Strategic Responses to Trends in the Legal Profession

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By Ward Bower

Each year the legal profession becomes more competitive, concentrated and demanding. The slow-growth economy has taken its toll on law firms in corporate and business transactions practice. But more than "just" the economy is at work. Law firms are influenced by many developments outside their immediate control.

Current developments with significant effect on the profession include:

- **Continuing economic pressures** in the form of revenue constraints (client scrutiny of rates, hours, and staffing; slow pay by clients) an inexorable cost escalation (especially associate and support staff compensation, IT expenditures, professional liability insurance, marketing) are creating a classic "profit squeeze." In addition, law firm balance sheets are burdened by unprecedented levels of debt.

- **A "war for talent"** as, even in the slow economy, demand for top graduates of top law schools exceeds supply. As many as 4,000 or 5,000 new law graduates every year are paid as though they were in the top 2,000 graduates in the nation. This phenomenon has kept starting salaries at the high levels established in 1999 for almost all large law firms.

- **Consolidation continues,** although law firm mergers so far in 2003 are slightly off the pace of the first half of 2002. There is continuing interest in New York acquisitions, as evidenced by the Ropes & Gray/Reboul MacMurray deal. There is escalating interest in the US by UK firms (and vice versa) as evidenced by the Jones Day/Gouldens merger and the on again, off again Fried Frank/Ashursts discussions. Transatlantic mergers are still hard to do because of economic and cultural differences. Even so, a number of other US and UK firms are rumored to be exploring their possibilities.

  Consolidation has produced two firms of 3,000 plus lawyers, one of which (Clifford Chance) is approaching 4,000. One benefit of size is recognition as a "brand" — marketplace cognizance as a leader in the field. The primary benefit of branding was identified in a UK study in 1994 as a 10-15% premium in billing rates.

- **The shakeout or business failure of firms** unable to compete persists. Brobeck is a spectacular example. Arter & Hadden and Altheimer & Gray are discontinuing operations. Others will follow. The shakeout fuels consolidation as groups join other large firms.

- **Globalization** is still on the agenda. An economic comeback in the US could fuel economic resurrection elsewhere in the world. When that occurs, global capital markets, M&A and deal activity will accelerate. For now, capital formation markets are moribund and firms reliant on the financial services industry are suffering.

- **Client initiatives** create both threats and opportunities. An Altman Weil survey shows that 50% of corporate counsel plan to change one or more of their outside law firms in 2003. Corporate clients also are reconsolidating legal work in a smaller number of outside firms, as part of their "convergence" efforts.

- **Re-regulation** is facilitating multi-jurisdictional practice (MJP) and even multi-disciplinary practice (MDP), as a number of US jurisdictions have eased their rules regarding non-lawyer ownership of law practices. The Sarbanes-Oxley legislation would seem to have put a damper on MDP, but *de facto* law practices continue in the Big Four firms in the US, and the only one of them with a remaining consulting practice, Deloitte, recently suggested that inability

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to provide legal and consulting services to audit clients still leaves 75% of the top tier of corporates as potential clients.

- **Lawyer mobility** presents opportunities and threats as lateral movement at partner and associate levels persists, new competitors (foreign firms, etc.) enter US marketplaces, groups of lawyers spin out to form new firms and active poaching of the most productive lawyers continues.

The result is a highly competitive environment, threatening to poorly managed firms. Particularly vulnerable are mid-sized, full-service and large, single city firms, the former at a competitive disadvantage versus large firms on the basis of breadth and depth in specialties and versus smaller firms on price. Large, single city firms are vulnerable to client attrition as they (clients) expand geographically and are exposed to firms in other locations, while MJP and technology render firm location less important to clients.

Strategies to Employ

Strategies that might be considered to deal with these trends include the following:

1. Acquire additional ***market share*** using the weak economy to establish a position in new markets with strong economic potential through merger or acquisition. Specifically, markets where higher rates and margins might accrue should be considered.

2. Extend ***global reach*** through branching or a possible relationship with foreign firms, or joining an international network of firms.

3. Capitalize on public attention to corporate ***governance*** by considering adding one or more "outside directors," subject to local professional rules (outsiders may have to be lawyers) and/or creating a client advisory council.

4. Explore opportunities presented by ***corporate law department trends*** and initiatives, including convergence (sell a multiple jurisdiction capability for replacing more than one firm as outside counsel), diversity (play to the corporate commitment to diversity initiatives in ACCA), and by creating an image-based value proposition for in-house counsel — play to their concerns regarding accountability, knowing their business, partnering, etc. in a formal program with an easily remembered message ("your extended law department"…?). Outside professional assistance should be sought for communication of the program in the marketplace.

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5. Extend and promote multidisciplinary ***strategic business units (SBUs)*** to include industry groups (high-technology, etc.) or types of clients (mid-market businesses, closely held businesses). Play to client concerns or opportunities, including homeland and corporate security, new officer and director responsibilities, the impact of new tax reform legislation, etc.

6. Create pilot ***ancillary businesses*** that relate to the firm's practices and activities, e.g., HR consulting, security consulting, corporate governance consulting, etc.

7. Invest in state-of-the-art ***professional development*** training programs, including components on leadership and management training for lawyers at various stages in their careers.

8. Consider greater ***focus*** on practice areas or market segments, eliminating less profitable areas or those with less growth potential.

9. ***Trade up*** in terms of lawyers (replacing less productive resources with more productive laterals) and clients (by referring less profitable clients to other firms).

10. ***Downsize*** by conforming resources to reduced demand in the current moribund economy.

11. ***Tier*** the firm to create new leverage for equity partners in the form of permanent associates, income or "non-equity" partners, paralegals, etc.

12. ***Employ IT strategically*** to create competitive advantage or new revenue sources (publishing, forms, etc.)

13. Consider ***outsourcing*** overtime and overload support functions to vendors promising low cost and high quality via modern communications technology, renegotiating vendor contracts to achieve savings, etc.

14. Evaluate emerging initiatives to ***free working capital*** used to advance client costs, via third party financing, if appropriate.

Although the latter two issues are essentially internal and operational in their nature, they could

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become sources of competitive advantage in the marketplace of the immediate future.

No firm is likely to employ all of these strategies and most will develop additional strategic approaches to the new dynamics of the market. Almost any action is better than none, as the same, old approach to business is unlikely to produce success today.

The US legal services marketplace of 2003 is one of challenge. What has become clear is that firms need to plan and manage actively to be successful. Those that passively wait for the next big opportunity are likely never to see it, as it will have been exploited already by a more active competitor. ◆

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