

## The Four Types of Firms Vying For the Top Work and Who Will Win Out

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*Law firm consultants Brad Hildebrandt and Tony Williams have identified four types of firms competing for the global work that keeps firms the busiest, and they identify which models are working and which have staying power.*

Most law firms of any size devote considerable effort to attract and retain the largest national and international corporate and financial institution clients. The reason is very simple, these clients have a need for legal advice across their areas of activity involving multiple practice areas and geographies. They usually spend tens or even hundreds of millions of dollars a year on external legal services. As a result, such clients, if properly managed and developed, provide a relatively consistent and predictable flow of work to their law firms which in turn provides a degree of robustness and predictability to the revenue and profitability of the law firms.

The reality is that there are a limited number of organizations that consistently spend over \$10 million per annum on external legal services. Many law firms want to act for them. Accordingly, the competition for roles with such clients is fierce and shows no signs of abating. General counsel in such companies have, at last, recognized that they have a high level of buying power and are increasingly exercising that either by establishing panels of preferred firms and/or demanding fixed prices or discounted hourly rates in return for representation. General counsel also have a far greater understanding of their own legal needs, of work that can be done in-house or needs external assistance and of the firms that are appropriate for certain types of work in relevant locations. With a greater parity of bargaining power between the consumers and suppliers of legal services it is inevitable that law firms have needed to be clear as to their expertise and value proposition in terms that are relevant to the client.

For these major clients there is no shortage of suppliers. Some firms may claim to be unique but in legal services this is difficult to maintain. In reality, a positioning within a small peer group of comparable firms may be the best that can be achieved. The individual reputation of key partners, their relationship with the client and key intermediaries, their availability and their empathy with and understanding of the client's business sector may become a key determinant of whether a particular firm is hired. In addition, client conflicts may eliminate some potential firms.

In this competitive market we have identified four broad categories of firms that are seeking to gain significant work from these major clients on a multi-year basis. These break down as follows:

- The global coverage business law firms that primarily offer a full range of services across a large range of countries.
- The major international firms that offer primarily corporate, finance and litigation in most major business and financial centers and some emerging markets.
- The strong international firms that focus primarily on the major business and financial centers.
- The domestic powerhouse firms who have leading M&A and litigation positions in their key domestic market which enables them to secure major roles on business-critical international engagements.

All these firms are fundamentally targeting the same clients although they may adopt very different business models and deliver fundamentally different financial metrics. We have identified some of the leading firms in these categories but there are many in each category or positioned between categories. The work that these firms do for their clients will also vary dramatically in terms of its boardroom visibility and the strategic importance of such work to the client. Each of the firms within any model and positioned between models can be and are successful and may have achieved impressive growth in both revenue and profitability in recent years.

### **The Global Coverage Business Law Firms**

These firms have developed an extensive international network of offices typically covering over 30 countries often with multiple offices in key jurisdictions. To effectively manage the range of financial performance achievable in a multiplicity of locations they may operate through a *verein* type structure which allows a high level of local management autonomy and financial independence between the constituent parts while operating under one global brand. Examples of such firms include Baker McKenzie, CMS, and DLA Piper. More recently this group has been joined by Dentons which has grown rapidly via acquisitions in recent years. In these firms, the overwhelming majority of the firm's lawyers will be outside the firm's "home" location. Indeed, Dentons eschews a "home" location in favor of describing itself as a "polycentric" law firm.

Typically, although the *verein* type structure makes effective analysis challenging and some firms do not disclose detailed firmwide financial information, these firms achieve revenue per lawyer (RPL) in the \$400,000- to \$700,000-range and profit per equity partner (PPP) in the \$900,000- to \$1.6 million-range. These firms have the highest head count and revenues but the lowest profitability and RPL of the four categories, although the leading players have significantly grown their profitability in recent years. They undertake a wide range of work for their clients with matters coming from head office and regional and local legal teams and management. While the work they do is often characterized as "business as usual" they will seek to broaden and deepen the client relationship so as to be seen as a relevant choice for more strategic multilocation transactions and advice including M&A, corporate investigations, litigation, tax and regulatory advice.

### **The Major International Firms**

These firms have a strong and broad international platform usually covering at least 15 countries including most major business and financial centers where they are able to practice. The model typically operates as a *de facto* "one firm" for management and financial purposes although the actual structure may be more complex to reflect local tax and regulatory issues. They tend to offer a reasonably full-service capability but with a particular focus on M&A, finance, regulation, litigation and international arbitration. They will often (but not exclusively) have more than 50 percent of their lawyers based outside their home country. Examples of such firms include Allen & Overy, Clifford Chance, Freshfields, Linklaters, Latham & Watkins and White & Case. Typically, they achieve RPL in the \$800,000- to \$1.2 million-range and PPP of between \$1.8 million and \$3 million. Their particular focus is on multi-jurisdictional matters, but with often strong, large and leading local practices, they may also advise on a range of higher-end domestic matters.

### **The Strong International Firms**

These firms tend to have a much more limited international footprint focused on between five to 15 countries including key business and financial centers. Usually they will have under half and often under 25 percent of their lawyers outside their home country. Their focus is on high-value M&A, disputes and investigations, and as their international offices tend to be smaller, their focus is more clearly on international and high-value work rather than domestic matters (except in their home jurisdiction). Examples of such firms include Cleary Gottlieb Steen & Hamilton, Davis Polk, Kirkland & Ellis, Simpson Thacher & Bartlett and Skadden, Arps, Slate Meagher & Flom. Typically, they achieve RPL of between \$1 million and \$1.5 million and PPP between \$3m million and \$4 million.

### **The Domestic Powerhouse Firms**

The domestic powerhouse firms also represent the same major corporates but using a fundamentally different proposition. They have a strong and deep capability and reputation in their home market and on international engagements may use their very limited international presence and will effectively work with leading domestic firms as required, often as a result of well-established and nurtured best-friend type relationships with these leading domestic firms. Their focus is resolutely on the “bet-the-farm” matters whether M&A, regulatory investigations or litigation. They are focused on one key location with a small handful of international offices which rarely account for 5 percent or more of total head count. Examples of such firms are Cahill Gordon, Cravath, Swaine & Moore, Slaughter and May and Wachtell, Lipton, Rosen & Katz. They typically achieve RPL over \$1 million and PPP between \$2.6 million and \$5.8 million. These firms have the lowest head count and revenues but highest RPL and profitability of the four categories.

### **Why Don't We All Turn Into Domestic Powerhouses?**

Given the disparity of financial performance between these four broad categories of firms it is tempting to ask why most firms don't aspire to be a domestic powerhouse. The answer is that, in a crowded marketplace, it is extremely difficult to establish and maintain such a powerhouse position and reputation. It requires real discipline in the standard and culture of those admitted to the partnership, an extremely strong culture and work ethic (aided by a focus on one location) and a preparedness to turn away work or clients that do not fit the firm's target profile. It also requires strong and effective working relationships with a range of independent firms to ensure that the client receives the proactive, business-focused and extremely high-caliber service that the client expects and is willing to pay for. They jealously guard, nurture and develop their client relationships and have a level of boardroom, intermediary and regulator recognition and credibility that has taken generations to develop. Conversely the growth of a global coverage business law firm, although challenging, can be achieved relatively quickly as evidenced by the growth of DLA Piper over the 1990s and 2000s and the development of Dentons over the last five years or so.

However, although we have identified four broad categories of firms seeking to work for major corporate and financial institution clients, it is important to appreciate that no firm is guaranteed a leading position in any category or indeed is immune from movement between categories.

The global coverage business law firms, as they develop their international platform are seeking not only to dominate their client's business-as-usual work, but also to be seen as increasingly credible choices for more high-value instructions. This may include higher value M&A, complex litigation, regulatory investigations, etc. The other law firms used by the client will try to push those firms out of such work and to paint them as low-cost commodity providers. Faced with a range of panel firms, the GC may decide that for high-profile matters it is just too risky to hire such a firm when others, more known and acceptable to the board, are available. As a result, these global coverage business law firms face an additional battle to keep their current clients (while facing competition from cheaper local firms, legal process outsourcers, firms using IT and cheaper locations to do such work well and profitably and even the in-house team itself) while also moving the glass ceiling up each year to enable them to act on more strategic and high-value matters for the clients. Based on M&A deal tables it appears that these firms are performing well on the number of corporate transactions that they are doing for their clients but less well on the aggregate value of transactions. This suggests that they are deemed acceptable for a range of upper mid-market transactions but have yet consistently to convince their clients to use them on the multi-billion-dollar strategic transactions.

For the major international firms there are also real challenges. They often act on major, high-value matters but may too have a significant tail of upper mid-value work. They have also invested heavily in integrating their global offering, providing a seamless service to clients and broadening and deepening their client relationships. They have a significant and fully integrated international presence, but this encompasses a range of countries with different economics and partner remuneration expectations. As a result, there are inevitably tensions between offices and practices achieving disparate financial returns, especially if the firm uses a lockstep or hybrid lockstep remuneration model.

Clearly, they do not wish to pursue the global business law model, (although the use of new technology and legal service centers may enable them to do some of that work well and profitably) but they do have a significant range of offices, not just in the major business and financial centers. But, global investment flows are concentrated on a very few countries. In 2016, outbound foreign direct investment (FDI), by the United States, China, Netherlands (which for tax purposes may have been a conduit for investment originally from other European countries) and Japan accounted for about 51 percent of global outbound FDI. In terms of inbound FDI in 2016, the United States, United Kingdom, China, Hong Kong (also a conduit into China), Netherlands (see above) and Singapore accounted for about 53 percent of global inbound FDI. Other countries such as India, France and Germany may also be significant investors or investees, but if a law firm is adopting the approach of "follow the money" it may be difficult to identify more than 10 to 15 countries that are significant parties to major M&A and greenfield investment and where the law firm can practice and achieve a level of financial return commensurate with that achievable in its home market.

Given the high level of top-tier lateral partner mobility, it is increasingly challenging for those major international firms to monetize the investment in their international operations and to achieve returns consistently higher than the strong international firms. If law firms, their partners and, indeed, the legal press are prepared to recognize that closing an office is not a sign of weakness or failure, but evidence of a firm prepared to make proper business decisions, we will see more office closures and even offices being open for a limited time as a country privatizes its businesses or embarks on major projects before closing them when that work is completed. It is quite possible that some of these major international firms will rationalize their international footprint and that this category will combine with the strong international firm category.

The strong international firms have had a good decade since the recession. Being predominantly New York based they have leveraged their U.S. depth and client relationships to develop a measured and focused international offering. They have had a major focus on London where their forensic approach to lateral recruitment and deep pockets has enabled them to hire some highly regarded partners from the major international firms. They have also increasingly improved their positioning in European and global deal value tables for M&A. More recently, these firms have added a high-level capability in litigation, international arbitration, white-collar crime and regulatory investigations. These firms have developed well although some of their European offices lack depth and breadth, but they do not necessarily see that as a disadvantage given their focus on high-value work and their preparedness to work with leading local firms when appropriate.

For the powerhouse firms, it is difficult to criticize a model which has achieved such consistently impressive financial returns. However, the model is not without risks. They need to be able to continue to recruit and retain the best of the best and they certainly have the financial resources to do so. On matters where most of the activity is focused on their home jurisdiction they also have an extremely strong position. It is on genuinely multinational work where they may face a challenge as the major and strong international firms deepen and broaden their international offering and demonstrate an effective level of service integration and client care. The best friends model, if invested in, can provide a credible alternative to the major and strong international firms but it is dependent on such best friends maintaining and developing their levels of expertise and client service. The fact that some of the strong international firms are actively trying to recruit partners from powerhouse firms means that there is no reason for complacency in relation to their market position.

The emergence and greater definition of a range of law firm models where each firm is eager to achieve a share of the major corporate and financial institution client's legal spend give the in-house team a real opportunity to analyze the work they do and to allocate it to the most appropriate firms whether based on price, geographic coverage, practice depth, specific expertise, boardroom credibility or personal relationships. Law firms need to take a long, hard look at themselves and understand where they are currently placed, where they want to be placed, how compelling their client proposition is and how and at what cost they can position or reposition themselves.

Big does not necessarily mean better for international law firms. The legal market and firms' market positions are much more subtle and nuanced, and a variety of models can be successful but firms that cannot clearly articulate and deliver their client proposition are likely to lose out in this new legal market.

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