



How to adapt and survive in the new legal era

New beginnings

The UK's Legal Services Act has permitted external investment in law firms and heralded the creation of new and highly creative structures, such as allowing banks and private equity funds to take ownership of legal practices. So far around 20 so-called Alternative Business Structures, or ABSs, have been allowed to operate in the UK and many more are expected. Radical as this may sound it has in fact been the contracting economy and a growing sense among clients that something needs to change in the way that they procure and pay for legal services that may have the most lasting impact on the world's second largest legal sector after the US.

The UK legal sector is now in an era where traditional models will be severely tested as pressure grows to reduce annually the costs of production, yet increase quality and innovation. An example of how the costs of production are coming under pressure is the demand by clients for process work to be produced more cheaply. Competition from process-focussed ABSs will only exacerbate this situation.

This has led to law firms to respond by forming joint ventures with Legal Process Outsourcers (LPOs), building their own process centres in cheaper locations outside the main financial centres, for example in Northern Ireland, or unbundling the work and sending the more commoditised elements to a regional law firm that has a lower cost base.

The start of this new era began in 2008, yet it is perhaps only now that lawyers in the UK are finally accepting that the 'good old days' are really not coming back. This does not mean we will all be worse off, but it does mean we will have to work differently and think differently about professional services provision, at least in the UK, and perhaps around the world.

What clients want

The client push-back on fees that we felt so strongly in 2009 has perhaps lost its crisis-driven sense of urgency as companies sought to cut costs across all areas, almost with a sense of desperation as the economic boom collapsed. However, the cost-consciousness of



clients remains and is not going away even if the panic is over. We may be beyond the shock of boom and bust now, but a very flat market will continue for several years to come. The eurozone remains trapped in a tangle of near impossible debt commitments, meanwhile the BRICs are slowing down. Global economic activity is not about to rise suddenly.

Against this backdrop, with less demand for legal work and a superfluity of providers, twinned with the realisation that value can be delivered at a lower price has made clients more questioning. The other factor is the pressure on general counsel to contain legal spending and use not only panels, but rigorous procurement systems that can be shown to hold down legal costs. In short, it will be tougher to increase profits even as inflation eats away at what profit growth there is.

As noted, the entrance of ABS law firms this year, from the rapid expansion of the Co-Op Legal Services to the merger of Australia-listed personal injury firm Slater & Gordon with Russell Jones & Walker and its Claims Direct group, will add to traditional firms' problems. These legal 'big brands' will initially only focus on the High Street, but they will eventually eat away at the SME sector and higher up the food chain when they can. Even if they do not make great headway in the corporate sector, they will undermine prices for process work which will eventually be felt higher up the value pyramid.

Improving your offering

Whether law firms are London-based, regional or High Street, or for that matter international, they will have to invest in an improved offering and yet cut production costs at the same time to keep, or grow, market share. They must innovate, meet clients' legal needs, but also show that they are flexible and open to produce often repeated work in a cheaper way but with the same or better quality. Failure to do so may mean a loss of work. The conversation between lawyer and client may often be about that most elusive of terms, 'value', but the implicit message is that the price and overall cost of process work will become increasingly negotiated by clients.

Many law firms naturally do not want to compete on price or even discuss it. However, many general counsel have to live with a fixed budget so in turn they will pass this pressure on to their advisers. IT and better systems will help law firms to produce work more cheaply to meet this need. But do firms necessarily want to invest in better, faster and more efficient IT that will make their 'product' cheaper and easier to produce? The awkward truth is that inefficiency has been rather profitable for professional service firms. For systems specialists like banks and insurers and cost conscious corporates, adviser inefficiency has been put under the spotlight.



In effect, law firms have come under the same financial and structural pressures that other industries, especially those in the retail supplier sector, have faced for at least the last ten years.

Economies of scale

The driver for merger had always been about bringing together a greater wealth of legal expertise, often in a wider range of locations, in order to help service clients and retain a greater share of their legal spend. This client-focussed approach remains the primary reason for merger. But in these new conditions, economies of scale are becoming an increasingly important secondary driver.

There are a number of benefits to economies of scale for a law firm. Back office costs could be shared. A doubling in the total lawyers in a firm does not necessarily mean a doubling in the number of support staff. Fixed support costs such as IT can be cheaper in larger firms relative to revenue generated. The more partners there are in a firm the smaller the cost-per-partner of paying for future investments, marketing campaigns and the development of new practice areas.

In a market where revenues and profits will not be able to rise as rapidly as they have in the past, reducing operating costs via merger synergies, which will also deliver an improved platform to serve clients, may make increasingly good sense. Another factor that will drive consolidation will be as panels shrink in size and become more stringent there will be a greater need to offer clients a significant and wide-ranging capability, at home and abroad. Failure to do so may mean being left off key panels. Those firms that fail to adapt to this new environment do not face sudden collapse, but they will steadily lose the goodwill of clients and gradually lose their ability to compete against their rivals. Adapting to the new conditions and developing new means of production may not be the preferred scenario for many law firms but it will be necessary to do so to prosper in this new legal era.

Note

This article is based on our report *After the Golden Age: The New Legal Era*. If you would like a copy, please e-mail Tony Williams.