higher than Indian costs.<sup>10</sup>

Another reason is that the rapid maturation of the LPO industry in India has increased perceptions of the quality and reliability of offshoring law work, which has been an important driver of the increase in offshoring volume. Our interviews suggest that LPO firms have addressed US clients' concerns about work quality and developed robust technical processes and systems that isolate Indian employees from access to confidential information. In addition, many Indian lawyers at LPOs are trained and supervised by US and UK trained lawyers, and these firms hire law graduates from both the US and the UK.<sup>11</sup>

Finally, offshoring is increasingly seen as a “legitimate strategy” amongst US law firms. In the Altman Weil survey (2014), the percentage of law firms viewing offshoring legal work to be a permanent trend increased from 27% in 2010 to 50.7% in 2014. It is also important to note that the spurt in offshoring occurred since the ABA's Standing Committee on Ethics and Professional Responsibility outlined its position in August 2008 regarding the obligation of lawyers when offshoring legal and non-legal support services. This pronouncement was widely seen as the ABA having “blessed” offshoring. In addition, there has been a “benchmarking” effect among law firms. As leading firms such as Allen & Overy and Clifford Chance in the UK commenced offshoring in 2009, a little behind US law firms such as Jones Day and Kirkland Ellis followed suit. Similarly, leading in-house corporate law departments of Rio Tinto, DuPont, Cisco Systems, Morgan Stanley also offshored legal work in 2007 and 2008, setting a precedent for other companies to follow<sup>12</sup>.

In summary, the *quantum* and *value* of offshoring law work to from the USA to India have increased rapidly especially after the financial crisis. The *nature* of offshored legal work has been changing in a way that substitutes for the work currently done by junior associates at US law firms. Hence, there has been a concomitant and steady decline in entry level recruitment in US law firms. We argue that the employment structure of large US law firms have been changing from its erstwhile “pyramid” shape to a diamond shape with a smaller intake of fresh law graduates, a “bulging” number of trained non-partner track associates, and a smaller pool of partners. As Passarella (2009), an observer of law firms writes: “Diamonds may be a law firms' best friends.”<sup>13</sup>

## EFFECT OF LPO ON THE INDIAN LABOR MARKET FOR LAWYERS

A relevant question from the global policy and business perspectives is to ask what repercussions LPO has brought upon in the Indian legal industry. Before the emergence of LPO firms, India's legal service industry was composed of a few elite firms dominating a vast majority of corporate legal works, a large number of small firms, and sole practitioners. Law graduates needed family or kinship ties in order to enter these elite firms, most of which are family-controlled. In this context, LPO firms have created a new job market for law graduates lacking personal connections to elite law firms, those not wishing to start their own practices, or those not having passed the All-India Bar Exam.

What is happening within Indian LPO firms in terms of employment system is akin to the Cravath system. LPO firms have employed law school graduates<sup>14</sup> who could not get into elite Indian firms, and offered them with a formalized career path from non-legal associates doing back-office work to eventually legal vice presidents. Salaries increase according to job ladders, and new associates receive on-the-job training by US- and UK-trained lawyers either from their firms or from client companies. Anecdotal accounts from LPO employees commonly speak of clearer career tracks and faster promotion in LPO than in a regular law firm. Should this employment system continue to function, the LPO industry can pave new ways for upper-middle-class mobility for many Indian law graduates.

## CONCLUSION

This research demonstrates that high-skilled high-status occupations such as lawyers, despite their capacity for occupational and market closure, is just as susceptible to

<sup>10</sup> According to Robert Half, one can hire a contract law clerk for between \$18 and \$22 per hour, paralegals for between \$18–\$25 per hour, litigation legal secretaries for \$15–\$18 per hour, and project attorneys for \$40–\$45 an hour.

<sup>11</sup> Interviews 22–24.

<sup>12</sup> Interviews 11–12 with US law firms.

<sup>13</sup> Currell & Henderson (2013) prefer to talk of a transition from a pyramid to a “tower.”

<sup>14</sup> Graduates from top-tier law schools with no luck in local elite firms find jobs in corporate legal departments.

offshoring as jobs in low-skilled occupations in manufacturing and some service industries. This research adds empirical evidence to Blinders' (2006) argument that there is no correlation between offshoreability and skills, and consequently, suggests that many highly skilled jobs in advanced industrial countries can be offshored. Global value chains, which have proliferated in so many industries, appears to be proliferating in highly skilled occupations as well, with major implications for employment in advanced countries.

The employment effect in advanced countries may not be the most important issue. While the initial impact has been a loss of jobs of junior lawyers and an overall reduction of employment in US law firms, there is potential for longer term job gains in the US. As Indian firms move up the value chain, they set in motion a process of "onshoring". This onshoring not only enables these firms to service their clients better and faster, but also permits taking on more advanced that work that cannot be offshored for regulatory reasons. In the foreseeable future, as more LPO firms experiment with hybrid offshore and onshore strategies, the LPO industry may add jobs in the USA, but at substantially lower salaries.

The bigger problem is in the long term effects on the production of needed skills in advanced countries, as well as the curtailment of social mobility. If junior lawyers are no longer necessary, then the elaborate system of training lawyers via the internal labor market model is also no longer necessary, resulting in the question of who will train next generation lawyers. And second, if junior lawyers are no longer necessary, Americans will not enter law school (in fact, there has been a sharp decline in law school applications, and several law schools are in danger of being closed), thus eliminating an important escalator to upward mobility. Americans have always viewed the legal profession as a sure way of entering the middle classes. That escalator seems to have broken down in the US while it is being re-built in India. •

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