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## An American View on Developments in the Law Firm Business

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### 1. News on trends

First of all: This is not meant to be a soundproof, research based paper trying to come up with all the statistics needed for backing up a scholarly discussion. It is more like an attempt to look into the crystal ball in order to find out what may be about to come. The developments up until today, as they are described later on, are of course based on facts. The assumptions for the future trends though are the work of – let us say – mere educated fantasy.

#### a. What is it that clients want?

When elaborating on trends, the clients' needs are never a bad point to start out with. Anthony Davis, a widely recognized expert on topics concerning the legal profession, keeps asking his law students at Columbia University «What is it that lawyers need most?» Eventually his students come up with the right answer: «Clients!» So, if we share this opinion we should move on to the question of what it is that clients want from lawyers when asking for their legal advice.

The answer comes naturally: Clients want reliable advice and most effective representation, both in an adequate quality. Furthermore, the legal service should provide a real solution for the clients' problem. They want the service fast, and at the least possible cost.

If we look more closely into these requirements there will be hardly any dispute about the elements of «reli-

able advice» and «most effective representation». These are the core elements of legal services, and, generally speaking, clients seem to be quite content with what they receive in this respect. We also see that most (business) law firms do a good job when it comes to speed and responsiveness. However, many studies show that we get in trouble when the expectation of clients with regard to generating a solution for their problem is at stake. This has to do with the nature of clients' problems which are seldom focused on an exclusively legal aspect. More often, these problems are comprised of a number of additional aspects of corporate life (e.g. financial or social issues, issues concerning the strategy, market orientation or risk management of the client). Therefore, it does not come as a surprise when clients sometimes complain about their lawyers' shortcomings of «understanding the clients' business». But then, many sophisticated law firms are working on this, sending their associates on secondments to clients or even allowing them to go through a training teaching them the basics of business and economy.

The real hard nuts to crack though are «adequate quality», and «cost». Lawyers take pride in delivering the highest quality in the work they do. It is not just client orientation that makes us strive for top-quality. We also want to keep our own liability risks low. The somewhat provocative question, whether legal work is always done best when carried out by qualified lawyers, remains. Joseph Lambert, General Counsel and Managing Director of UnitedLex, one of the fast growing so called «Legal Process Outsourcers (LPO)» in the U.S., is convinced that some legal services, in order to be delivered in high-end quality, require not only the skills of well trained and experienced lawyers, but primarily a sophisticated and reliable process and powerful IT systems. Think of project management in complex M&A transactions, due diligence, or document review in large litigation cases. If such work is done by specifically qualified non-lawyers with the use of powerful IT it is not only the quality that may be at least as good as a traditional lawyer's work. On top of it the clients will pay less! Instead of first or second year associates performing the work it is done

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by people with substantially lower salaries in much less hours.

Therefore, ever more corporate clients require their external counsel to make use of such LPO-services. They are no longer willing to pay for first or even second year associates doing work they are not qualified for. Moreover, they want this work done more efficiently and for less money. That is the good news. The bad news is, this trend will accelerate. Silvia Hodges, Director of research services with TyMetrix, a corporate legal services provider focusing on legal procurement, claims that corporate clients are no longer willing to pay fat hourly rates without closely looking at possibilities to save money. They do that by increasingly using LPO-services and by picking law firms only after having conducted a thorough process comparing – among other criteria – prices. On the basis of substantial data, she shows that prices for corporate law firm services come down by 7 to 10 percent, just by going through procurement. And, she adds: «Sometimes prices drop even more, without negative effects on quality!»

#### **b. Assumptions on market developments**

If we want to take this one step further we need to look at the latest developments in the market for legal services. In recent years, we have seen hourly rates for associates declining (see latest numbers for Germany), high-end law firms shrinking in size or at least remaining stagnant, LPO-providers growing fast, both off-shore (i.e. India) and on-shore (i.e. USA or UK), and decreasing profitability in many full-service-providers among law firms in the USA, the UK, or Germany. Very latest numbers for 2012 show that AMLaw 100 may progress again slightly in terms of revenues and profits, which might well be due to the tender recovery of the economy. We do not have any indications that it is thanks to structural changes that will lead us back to the «good old times» in the law firm business.

Now what assumptions can be drawn from this for the future of the market for corporate legal services? Bruce MacEwen, a longtime observer of the U.S. legal services market and renowned publisher on the topics in question, says: «There will always be first tier law firms (maybe less and smaller ones than today and only a few will be doing global business). There will always be «boutiques», focusing on doing one thing exceptionally well. And there will be what I call «category killers», specialists who target broadly needed services, and who will be the dominant market leaders in the respective field. The full-service, national, one-size-fits-all firm though, typically located in the middle section of the market, trapped in between global high-end law firms and boutiques on the one end, and the uprising commodity-services providers on the other, is an endangered species. For them – and

this is the vast majority of all law firms serving corporate clients –, it is either a dramatic change in their business model or, I am afraid, a decline.»

#### **c. Risks of being an attorney in times of market shifts**

Based on these assumptions we will be seeing a tremendous shift in the paradigms of the law firm business. Given that developments in early-movers-markets for legal services such as the USA and UK will sooner or later spill over to other parts of the world, the ones who are in this business will face some risk.

Attorneys will eventually have to adjust to an entirely new set of paradigms ruling their market. Partners in law firms will be challenged as businessmen, more so than as legal experts. In times when industries transform, its leaders will have to make decisions that can take their firms to more prosperity or to demise. They can even go out of business. Occurrences like these happen all the time in other industries. Look at Kodak, Nokia, or – most recently – Bank Wegelin for examples.

So, law firm partners will have to become entrepreneurs. The problem is, nobody taught lawyers the basics of managing a firm. In times where growth was self-evident, the leverage and the profits per partner increasing every year, management skills were not so critical. However, they are of utmost importance when the traditional ways of doing business are threatened by market trends going in the opposite direction. That is the position we might find ourselves in today!

Peter Lederer, former Partner with Baker McKenzie and one of the founders of the Miami Law School venture «LawWithoutWalls», puts it this way: «When change comes you want people to handle it themselves rather than having change imposed on them.» No doubt there are law firms that move beautifully towards this new world Patrick Susskind described years ago in his remarkable book «The End of Lawyers». But many do not move at all. The majority of law firms still act as if for this very industry the «law of change» does not apply. It might be hard to see, but there are at least as many opportunities down the road as threats. The law firm strategy will decide if a law firm is going to travel towards «good-land» or «bad-land».

## **2. Possible impact on law firm strategies**

Boutiques and «category killers», as Bruce MacEwen likes to call them, left aside, there will be three layers in the law firm market: (1) high-end legal services providers, (2) commodities providers, and let us call them (3) the «middle segment».

The first and most important strategic questions law firms will have to find an answer to is which of these market layers they want to belong to. When we talk to law firms serving corporate clients they most frequently say: «We strive to be on the high-end side of the market».

No doubt there will be a very interesting market on the high-end. It will be dominated by firms who deliver cutting edge work in the most complex legal questions faced by corporate clients. In this context complexity could be described as legal advice that (1) requires most innovative thinking in order to create answers to intricate legal problems, (2) involves more than one legal (or other) discipline, and is (3) required in an international context. If a law firm can deliver on these premises it will be fine indeed. It will be strongly focused and not necessarily very large. The leverage will most likely not exceed a partner/associate ratio of 1:2, and the firm will intensely collaborate with LPOs who bring their special knowledge on routine work connected with otherwise complex legal work to the table. As a rule the best talents will be aiming to become part of the firm, the clients will not ask for the price, the salaries for associates will be high, and the profit per partner will be absolutely wonderful. We might think of these firms as the Ferraris and Lamborghinis of the market. There is not a doubt though that there will be just a few of them in every market; much less than one would wish to think. Therefore, the vast majority of law firms will have to come up with an alternative strategy.

What about wanting to be a provider of legal commodities such as contract drafting, doing the daily corporate work, helping to get the routines done in M&A transactions, being specialized in handling large amounts of documents, or giving support in IP matters or litigation cases? Firms like Riverview, Axiom, or UnitedLex do this in the Anglo-Saxon markets, Cornuum in Germany. They employ fine lawyers, together with paralegals and non-legal staff. They know how to streamline workflow so as to design lean and highly reliable work processes. And they of course count on powerful IT supporting their work. It is not surprising that according to UnitedLex' Anthony Davis many of the most prestigious corporates are among their clients and even numerous of the high-end law firms. LPOs clearly aim to be an indispensable collaboration partner for high-end law firms and in-house legal departments. If executed well, this business model could work just as fine and lead to great profits too.

Law firms in the aforementioned middle segment of the market will have to make strategic decisions as well. First, they will have to carefully explore the services they want to deliver, the clients they want to target, the territories they want to be in, and the means of distribution of their services. While doing this they will have to care for three things: (1) focus, (2) focus, and (3) focus! «No»

will in most cases be the right answer to the question on what, to whom, where and how to. Sailing from opportunity to opportunity will lead nowhere. It will be a matter of utmost importance to reach a position where these law firms will be highly visible in the market. This can be achieved by creating one or the other beacon. However, for most of the work done by these firms the rule will apply that it must be conducted very efficiently, in sufficient quality, and at the lowest possible cost. The combination of a few sparkling abilities with good «craftsmanship» in general, as well as a great service attitude could be the way to success. Profits per partner will not skyrocket (but partners will make a good living), salaries for associates will be on the modest side (but jobs will still be around), and well served clients will be the basis for a sustainable future of the firm.

### 3. Possible impact on legal education

What does all this mean for legal education? Are young lawyers sufficiently prepared to enter a world they possibly expected to be like the world their fathers knew but in fact is totally different? Are these young people sufficiently equipped with the skills necessary to develop (rather: invent) new business models for law firms?

There might be some doubt about that. In most jurisdictions lawyers are not trained for being in charge of a firm as an entrepreneur or as a member of the management team. Nobody teaches them on how to develop a strategy, on the importance of client-orientation, on marketing their services, on designing lean workflows, processes, and structures, on project management, on interpreting financial reports, and on many other aspects related to law firm management. Moreover, there is no «special» training for lawyers or paralegals who want to join an LPO. And: how would a freshly graduated lawyer know how to successfully contribute to the work done in a high-end law firm?

If and when the market shifts described in this article occur, today's legal education does not offer adequate training for the future markets lawyers will work in. Therefore, as markets develop the way they might, we have to be prepared for thorough analysis and a timely alignment of our legal education. These necessary changes will not only affect universities and law schools. Law firms might have to think things over too. Maybe high-end law firms will not be able to keep on relying on the steady stream of talent joining the firm and, for the most part, leaving again after having served as associates for a few years. Remember? Clients will most likely stop paying for the work done by first or second year associates. So where do these firms recruit the highly qualified staff they need? Are lateral hires the answer? Do they use «farm teams» of young lawyers, supervised by retired partners

and closely led while growing into their responsibilities as future associates in an extremely demanding segment of the market? Or are there other innovative models we could think of? And: who will train the staff of firms on the commodity-end of the market? What should be the law related part of their skill set, what the process- and technology-related part?

#### 4. Considerations applicable to the Swiss market for legal services?

Since this is a Swiss law journal that kindly chose to publish these notions one feels bound to ask if the thoughts laid out here are in any kind of relevance for Switzerland or any other Continental legal markets for that matter. As the paper is on future trends the answer can only be: I don't know!

There are a few peculiarities in Switzerland that distinguish its legal market from others indeed: Peaks of hourly rates billed by law firms in general do not reach the numbers scored by «Big Law»-firms in New York or by «Magic Circle»-firms in the City of London. LPOs, on-shore or off-shore, are not widely used by Swiss law firms and their clients, at least not for work done in Switzerland. Large foreign law firms did not enter the Swiss market so far, Baker McKenzie being one of the very few exceptions. Swiss law firms in the financial centers of Switzerland (Zurich and Geneva) maintain «best friends» relationships with a great number of important law firms operating internationally, so these law firms do not feel the urge to come here. And last but not least: the Swiss market for legal services, despite Switzerland being host to many headquarters of large corporations, is relatively small.

Nevertheless, we should think about these clear trends towards a significant change in global markets for legal services. And we should think of them as a possible way how market shifts could occur in Switzerland too. Of course, there are also the options that things stay as they are or that markets will take completely different turns from those discussed here. However, if we do consider these trends and their effects on law firms as potentially relevant for us it will be of no harm. Strategies will be sharpened, processes will be designed to be leaner, client-orientation (including pricing policies) will be improved, recruiting requirements and career planning will be revised, proper risk management will be put in place, leadership capabilities of partners will be brought forward, and state-of-the-art technology designed to support workflow as well as communication will be introduced more likely. If all this will be done, regardless of what kind of future may come, a law firm will be timely and better prepared for any challenge to face.

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