PETER SCOTT CONSULTING

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A plan to resource competitive growth

If a law firm is clear as to:

- what services its clients are going to need in the future; and
- it has identified the skills and behaviours which will be needed on the part of its people to deliver those services to clients;

then it will need to construct a realistic plan if it is to build its competitive edge. The plan will need to be clear, have achievable objectives and, importantly, detail the resources required to enable the firm to achieve those objectives. Law firms will not be able to successfully deal with the challenges facing current and future legal practice unless they have sufficient resources to do so. They will, for example, need to consider how they are going to:

• provide clients with the 'value for money' services clients increasingly now require, in order to gain a competitive edge over rivals;
• provide the management infrastructure now required if firms are to manage and develop their businesses successfully; and
• achieve the specific objectives they have set themselves within given timescales,

In particular, the **people resources** required will need to include not only good lawyers, but also provide excellence covering a wide range of roles, including those relating to leadership and in areas of senior management such as finance, business development, HR, IT, knowledge management, training, risk and compliance. To provide such people resources and fulfil other resource needs on a basis sufficient for successful legal practice now and in the future will require a level of **financial resource** which is likely to be beyond the pocket of all but the larger and most profitable law firms.

The leadership of a law firm, if it has undertaken the exercise of challenging every aspect of how the firm thinks and operates and in particular has listened to its clients, partners and staff, should then be able to develop a clear, focused and realistic competitive strategy. However, it may as a result of that exercise also conclude that the firm must grow substantially beyond its current size if it is to be able to develop the resources necessary to achieve its goals. If so then a firm will also need to consider whether it can achieve its objectives on its own or whether it will need to join forces with others to do so.

Providing the necessary resource for a law firm to gain and then sustain its competitive edge over rivals will require a great deal of investment, in terms of people, finance, effort and organisation. Whilst some organic growth will often be possible and desirable, for firms to achieve the required levels of critical mass needed to service clients effectively and profitably and to manage every aspect of the performance of their businesses to a higher level will, for most, require a `quantum leap' on their part. Organic growth by itself will, for most, be unlikely to provide the desired results, especially during a period of economic restraint and falling profits. Even if firms attempt to grow organically to meet their challenges, their rivals may be growing at an even faster rate and be better placed to gain that competitive edge.

The need to grow and to be more focused can be seen clearly in the case of mid-size and smaller firms, which are currently facing increasing competition as clients look to larger and more developed firms to provide them with the breadth and depth of expertise clients now require. As well as difficult economic conditions eroding their traditional markets, we are also now seeing pressures mounting on smaller firms from the regulatory changes being implemented and from a far more cautious approach from professional indemnity insurers to covering risk. The need to be able to practise law safely and compliantly has never been greater or more difficult to achieve.

Client feedback from surveys often reveals that where clients use more than one firm, they perceive there to be a clear distinction between the kinds of work they would give to the firm, and what would go elsewhere. The reasons given by clients and referrers of work, such as accountants and banks, often include the following or similar:

- specialist expertise or knowledge not available at the firm;
- larger deals go elsewhere where greater resources are available than are perceived to be available at the firm;
- in some cases, clients mention that work carried out by a smaller firm with less of a reputation is often checked by another, larger and better known firm, simply to give comfort that a big name was involved;
- where outside stakeholders are involved, such as stock markets, overseas parent companies, lenders and the large accountants, the reputation and perceived expertise and capability of a `big name' is needed for reassurance.

Breadth of expertise

Whilst many firms will have a certain breadth of expertise across a number of work types, client types and sectors, there are likely to be critical gaps in expertise which will need to be plugged if in the future they are to be able to provide their clients with the services they are going to require.

Feedback from clients may, for example, indicate that a firm is not the first choice for testing the boundaries of the law because of a perceived lack of `cutting edge' expertise in a particular area of work. This is always dangerous because the other firms instructed on the work which the smaller and less resourced firm cannot do, will always be looking to pick up a client's entire business. There are many examples of larger firms successfully doing this and destroying smaller firms in the process. This is likely to be particularly so now, as larger firms which may be short of work, will go `fishing' for work which in the good times they turned away.

Depth of expertise

Client - perceived lack of depth of expertise within a firm should be of even greater concern and client and referrer surveys often highlight this problem. The consequence is that if clients perceive a firm as lacking the depth of expertise to compete with larger firms then they are likely to migrate to those larger firms. A merger will not solve this problem overnight but the combination of two or more firms can begin to address the perception that there is no, or very little, depth of expertise below partner level.

Greater financial resources

Providing for resources of expertise (people and knowledge) is dependent upon having sufficient financial resources available. To successfully build breadth and depth of expertise into a law firm to provide clients with what they need will require the building of teams in focused areas and by concentrating limited investment resources on those areas where they can be most successfully and profitably employed.

Many mid-size and smaller firms do not currently, from their own client base, have the volume of work to justify recruiting a specialist lawyer in an area of law not presently covered, even though such cover may be critical from both client service and risk points of view. However, a merged firm is not only likely to have more work to justify the cost, but also relatively speaking, the cost to a merged firm of such investment is likely to be less than it would have been to either individual firm. Importantly, in the context of a larger firm, providing the resources to enable the firm to do such work is likely to be seen *internally* as more affordable (and thus more acceptable) and so is more likely to be implemented.

Access to management skills resources

The economies of scale which can be created by a merger can also begin to show other benefits. A smaller firm has to spend a greater proportion of its income on providing for management and compliance infrastructure than, say, a firm twice its size.

A larger and better financed firm will be more able to afford to invest in the necessary infrastructure, particularly IT systems, which law firms will increasingly need in order to build efficiencies into their businesses and to maintain competitiveness.

Modern law firms require a minimum level of infrastructure to be able to operate safely, compliantly and efficiently. Too many smaller firms are still not able to afford what is required to meet even this minimum. For example:

- financial management will be inadequate or non-existent, so that financial performance suffers instead of being driven to provide the necessary financial resource needed to enable the firm to develop;
- there is unlikely to be an integrated knowledge management / risk management / compliance strategy in place, these areas being dealt with ad hoc and on a patchy basis, or not at all;
- there may be no professional HR function to ensure that a firm's greatest asset — its people — are being properly looked after;
- there will be no effective and adequately resourced professional business development team, so the winning of new work suffers.

On the other hand, larger and better resourced rival firms (including the likely new entrants to the legal marketplace post-October of this year) with which smaller firms will have to compete on a day-to-day basis and against which they will have to fight for clients, will already have such infrastructures in place.

If a firm concludes that, if it is to compete successfully in tomorrow's challenging legal markets it will need to grow its people and financial resources, but it cannot see how it can do this alone, then joining or collaborating in some way with others will need to be considered.

However, consolidation in the legal market between law firms (whether it is called merger or something else) is not a strategy. It is simply a means to an end — to provide the two (or more) firms which come together with a better platform on which they can build a more competitive business.

The rationale for law firms to consider merger or some other form of consolidation as a way forward should therefore be seen primarily as client driven, and the process of consolidation should be used as a means for firms to provide for those greater resources which are perceived by clients as needed if law firms are to be competitive. Many firms are perceived by their clients as lacking in expertise resources and unable to provide them with what they want. Some are too unfocused to be 'niche' and too small to be capable of delivering a broader and fuller service which clients are increasingly likely to require.

However, simply joining firms together is not on its own the answer. Merged firms created from midsize or smaller firms, (the sector that particularly lacks resources to compete), will not be capable of becoming (and should not even consider becoming) 'all things to all men'. On the other hand, being focused on a limited number of areas of work, client types or sectors and using a merged firm's greater people and financial resources, is likely in the longer term to provide a better platform for future growth than either of the individual firms could have provided on its own.

The investment needed to take most firms to the required competitive level of people / expertise resource is likely to be beyond the financial means of many partners or beyond which they are willing to commit. In particular, organic growth can devour large amounts of scarce financial resources and depress the profits of a firm for a long period of time before the `investments' begin to provide pay-back, if ever. Further, organic growth, even if it were to be considered a realistic strategy to be adopted, should not be put forward as an excuse not to take in any event measures necessary to enable a firm to become more competitive. Difficult decisions will still need to be made regarding, for example:

• What kind of firm do the partners (or most of them) want to become?
• Which areas of work should the firm drop or invest in?
• Does the firm have the right people who will enable it to achieve its objectives?
• Are all the partners prepared to be managed?

• What should the partners be doing better / more of / less of / differently if the firm is to achieve a competitive edge over its rivals?

A merger or two law firms will not by itself provide the competitive advantage they may be seeking. However, their combining together is likely, if implemented well, to provide a better platform for future growth and act as a stepping stone and catalyst for building a stronger, more competitive and profitable firm than either of the two individual firms could achieve on their own. But such progress will not happen unless it is made to happen.

A firm which is considering merger or some form of acquisition as a means to help it to achieve its strategic goals should, as a first step, test its own strategic plans against, inter alia, the resource / competitive advantage rationale set out above to establish whether there may be a case on that basis for taking further the idea.

A tested business case as to whether merger will help achieve strategic goals needs to be developed at an early stage, and certainly before approaches are made or firms get into discussions. For example, the question whether merger will help a firm to win more and better quality work from existing clients and new work from potential clients that neither individual firm could hope to win on its own, will need to be tested. A merger based on a strong business case, if well implemented, should help to build long-term sustainable profitability.

To do this, a firm should put itself into the position of its clients, because successful mergers between law firms need above all to be client-driven:

Will our clients regard this merger as good for them?
Will our merger have the 'Wow' factor? (As in *'Wow, that will be good for us!')*

In the next Briefing Note we will look at the process of merger and how to successfully negotiate some of the more difficult issues likely to arise, to ensure a satisfactory outcome to discussions.