Law firm of the 21st century

The clients’ revolution

An Eversheds report on the post-recession legal sector in 2010

Eversheds
Foreword

There is no question that the worst recession for 80 years has had a major impact on the legal sector.

General Counsel are under pressure to deliver more for less. In turn, they are demanding reduced costs and greater value from their legal advisers. Quite rightly they want accountability when it comes to how their budgets are being spent and more imagination when it comes to fee structures. For law firms this has meant facing up to challenge and change. Whilst some are holding fast, hoping that the boom times will return soon, the smarter ones are adapting for the longer term.

This report shows that the legal landscape has changed permanently and more quickly than anyone imagined when we produced our original 21st century law firm report in 2008. Even before the credit crunch, it was clear that business people were disillusioned with ever increasing fees, wasteful practices and an unwillingness to change. Harsh economic times have pointedly polarised these issues.

During the recession we, as a high quality provider of legal services, set about changing our business to provide greater efficiency, better service and realistic pricing. Innovative use of technology and the possibility of moving work to lower cost centres are all part of our agenda to deliver more for less. We think that others will have to follow in order to survive.

Whilst little good has come out of this recession, the much needed reality check for lawyers is, perhaps, one positive by-product. Is the time ripe for a revolution in the delivery of legal services? This report suggests, that the revolution has now arrived.

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Introduction

When the severity of the recession became apparent at the end of 2008, opinion was divided as to what this meant for the legal market. Would it bring about a new world order, or would the market revert to its pre-recession shape as soon as the cycle swung up again?

For our 2010 update, 130 General Counsel and 80 law firm partners were asked whether they thought the recession would have a lasting impact on the profession. A resounding majority (78%) answered “Yes”.

However, the recession in itself was not thought to be the key driver of change. What it has done is accelerate other significant, long-term drivers of change. Some law firm managers believe that this change has been accelerated by as much as ten years.

The research identified four major factors which are driving change. In order of importance, they are:

- globalisation – the move to the East
- increasing professionalism and status of the General Counsel
- technology
- the Legal Services Act in the UK.

The confluence of these four factors, stimulated by the recession, has created a perfect storm in the legal market. The storm and its aftermath are investigated in this report.

Which factors will have the most transformative effect?

- Globalisation 37%
- Legal Services Act 8%
- Increasing status of GCs 35%
- Technology 20%

Response from law firm partners and General Counsel
The recession has accelerated the globalisation of the legal profession. Whilst cost pressures force General Counsel and firms to look to low cost jurisdictions to resource work, the inexorable shift of the economic fulcrum to the East means that many international law firm leaders are now starting to envisage moving their HQs from the West to China or India. The developing markets in the Middle East, Asia and Latin America are also attractive pools for new work.

Whilst there might have been some debate in the immediate period following the credit crisis as to the viability of the global law firm, the continued requirement for cross-jurisdictional expertise and the interconnected nature of regulation mean that the move to internationalise is unhalted. Most law firm leaders said that emerging markets and the consequent need to develop a sophisticated international footprint were still as high on the agenda as before the recession. In fact, for law firm partners, globalisation was considered to have the most transformative effect on the legal market (44% of partners put globalisation first compared to 31% of law firm clients).

36% of legal clients felt that the increasing professionalism and status of the in-house lawyer would have the most transformative effect on the profession. The credit crisis has given this trend additional momentum as the remit of in-house lawyers in business broadens and the status of General Counsel rises. In October 2009, Mark Harding, the General Counsel for Barclays Bank, was appointed to its Executive Committee – a relative rarity in the legal market. This is indicative of the growing importance of General Counsel as a strategic partner to business.

The Legal Services Act (LSA), although limited to the UK, also affords opportunities. Even US managing partners watch with interest at the way in which UK law firms respond to this new legislation. Two years ago, the Eversheds 21st century report suggested that law firms were not open to the changes that the LSA would bring. Now, the research shows there has been a shift away from the blanket dismissal of the Act as irrelevant. General Counsel, in particular, welcome some of the provisions of the Act where they feel it will effect a better buying position for them.

On the technology side, a significant proportion of law firm clients and managing partners reported greater use and investment in technology. Over half of law firm clients interviewed (58%) had used technology to deliver legal services more efficiently as a result of the recession. A third of managing partners were actively investing in technology to either standardise legal processes or communicate more effectively within the firm and with their clients.
The aftermath of the perfect storm

This could be described as a revolution where the stakeholders in the legal market have finally become appropriately aligned. The client has in effect moved to the centre of the legal services solar system, whilst the premium law firms have been relegated to an orbiting position. The characteristics of the legal market, post-recession, are as follows:

• **Clients take centre stage:**
  – balance of power shifts to clients and the legal sector enters the modern world
  – fee levels are set for long-term overall decline or stasis
  – General Counsel have increased status and expanded their role in business.

• **Delivery of legal services is geared up to efficiency and value:**
  – recession drives efficiency
  – legal services are increasingly unbundled, also contributing to efficiency
  – strategic resourcing through outsourcing and technology dramatically increased
  – the hourly rate is simply one billing tool among many
  – value enters the client-lawyer relationship through increased use of value billing and the development of value resourcing.

• **Law firm market in flux:**
  – law firm peer groups and categorisations re-align
  – less premium work means there is a new optimal size for large international law firms with less headcount and lower leverage; moderate growth will continue for mid-sized firms, at least in the medium term future
  – loyalty to partnership model continues to decline; other models develop
  – UK law firm leaders begin to see opportunities in the LSA.
Clients take centre stage

- **Legal sector enters modern world**
  76% of legal clients and 75% of partners say that the current balance of power in the client-lawyer relationship is now with clients. A majority of both groups believe the shift to a client-led market will be permanent.

- **Clients drive change in legal services**
  Partners and clients said that the increasing power and importance of General Counsel was almost as important a driver of change as globalisation and the shift to the East.

- **Fee levels set for long-term decline**
  The vast majority (90%) of General Counsel said they were under internal pressure from their Finance Directors or equivalent to provide better value, efficiency and cost reductions. 60% of General Counsel said they had already reduced their overall external legal spend.

- **Credit crisis propels General Counsel to the forefront of business**
  74% of General Counsel said that they now occupied a far more senior commercial advisory role in their companies compared to before the recession. In some cases, job descriptions had dramatically altered after the credit crisis and the in-house legal department is now seen as more of a business unit rather than a support unit. General Counsel are more likely to be strategists and business partners now than ever before. Just over half (55%) said they had assumed more responsibility for corporate governance since the credit crisis and many have taken on more functions and new responsibilities in business:
  - **New role of risk:** the enormity of the financial crisis has reshaped the attitude of business to risk. The ‘back to basics’ approach is making a return and the in-house lawyer has a crucial role to play in setting the balance of risk for their organisations. 73% of in-house lawyers said that their organisation’s approach to risk had changed as a result of the crisis.
  - **Ethics champion:** a not insignificant minority (33%) also said that there was a new dimension to their roles as ethics champions in the business.

- **Redrawing the client-lawyer relationship**
  With the credit crisis and recession, the boundaries of the client-lawyer relationship are being redrawn. General Counsel are more likely to occupy the role of trusted adviser to the business. Although law firms still aspire to this role, they are seen by the in-house lawyer as service providers and, at best, close collaborators. This dynamic is demonstrated by a reduction in loyalty amongst General Counsel: 73% admitted to either changing or reducing the number of their external legal advisers as a result of the recession. Over half said as their in-house capabilities increased, they would only look to external lawyers as a source of highly specialised advice.
Legal sector enters modern world

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Credit crisis propels GC to forefront

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What we’ve learned

Many managing partners have recognised that they are becoming primarily service providers and that their previously dominant role at the centre of the client-lawyer relationship has irrevocably altered. However, at the rank and file level, the research shows that partners are still disconnected from what their clients want and need. For example, over two-thirds of General Counsel are demanding lower fee rates from their external lawyers and 47% of partners recognise that this is their clients’ number one priority. Crucially, however, only 25% of partners are actually delivering reduced rates, despite knowing that it is what their clients want.
Efficiency and value

• **Recession drives efficiency**
  The drive to better and more efficiently resourced legal work has received a huge boost from the recession. 73% of clients said that they are implementing better and more efficient resourcing of legal work. A majority of law firm managing partners recognised that the need to be more efficient was key to being a sustainable business. Efficiency is the area in which they are driving the most change as a result of the recession.

• **Recession pushes technological innovation up the agenda**
  When asked about their greatest challenge over the next ten years, partners rarely (<10%) cited the effective use of technology in the Eversheds 21st century law firm report 2008. The recession seems to have changed this: 48% of partners are now offering technological solutions directly to their clients in order to streamline services and a significant number of managing partners said they were keeping up their investment in IT despite cost reduction pressures.

• **Clients are actively outsourcing and using technology**
  The greatest change over the past two years has been among clients whose appetite to outsource and use technology has increased. Just over a third (38%) of General Counsel were actively implementing or considering outsourcing low-level work to low-cost jurisdictions and a further 29% were receptive to the idea of outsourcing provided they had suitable work. 58% of clients are implementing or considering technological solutions to standardise processes. However, their shift in attitude is not equalled by private practice: over half (56%) of clients reported that they had not received offers of alternative resourcing from their external advisers as a result of the recession.

• **General Counsel take more work in-house**
  As in-house legal departments ride an internal popularity wave, the recession has meant that many of them (52%) are actively reducing the work they send outside and taking more of it in-house. Over half of General Counsel (55%) said that the capabilities of in-house legal departments would grow over the next five years and that the recession had given a boost to that trend.
• **Hourly rate is relegated**

One of the biggest casualties of the recession has been the hourly rate which has been relegated to one of many tools in a varied fee tool box. There are some regional variations to this trend: the relegation is more severe in the UK than either continental Europe or the US, who report greater use of alternative fee arrangements but still say that the hourly rate is a central tool to bill clients. UK law firm managing partners were the most positive group about the hourly rate with 79% saying that the rate was almost dead and simply one fee arrangement among many.

• **Radical shift to value billing**

There has been much debate about the role of value billing. Value billing is billing based on the value of the work for the client rather than the amount of hours spent on it by outside counsel. In effect, it is billing based around business outputs rather than lawyer inputs.

Two years ago in the 21st century report, only 22% of clients and 48% of partners saw value billing as a trend of the future. It was a short-term future. Now, a whopping 86% of clients and 88% of partners say they often or sometimes use value billing. A vast majority of both groups believe that it will become prevalent over the next 2–5 years.

• **Unprecedented value**

Clients say they are receiving levels of value add services not previously seen. 63% report receiving better value for money since the credit crisis. Value-add services (or ‘freebies’) delivered by law firms such as secondees or access to knowledge management resources have been given to clients on a complimentary basis across the industry as a result of the recession. A majority of clients (87%) now say that these value-add services are a crucial factor in their decision to instruct external law firms.
Law firm market in flux

- **Law firm peer groups re-align**
  Traditional categorisations of law firms will break down as a result of the credit crisis and recession. Just over half the clients (51%) and just under half the partners (46%) thought that the ‘magic circle’ terminology had lost its value. A vast majority of clients (94%) said that they would welcome a revision of law firm peer groups and thought this would be a beneficial development in the legal market. A surprising number (81%) of law firm partners also thought a revision of traditional categorisations would be a positive move for the market.

- **Differently shaped law firms**
  Many (46%) of the managing partners said that reduction and change to the composition of premium legal work available would have an impact on their shape and size. The larger firms reported a long-term decrease in headcount and leverage and a potential change to the ‘up and out’ pyramidal structure of law firms. Seven out of the ten top law firms said that they would have spare real estate capacity for some years to come particularly as the shift to outsourcing both legal and back office functions accelerates. However, mid-sized firms in the main still thought that growth in headcount and revenues would be in their medium-term futures.

- **Loyalty to partnership model on the decline**
  Clients’ indifference to the type of organisation in which their external lawyers work continues – 68% said they were indifferent to the structure. Partners are also more open to different organisational structures. In the Eversheds 21st century report 2008, 57% of partners said they were wedded to the partnership model, but only 30% say that now.
What the future holds

A collection of attributes has been drawn together from all the research for this report. These attributes suggest a successful, sustainable premium law firm will have the following characteristics.

Diagram 1
Premium law firm

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**Premium law firm**

**successful and sustainable**

**Resourcing**

**Efficiency:** all superfluous cost base outsourced, resourcing appropriate to value provided to client.

**Technology:** sophisticated use of technology for standardising processes, remote working and setting up communication systems.

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**Legal practice**

**Well hedged:** a hedged, well-rounded legal practice arranged around an industry sector focus.

**Emerging jurisdictions:** well developed practices in China, India and other emerging jurisdictions.

**Regulation:** as regulation increases and is reformulated a regulatory practice is crucial.

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**Human capital**

**Lean:** low leverage, emphasis on quality lawyers.

**Commercial, generalist lawyers:** continued investment in training and development of generalist lawyers with more than legal skills – MBAs, leadership training, etc.

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**Client relationships**

**Collaboration:** accepts the law firm is a service provider which can provide genuine collaboration with clients; willing to share risk and reward.

**Billing:** provides a tool box of fee arrangements, including fixed fees and value billing.
Summary and analysis

The shift from a supplier led market to a client led market is shown in Diagrams 2.1 and 2.2.

Diagram 2.1
Pre-recession: supplier led market

Previously, law firms providing premium services grew big and profitable under market conditions which allowed a boom in the financial services sector. This period of time brought about the unusual circumstance of private practice law firms being allowed to dictate the terms and prices of delivering their services. It was a time of exponential double digit growth for the big international firms in terms of headcount, revenues and profitability. The growth of LPO and standardised services was slow during this period although there were underlying trends to efficiency and outsourcing among corporates.
The onset of this particular recession with the accompanying crash in the market for new financial products has accelerated the underlying trends so that post-recession General Counsel and in-house lawyers take their rightful place centre stage, as the clients and purchasers of legal services. They are being propelled to this star position also through the growth of regulation and the shift in business to being more risk aware and ethical. Largely under their auspices, LPO and standardisation has accelerated. The market for premium legal services is shrinking – with the notable exception of those firms foresightful enough to have developed a regulatory practice.
Shifts in the business world will affect the way lawyers interact with business. GCs have increased in importance in their companies, private practice has been put in its supplier place and the billable hour has been relegated to an internal facing tool in a varied fee toolbox. Value and efficiency have finally become common in a sector that has stubbornly refused to follow business rules that say the client is always king.

The recession may have caused redundancies, and firms more exposed to financial services and real estate will have felt the pain more than others. But overall lawyers will actually be more significant business players in the new world. The increasing role of regulation, ethics and the re-examination of risk are heartland areas for the lawyer, ensuring that even as the transaction ‘go-go’ days wane, they still have an important role to play. What they might not see any more are super-high fees and, at the premium end of the profession, headcount may shrink for the next generation.

For Western law firms, the shift to the East is well underway both as a move to follow a global economic trend but also as the drive to efficiency dictates that low-cost jurisdictions are a key component of cost base reductions.

Has there been a paradigm shift since Eversheds released its 21st century law firm report in 2008? Yes. The client prediction that the model was unsustainable has come to pass. Few law firm leaders now believe that old models will survive. Some may occupy the role of trusted adviser, but even this has been assumed by General Counsel who, whilst wanting collaboration, will put value for money first. And with the power resting with General Counsel for some time to come, what they want (and need) will dictate how the market develops.

Conclusion

Law firm of the 21st century: The clients’ revolution