

# Large law firms: A business model, a service ethic

**W**hat it means to be a large law firm has changed in recent decades. Most obviously, large firms are much larger today than ever before, and they continue to grow at a rapid pace. The number of lawyers at the average *AmLaw 200* firm increased by 29 percent from 2003 to 2013. And generally speaking, the higher a firm's revenues, the faster its headcount grew. *AmLaw 50* firms grew by 40 percent during that period. The 20 firms that had revenues of at least US\$1 billion in 2013 had grown by 54 percent since 2003.

To manage their increasingly complex organizations, large firms have begun to adopt more of the business strategies and practices that are common in most other sectors. Although the pace of adoption has accelerated since the 2008 financial crisis, the process is still in its infancy. Success for most large law firms will increasingly depend on their becoming more businesslike, particularly with respect to how they manage their organizations and operations and engage with clients.

The 2008 crisis was pivotal in part because it unleashed unprecedented cost pressure on the legal sector as corporations increasingly demanded more for less from law firms. But the crisis also refracted and accelerated trends that were already affecting the legal sector. Globalization reshaped competitive dynamics for large firms in the decade leading up to the crisis, and it will continue to be a dominant force in years to come. The effects of technology and new entrants have been compounded by the crisis, particularly as companies look for new, more efficient ways to work in a persistently value-conscious environment.

Success for large firms will always depend on the ability to achieve excellence in practicing law, but other factors are becoming increasingly important as well. Firms should embrace proven business strategies and practices that can enable them

to be more efficient, client-focused, differentiated and socially engaged. These are some of the characteristics that have the greatest potential to set large firms apart in the future.

Large law firms face many challenges in coming years, but developments since the crisis are ultimately a cause for optimism. Leading firms of the future will serve clients and society better, and this will drive profitability, not destroy it. In that sense, the outlook is bright for large firms as well as for those they serve.

## I. Forces reshaping the legal sector

Most industries have been grappling directly with three powerful forces since the late 1990s: accelerating globalization, the rising importance of



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technology and (partly as a function of the preceding two forces) the proliferation of new entrants. Until recently, with the possible exception of globalization, these forces may have affected most large law firms less than they affected companies in other sectors. Why? For decades, large law firms enjoyed a nearly uninterrupted rise in profitability that far exceeded inflation, and few clients pushed back on fees. The expectation of rising profitability stood as a buffer against the perceived need for change—until the 2008 economic crisis made cost a paramount concern for corporations

and law firms alike. Once the buffer was removed, firms felt an increasingly urgent need to adapt in a number of areas. This section considers how key forces related to cost, globalization, technology, and new entrants are playing out in the legal sector today.

### A. Persistent cost pressure

Seven years after the onset of the financial crisis, corporate legal departments still face pressure to reduce in-house staff and lower the cost of legal services provided by outside firms. As recently as 2013, Richard Susskind reported that many firms still sought to reduce their legal costs by 30 to 50 percent. And the pressure persists even as legal work grows more complex due to globalization and increasing regulation.

Companies have responded by demanding discounts and requesting alternative fee structures from law firms in an attempt to reduce their legal bills. This has had significant effects. Among large firms, the realization rate—defined as the portion of their standard fees that firms actually collect from clients—fell from 92 percent in 2009 to almost 83 percent in 2013, according to Peer Monitor.

Perhaps more important in the long term is the growing demand from clients that firms change the way they work to deliver more for less. These new ways of working come in many forms, but they often involve technology, offshoring and outsourcing—levers that can enable firms to carry out routine or basic tasks less expensively.

### B. Accelerating globalization

Although the legal sector was relatively slow to pursue globalization, many large firms have rapidly increased their foreign presence since the 1990s. Of the 45,000 lawyers working at the 20 firms that *Law360* ranked as having the biggest global presence in 2014, about 58 percent were based outside their firm's home

country. The primary motivations for large firms were to access new markets and establish the footprint necessary to continue to provide highest-quality legal services to their global clients.

This has proven to be a tremendous boon for many firms, but history shows that globalization presents many challenges as well. Expansion is expensive, in part because it often involves opening new offices and developing business in unfamiliar places, but also because large firms often cannot charge the same rates in many new locations as they do in their home countries. Thus, building a global presence may be more difficult when costs are more constrained.

Moreover, it can be difficult to recruit, develop and retain high-quality talent in distant locations, and it is more difficult to maintain consistent, high-quality service across a large office network—particularly because legal practices and work ethic can vary significantly around the world. And as more firms expand internationally, it will be increasingly difficult to stand out for being global. Firms will have to show why their global value proposition is distinct from competitors with similar footprints.

Law firms are still quite new to globalization of another sort, which is usually focused on capturing cost arbitrage opportunities. Many have begun to establish offshore operations in low-cost locations to run their back-office functions and carry out routine work. And some have begun to outsource some tasks to third-party providers in other countries. This will become more common as firms strive to reduce their costs, but firms will have to balance concerns about cost and quality to ensure that they do not dilute their value propositions by relying too much on third parties.

### **C. The rising importance of technology**

Computers, smartphones and enterprise IT systems (such as customer relationship and knowledge management systems) have revolutionized how lawyers work and interact with clients. But advances in areas such as e-discovery are enabling automation of routine tasks in ways that reduce costs, often while improving quality of service. Predictive analytics will enable firms to identify patterns and use data to inform decision making. And social

media and online reputation markets are reshaping relationships between lawyers and those they serve, often shifting the balance of power toward clients (a shift that has already taken place for consumers in most industries).

Each of these developments presents opportunities and risks for firms. Automation, outsourcing and contracting with highly skilled lawyers and nonlawyers can reduce fees that firms have traditionally collected to carry out basic tasks. Firms that have benefited from high leverage rates may have to adjust their staffing strategies to maintain profitability. But this could ultimately enable firms to improve their talent management approaches, allowing associates to focus on more substantive work that could increase job productivity, satisfaction and retention.

Technology adds value in other ways as well. Analytics technologies can surface critical insights related to matters or client service, but firms will have to continue developing and refining capabilities in-house to deploy these technologies and analyze their outputs. Digital and social technologies can enable firms to develop closer relationships with clients and provide insight into their needs, but firms must manage them carefully to minimize associated reputation risks.

### **D. The proliferation of new entrants**

As discussed, companies around the world are developing low-cost tech-enabled solutions for delivering a spectrum of legal services. Legal process outsourcing firms are performing an increasing number

of basic tasks for law firms, and third-party funders have emerged to facilitate dispute resolution. The number of in-house counsel has grown exponentially in the last decade, enabling companies to carry out many legal tasks they would previously have hired law firms to perform. And some corporations are even beginning to form service centers themselves to handle basic legal tasks at lower cost.

Accounting and private equity firms are taking a larger role in the legal sector, particularly as some countries pass rules that allow nonlawyer participation in law firms. The U.K. Legal Services Act of 2007 allows nonlawyers to participate in the management and control of law firms, and it introduces options for Alternative Business Structures (ABS) that allow nonlawyers to invest in law firms. In 2014, PricewaterhouseCoopers, Ernst & Young and KPMG were all granted ABS licenses to provide legal services in the United Kingdom. Canada and many other countries are considering changing their laws along these lines, and others such as Russia, Spain and the Netherlands have long allowed nonlawyers to participate in law firms. Ernst & Young already has more than 1,100 people in its global law practice, and it expects to have a presence in 80 jurisdictions by 2017.

These developments complicate competitive dynamics, forcing firms not only to position themselves relative to other law firms but also to compete with players that bring new sets of capabilities to the sector.

## **II. Characteristics of leading firms of the future**

The forces discussed above do not displace excellence in the practice of law as a primary basis of competition for large firms, but they do provide an impetus for establishing new competitive advantages based on other factors. Due to clients' concerns about cost, the most urgent focus for many firms is to become more efficient. A second set of objectives—to develop a more client-focused and differentiated value proposition—demands attention in the short to medium term. And firms that become more socially engaged can help foster prosperity while developing new competitive advantages for the long term. This section considers these characteristics—efficient, client-



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focused, differentiated and socially engaged—with a focus on how firms can adopt business strategies and practices from other sectors to develop sustainable competitive advantages for themselves.

#### **A. Efficient**

Law firms can meet the more-for-less challenge by implementing proven principles to eliminate waste and focus on their most value-added activities. These principles are codified in two similar and widely used approaches: lean manufacturing, which is based on lessons derived from the Toyota Production System, and the Six Sigma model, which was developed by Motorola and made famous by General Electric. Today these principles are applied in virtually every industry, from manufacturing to banking.

Firms that focus on efficiency may often identify opportunities for outsourcing activities to third parties or enlisting skilled contract lawyers and nonlawyers. As mentioned in the previous section, a host of new legal process outsourcing firms have emerged that can perform basic tasks at low cost. And because they focus all their attention on a small set of activities, these companies can often get the job done faster and more effectively than large law firms can. Technology also enables firms to automate routine tasks. E-discovery technologies, for example, can dramatically reduce the cost of analyzing large volumes of documents in preparation for litigation. And as predictive analytics technologies improve, firms can use them to identify relevant facts or patterns that humans might overlook.

Firms are also using technology to improve their internal operations and monitor performance. Many have deployed IT systems to manage matters more effectively, ensuring that relevant firm resources are surfaced when and where they are needed. Performance management systems enable firms to monitor progress toward particular goals and ensure that individuals focus on the most value-added activities.

All this is made easier by the trend among large firms toward developing clearer organizational structures and empowering professional managers to focus on running their businesses without also having to practice law. This is particularly important for global



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firms with many offices around the globe. A professional team of C-level executives, supported by a qualified executive board, is more likely to succeed in setting a direction for the firm that makes sense across disparate geographies and establishing a viable and cohesive culture that bridges national boundaries.

#### **B. Client-focused**

All firms earnestly strive to meet their clients' needs, and most take steps to ensure they are highly responsive and can field requests at a moment's notice. But law firms have not gone as far as businesses in many other sectors to develop what is elsewhere known as a "customer focus."

Customer-focused firms go to great lengths to understand their customers' needs. They often start by developing processes to gauge customer satisfaction, typically through surveys, interviews and focus groups that ask customers to provide feedback and identify opportunities for improvement. But customers do not always reveal what they are thinking, and they may not always be in the best position to identify or articulate their own needs.

The most sophisticated companies use empathy-based approaches adapted from sociology to put themselves in the shoes of their customers and identify challenges they face. An approach called "design thinking" calls for observing customers as they use products or services to gain insights about their experiences. This can enable companies to develop solutions to problems consumers may not even recognize they have. Anticipating and meeting these

kinds of needs can transform how customers think of the company.

Law firms have opportunities to apply these approaches and work more closely with clients, sometimes through secondments, to identify ways to meet client needs more effectively. Indeed, it is the great lawyer who helps clients identify and think through their unrecognized legal needs.

Client-focused firms are also committed to adapting their value propositions and business models to meet their clients' needs. They assess their objectives and strategies to ensure they are focused first on clients rather than products and services (or the firm itself), and they develop tailored value propositions that appeal to clients with similar needs. Often this involves segmenting clients into groups that have similar profiles and developing targeted processes and services to serve them. To be effective in the long term, these approaches must be refined and improved on a continuing basis. Top firms constantly assess their performance and relationships to identify opportunities to serve clients better.

#### **C. Differentiated**

No firm can be everything to every client. Even full-service firms must make trade-offs, ensuring that they meet an acceptable threshold of performance across the board but aiming to excel in selected areas. Indeed, those that do not clearly define their focus may not excel in any area.

Top firms tend to develop very clear strategies that are easy to understand and articulate, both within and outside their organizations. They also recognize that the competitive landscape is always shifting, and they adjust their value propositions as conditions evolve. Ten years ago, for example, some firms were able to differentiate themselves just by establishing a presence in key markets around the world. That's no longer the case. Too many firms have now expanded internationally, and firms with a global value proposition must now articulate how their offerings set them apart from others with a similar footprint.

Of course, excellence in the practice of law is essential, but it is only part of the equation, and those that achieve it may find that it isn't

a sufficient basis for distinguishing themselves from their closest competitors. The culture of a firm can be a significant differentiator for those that manage to establish an identity based on commitment to certain values or principles. Cravath, Swaine & Moore is one of the most famous examples of a firm that has done this in the legal sector, having codified its principles as the Cravath System. Other fronts for differentiation include value, client service, innovation and network reach.

Whatever the strategy, marketing is increasingly important to success. More firms are availing themselves of the full range of tools available to get their messages out, including tapping into social media and other digital forms of marketing that enable firms to connect with clients via their preferred media and channels, and at their convenience.

### D. Socially engaged

Large law firms have always been at the fore in providing pro bono services to individuals and groups that lack access to justice. Most will maintain their commitment to this essential professional duty. But large firms—particularly global firms—are uniquely positioned to make a broader social contribution by leveraging their resources and reach to foster prosperity around the world, often by helping to maintain and establish the rule of law.

This may often involve helping to establish standards, regulations or legislation to stabilize conditions in a country or region and to facilitate global commerce. It may also involve helping to train and empower the judges and lawyers needed to uphold and administer the law. Such activities can help raise standards of living; expand labor pools by bringing excluded groups such as women and minorities into the workforce; attract investment by providing the legal foundation for free and fair competition; and create enforceable standards for protecting the environment.

Corporations can benefit because these types of activities often help to create better conditions for doing business, particularly in emerging markets. Indeed, firms will often find opportunities to collaborate with clients on social efforts, helping companies to advance both their social and commercial ambitions.

Law firms can also benefit when they take on larger roles in addressing the world's challenges. They can deepen relationships with clients by collaborating on social programs, and they can expand their network among top thinkers and decision makers in business, government and social institutions around the globe. This may often require lawyers to be opinion leaders in their communities, maintaining visibility and prominence. Taking a page from management consultancies, law firms can join the virtuous circle of world leaders with the ambition and means to effect change and create the conditions for economic growth.



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### III. Conclusion

The 2008 economic crisis unleashed the full strength of a number of forces in the legal sector that have already reshaped many other sectors. Companies across industries have already pioneered and refined strategies and approaches for dealing with these forces, and large law firms will adopt an increasing number of them to navigate the new realities they face. That does not mean firms will have an easy time developing the best approaches for this new era. They will have to experiment and innovate to succeed, but at least the starting points may be fairly clear for firms that look to other sectors for guidance. A primary lesson is that change is constant, and it is likely to continue to unfold at an accelerating pace. Those that take up the challenge in earnest have an opportunity to improve or fortify their competitive positions and potentially increase their social contribution in the process. ■

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