

Legal Week

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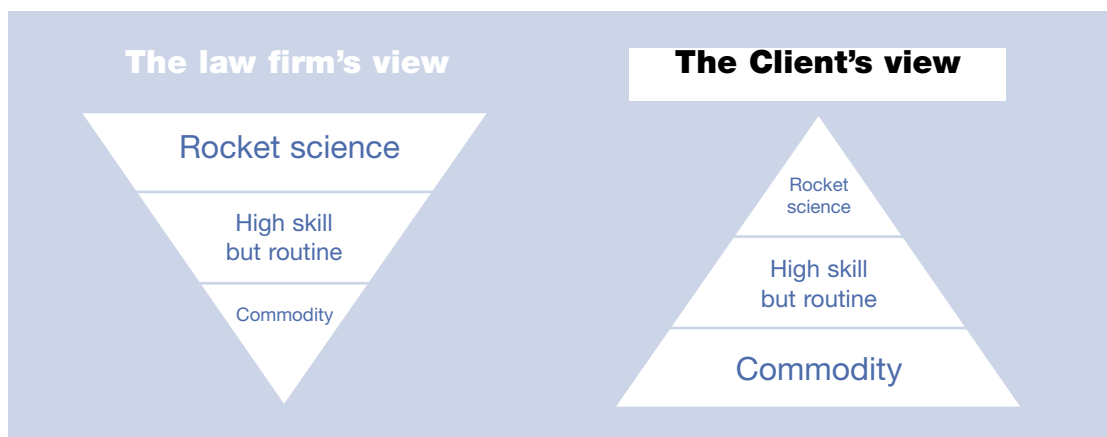
Precious commodities

Lawyers must respond now to the challenges of commoditisation – unless they are about to retire, argues Tony Williams

There is often a degree of unreality in a law firm's approach to the commoditisation of legal services. The first approach is denial: 'No, of course we do not do that sort of work, but firm X does.' The second answer is: 'Yes – but we do very little, although it is useful for training our junior lawyers or trainees.' The third answer is: 'We do not do much now but we anticipate more of our work being commoditised and do not know how to cope with it.'

All of these answers are somewhat bizarre and disappointing. There is no reason for any firm to feel ashamed of doing commoditised work. Indeed, firms that recognise how their clients view the work they do are far more likely to satisfy their client's needs and maintain satisfactory long-term relationships. Currently, there is often a disconnection between the work the law firm thinks it is providing and the significance the client attaches to it (see graph below).

Ultimately, the client's view will prevail. They know how much they are prepared to pay and how they want that service delivered.



Too important to ignore

In trying to ignore or resist this trend towards commoditisation, law firms are ignoring the key pressures now faced by general counsel: the need to achieve more with less resource, the need to demonstrate 'value' to the business from the internal and external legal resource and continuing pressure to apply procurement best practice and to use the internal procurement team in the selection of outside counsel.

Instead of proactively assisting a general counsel to address these challenges, too many law firms are hoping the spotlight on legal services will soon move elsewhere and that pressure on fees will soon abate as corporate activity increases.

The cost-cutting and de-equitising of partners conducted by UK firms over the past two years, combined with an increased level of deal activity, will inevitably increase the profits of many law firms this year. It would be a mistake, however, for firms to use that improvement as an excuse to avoid addressing commoditisation and how it may affect the business in the long term.

This is not to suggest that commoditisation will affect all parts of the legal market. For big-ticket M&A work, 'bet the farm'-style litigation, innovative financial products, business critical IP and similar matters of major significance to the client, the client will invariably buy on the basis of reputation and depth of expertise rather than price.

However, it is necessary to be realistic as to the size and depth of this market. It is unlikely that this work accounts for more than 10%-15% of the UK legal market. Of that, much of this work tends to be concentrated in the magic circle and other major UK and US firms operating in London. Firms without a top-quality reputation and depth of expertise face the following pressures:

- how to provide interesting and challenging work for the best lawyers
- how to adjust their gearing model for different types of work
- how to cope with widely varying levels of profitability across the firm; and
- how to develop new charging models, including fixed price menu pricing

The recent decision of Motorola to cut its spend by reducing its internal legal staff and streamlining its external legal panel is but one of a series of similar moves by major corporates. Irrespective of the level of deal activity, this trend will continue relentlessly for many more years. It is now an integral part of corporate good housekeeping.

Look on the bright side

But all is not doom and gloom. Tesco is extremely successful and profitable in what is fundamentally a commodity business. It probably has no regrets that it is not Fortnum & Mason at the premium (but very small) end of the groceries market.

Law firms, too, can have a very successful future doing more commoditised work. They do need to identify what work is now commoditised, the next area likely to be commoditised and how to respond to this change. This response will almost certainly include the greater use of information systems, 'just-in-time' training programmes, intelligent drafting tools and a range of standardised responses to frequently asked questions.

But the use of these aids must go hand-in-hand with new pricing models designed to price the value of the output (the value of that advice to the client) rather than the value of the input (the time taken by the lawyer to prepare the advice). The hourly rate discourages efficiency and the innovative use of technology and know-how systems, while fixed and menu pricing relies on innovation and the advanced use of technology and know-how systems to be profitable and remain so.

How the culture could change

This change will cause a major transformation of law firm culture. It may change the partner-to-associate ratio, increase the number of fixed share or salaried partners, place pressure on

lockstep remuneration systems, necessitate regular and effective partner and lawyer reviews and require the timely addressing of underperformance. In short, law firms will need to be far more businesslike in every aspect of their operation.

Firms can, of course, refuse to address these concerns. But, except for a very few, this is a dangerous course. In recent weeks there has been considerable press coverage of the possibility of the offshoring of legal services to India and other, lower-cost common law countries. A report by Forrester research last year suggested that 12,000 legal jobs in the US had already moved to low-cost countries. This number is expected to grow to 39,000 by 2010 and double again to 79,000 by the end of 2015. DuPont and GE have already moved some routine legal research and other legal work to India. Other major corporates, having already seen the benefit of offshoring other functions, are expected to follow.

Top-rate IT and know-how systems will enable a raft of routine work to be outsourced. The client will get a high-quality, if relatively standardised, service at an acceptable price. If law firms do not respond quickly they risk being disintermediated. If that happens many firms will be forced to radically restructure – and some will fail.

The trends towards commoditisation and the threat of offshoring may be compounded by the arrival of new entrants to the legal market upon the implementation of the Government's White Paper on the future of legal services. This, by the introduction of 'alternative business structures', goes far further than the Clementi report and appears to endorse the wholesale use of multi-disciplinary partnerships, which could be 100% owned by other businesses.

Potentially, new entrants, backed by major institutions or private equity, utilising cutting edge technology and know-how systems and undertaking major brand advertising, will transform the provision of commodity legal services to the retail client. But it is unlikely to stop there.

These services will become available to small and medium-sized companies and, as their credibility and reliability becomes appreciated, start to be used by bigger corporates on more routine matters. These new providers will relentlessly work their way up the value chain.

These challenges are potentially daunting. But the tools to help firms change are available now. If they use them quickly and effectively, firms have every opportunity to beat off the new competition, to respond to the general counsel's needs and to remain very profitable, at least in the medium term. You can do nothing – but only if you intend to retire within the next five years.

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