

PETER SCOTT CONSULTING

Briefing Note May 2012

Planning and innovation will be the key to future competitiveness

As each week goes by we hear of new entrants into the UK legal market who not only have serious ambitions but also deep pockets to fuel those ambitions. Some of these new entrants may fail to make the impact they would like, but others will develop and become serious competitors to existing law firms. Some are likely to become market leaders. Few, if any existing firms will be immune from the effects of the new competitive forces which have been unleashed.

In response to these developments, many existing law firms are being forced to urgently think ahead and plan for their futures and, as a result, are beginning to manage the changes necessary to build their competitive edge. Complacency on the other hand is one of the greatest dangers and those who are not already planning ahead are likely to suffer as a consequence.

A useful way to look at '*competitiveness*' and one which fits today's legal markets, is to consider what the process of becoming competitive involves.

"Competition is a process by which...

- ***Services that people are not prepared to pay for***
- ***High cost methods of production and***
- ***Inefficient organisations***

are weeded out and opportunity is given for new ...services, methods and organisations to be tried" *

* (A. Seldon and F. G. Pennance – Everyman's Dictionary of Economics)

Is this not the process which is currently happening in many parts of the legal profession today? It may be instructive to consider each of the component parts of this process to see how firms can understand and apply these when planning how to build their '*competitive edge*'.

1. 'Services that people are not prepared to pay for are weeded out'

Unless a firm regularly and methodically listens to its clients regarding how they are being looked after, the services they are going to want from the firm in the future, how they will require those services to be delivered and what prices they will be prepared to pay, then that firm in tomorrow's more challenging markets will be at a disadvantage.

It is only when a firm listens to its clients, its prospective clients and those who refer work to it, does it find out what they think of the firm, the way it looks after its clients, the services clients are going to need and how much they will be prepared to pay. In fast moving and challenging market conditions as we have now, it is more than ever vital to keep close to clients to understand their thinking and their plans.

One of the most revealing statements to come out of a client perception survey carried out for a law firm was:

"They always try to sell to us on price – but what we really want is to have a good job done at a reasonable price"

Listening to clients, prospective clients and referrers will also enable a firm to plan how to take advantage of the likely opportunities which will emerge as clients plan their own future competitive strategies.

The exercise of listening to clients will also enable a firm to look critically at every type of work it currently carries out and consider whether there will be a profitable market for that work in the future.

Is all the work we do currently profitable?

If not, are there ways to make it profitable?

If not, then why are we continuing to do this work?

Are we able to measure whether it is profitable or unprofitable?

Will there be a profitable market for this work in the longer term?

Is every client we act for profitable?

Which are our most profitable clients?

How can we measure client profitability?

Establishing clients' needs will begin to provide a basis for realistic consideration of what a firm will need to do in order for it to get into shape and build the foundations of a successful long term business. Armed with the knowledge of what clients and the market are going to require, a firm will then be in a better position to take an objective and realistic look at itself.

If firms are to better manage the need to rapidly adapt to changing market conditions, then keeping close to clients and markets in this way will enable them to constantly review their strategic thinking based on the knowledge gained. Armed with information as to:

- external perceptions as shown by client feedback;
- current market positioning and competitors;
- client base / areas of expertise; and
- the most significant threats / risks faced;

a firm is likely to be in a better position to answer this question:

What kind of law firm will we need to become if we are to successfully compete in the future?

"Listen to your clients or else...." should now be a survival imperative for law firms as the economy struggles and firms face fiercely competitive markets in which clients are likely to increasingly vote with their feet.

2. High cost methods of production are weeded out.

Law firms need to continually question their productivity. In reality this means looking at the productivity of all the people in a firm.

What should our people be doing more of, less of, better or differently?

Are all our partners prepared to go 'the extra mile' in the interests of the firm?

Are all our partners putting more effort into effective business development instead of expecting work to be given to them on a plate by others?

Are all our partners continuously seeking to develop new and enhanced skills to enable the firm to better compete?

Are we paying our partners what they are 'worth'?

Are we effectively measuring performance so we can profitably plan productivity?

An internal consultation process may show that a number of partners may not wish to become more 'productive' by adapting to a changing and more demanding environment, with the result that it may not be possible for a firm to profitably deliver to clients the kind of 'lower cost / value for money' services which clients are telling the firm they require.

Where the 'values' of some partners may not be aligned with what existing (and prospective) clients are telling the firm they want, then a re-appraisal of "what it takes to succeed at this firm" may be called for. Otherwise the firm is likely to be held back from achieving 'lower cost methods of production' as a means to achieving the competitive edge it seeks.

Some further related and revealing questions may include the following:

Are all our partners 'passionate' about building our firm?

Are all our partners 'hungry'?

Is 'hunger' something that is valued and rewarded in our firm?

Are all our partners prepared to stretch themselves for the good of the firm as a whole?

Can we say we have no underperforming partners?

Are all our partners prepared to be managed?

What sanctions should there be on a partner who refuses to comply?

Currently do we have any alternative but to face up to our 'underperformers' and deal with them?

3. 'inefficient organisations are weeded out'

Does this need to happen across the legal profession today?

Does the size of law firms and the manner in which they are structured and operated mean that many of them are currently 'inefficient' so that their size, structure and operations will need to radically change if they are to become more competitive?

Some definitions of the word '*efficient*' provide a few pointers as to what may be necessary:

"working in a well-organised and competent way"

"achieving maximum productivity with minimum wasted effort or expense"

"preventing the wasteful use of a particular resource"

Given some of the challenges now facing law firms, including

- increasing competition brought about by the Legal Services Act;
- the effects of recession;
- the need to manage compliance and regulation;
- the need to manage risks more effectively in a difficult P I market;
- the need to invest in technology to reduce costs and increase efficiency;
- how to develop competitive recruitment and retention strategies;
- the imperative to access new markets;
- above all, a **fragmented profession** where many law firms are too small to generate sufficient resources to meet the above challenges,

how are law firms going to:

- provide to clients the depth and breadth of appropriate *expertise* which clients now demand, where they need that expertise and when they need it, by being able to attract and retain the best people? Size is not everything, but critical mass is important in enabling firms to provide not only depth and breadth of expertise but also leverage, because leverage (and the ability to delegate which leverage can provide) is a key to law firm profitability.
- Build the necessary *quality management* (in terms of active and visionary leadership / effective business development / sound financial disciplines / people management) which will be required if a firm is to become a successful and highly profitable business?
- Provide the necessary *infrastructure*, know - how and expertise to underpin the effective and efficient provision of the high quality legal services now demanded by clients?
- Invest in longer term, *focused strategies* to better service their clients? Those firms outside the highest echelons of the profession cannot be all things to all men. Being focused on a limited range of areas of work or sectors at which firms are good and for which they are known, using their relatively scarce resources, is likely to be a more sensible and successful way forward in the longer term.
- Build '*brands*' which can begin to compete with larger, more developed law firms for better quality, higher value work, leading to greater ability to compete and profitability? A 'brand' which is developed must not be just a well-known recognisable name; it must reflect the substance of a firm in terms of the quality of its people and its clients, as well as the advice and added value it must be determined to provide to its clients. Satisfied clients are the key to building a highly profitable law firm and the only real measure of its success.

How can law firms organise themselves better / differently to successfully deal with such challenges and:

- profitably provide clients with the advice and service that clients now require?
- at prices which clients regard as '*value for money*'?,
- and succeed in doing this in a manner which is regarded by clients as better for them than other competing law firms can provide?

To achieve any of the above will, at the very least, require **RESOURCE** which many individual firms on their own cannot realistically and at an economic or acceptable cost, provide. The investment in resources needed to take most firms to the required level to be competitive is likely to be beyond the financial means of many partners and their firms, or beyond which they are willing to commit. On the other hand, 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. Organic growth, even if it can be considered as a realistic growth strategy (or as part of a growth strategy), should not be put forward as an excuse not to take those internal measures necessary to make a firm more competitive.

If a firm cannot on its own provide the resource needed to implement its plans then in some form or other there will need to be a consolidation of available resources with others. This process is however merely a means to an end - which is to become more competitive, and more profitable on a sustainable basis. It should not be forgotten that the momentum for consolidation across the profession is primarily **client driven**.

To achieve this, the scale and method of consolidation should aim to enable the level of resource required to ensure competitiveness to be effectively developed at an economic cost to the new organisation.

4. 'and opportunity is given for new services, methods and organisations to be tried'

What are some of the ways in which law firms can with others, consolidate their scarce resources to build organisations which, over a given period of time will become 'greater' than the sum of the individual firms which comprise them? Discussed below are just a few of the routes which law firms may consider taking to achieve greater competitiveness through consolidation:

- **Merger / acquisition**
- **Networks**
- **Collaborative ventures including alliances, federations and ABSs**

Merger / acquisition is only one route to building a successful law firm, although it is an increasingly well-trodden path which if the appropriate component elements are present and it is well managed, can enable law firms to achieve their vision. For a detailed commentary on how merger / acquisition

can build greater competitiveness, see the July 2010 Briefing Note www.peterscottconsult.co.uk/briefings.php

Merger or acquisition may not be the right approach or the preferred approach for some and is not a ready-made solution to making a firm more competitive. 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 the legacy firms could have provided on their own.

It may also be worth considering in some cases **demerger**

Some firms have grown over the years without any vision or planning or markets may have changed, and the component parts of a firm are now just a collection of separate businesses, not working with each other or hanging together as a balanced business. Often there is no longer any strategic reason for being together.

In such circumstances and as part of a strategic review, serious consideration should be given to whether it would be more advantageous for some parts of a firm to go their separate ways. This has happened to firms in the past and the separate parts have flourished, either on their own or as part of other firms where there is a better fit.

Networks

Are 'networks' a way forward for some law firms to become more competitive?

As the regulatory changes brought about by the Legal Services Act have been seen to become reality, there has been debate about smaller and mid-size law firms becoming members of 'networks' and the building of so-called "brands", which hold out the prospect of competing with both new entrants to the legal market and with existing more developed firms for better quality, higher value work, leading to greater competitiveness and profitability.

'Networks' are not new. Internationally, networks have been successfully used by law firms and accountants for many years. However, whether a strong trend towards networks in the UK will happen to change the face of parts of the legal profession, will very much depend on whether law firms understand what they want from networks and how far they and those who run networks wish and are able to develop such organisations, so that clients will in the future choose to buy from network members instead of from 'independents' in the market.

At the heart of a well-constructed network will be the ability to provide its members with access to resources which no individual member could realistically provide on its own. This may mean that certain resources, using the benefits of scale and the buying power of a larger organisation, are most cost effectively and best provided from one central source for the benefit of all.

Membership of a network should not be regarded as an objective on its own – it is a means to an end which is to enable its members to gain a competitive edge. Those considering participating in a network will at the outset need to clearly identify their objectives and strategy and ensure that they really do have compatible ambitions with the aims of the network and of other members.

Will being part of a network represent a new competitive advantage so that its members will together be able to 'steal a march' on their competitors? If the answer to this is 'no' or at best unclear, then a firm will need to consider very carefully the benefits or otherwise of joining.

Questions to ask before joining a network are likely to include some of the following:

- What is the nature of the network?
- Who is running it?
- Who are the other members?
- Is the network a 'mutual' organisation established solely for the benefit of its members or is it a profit-driven organisation owned by a third party?
- Do we need to join this network?
- What will we get out of it which we could not achieve ourselves?
- Could we achieve the same or more on our own or by joining with others in a different kind of collaboration?
- How cost effective will be membership?
- Will membership of the network add to or detract from your profile / reputation / 'brand'?
- Whose goodwill is the network building? – the firm's or the network's?
- What is the 'end game' of the network?

In recent discussions of 'networks' in the legal media, mention has been made of the ability of firms to plug in to a 'brand'. However, a 'brand' is not just a recognisable name, but something which reflects the substance of an organisation, in terms of the quality of its people and members and the advice and added value it must be determined to provide to its clients. In a world where branding is all important, how is the brand of a network to become known in a way that makes sense to clients and to each of the member firms? A network 'brand' which differentiates its members from other law firms is likely to take a long time to build.

As important will be the question of whether and how the members of a network build their respective brand values into the network's brand – because branding comes from *within*. To build a network delivering legal services will require 'standards' to be built into every aspect of the operations of each member of the network. This will require stringent risk audit and review procedures to be accepted, with no exceptions, across the entire organisation, because *'a chain is only as strong as its weakest link'*.

Other collaborative ventures including alliances, federations and ABSs

In the changing legal markets now evolving in the UK, collaboration by law firms *coming together for mutual benefit* in a manner not immediately involving merger or acquisition is likely to be one of several collaborative routes for firms to follow if strategic aims are to be achieved.

A convenient shorthand term for such collaboration is **alliancing** which can take many forms, including strategic alliances, joint ventures, federations and ABSs (if involving non-lawyers), and which may be as 'tight' or as 'loose' as the needs and ambitions of the parties require, and involve all of a firm or just a part of a firm. This is not new - one of the most successful 'national' firms started life over 20 years ago as a collaborative venture in the form of a 'federal' model, before developing over time into a fully integrated law firm.

For example, if merger is not immediately desirable or achievable a tight federation could be created under an 'umbrella' organisation, working towards in the short term, operational and management integration, and in the longer term, seeking to create a financially integrated firm. How can an alliance be made to work to help its members achieve their objectives?

Alliancing (like merger) should not be regarded as an objective in its own right – it is a means to an end to enable its members to gain a competitive edge. At the outset those considering participating in an alliance will need to identify their objectives and strategy and ensure that they really do have compatible ambitions –

- Do they wish to go in the same direction?
- Are their priorities for building the business the same?

- What is their ultimate destination?

A tight alliance, initially working in the short term towards operational and management integration, may for some be a practical way forward to achieve their goals. However, the ultimate destination will also need to be clear and agreed at the outset. Moving towards financial integration in particular is likely in most cases to be desirable and necessary.

Client added value?

The successful alliance will be the one which is seen by clients to benefit them rather than just the parties involved.

- How will clients benefit?
- What will they get out of it?

Accordingly, firms contemplating an alliance need to develop in particular the notion of client added value as being central to their alliance and ensure that it is effectively communicated to the market place.

How can they do this?

Identify the focus of the alliance

The members of an alliance will first need to identify those areas of their businesses that are going to be the drivers of their alliance and make them their focus to take forward their collaboration. We are here talking about what their alliance will become known for and this will often be something which none of the parties can currently achieve on their own without collaboration with others. The business case must be right and then implemented. In particular, everyone's strategic ambitions will need to be achieved.

And when constructing an alliance, firms need to be clear as to their territories. For example, will the alliance comprise the whole of each firm's business or just part? They will need to establish at the outset the way in which they are going to work together.

Performance issues

In an alliance, as in any other organisation, performance will need to be managed.

- How is performance to be defined in ways that make sense to all members and in particular to clients?
- What performance expectations should each member have about the others?
- How are the members going to control and manage for example:
 - Levels of client service?
 - Quality and risk?
 - Pricing?
 - Branding?
 - Know how?
 - Sharing of fees?
 - Regulatory and compliance issues?

Work at it

Alliances do not work unless worked at by everyone – they are like marriage! The members will need to examine what practical steps each must take to ensure success. This must not be confined to just

a few people in each firm – an alliance will need to be communicated throughout each member firm so everyone can buy into the relationship and work at it.

Working together

The members must also get their people really working together. Law firms are people businesses and success depends upon having the trust and confidence of the people within the organisation. Effort will need to be put into integrating the people from each alliance member and making sure they work together well to achieve the alliance's objectives.

Alliancing - as a way to create a new national firm?

One application of this organisational concept to current needs is the idea of a number of firms coming together to create a new 'national firm' involving the building of a law firm across the UK which will in due course become "greater" than the sum of the individual firms which comprise it. 'Greater' will need to be measured and judged by the improved ability, perceived by the clients, partners and employees of such a larger and stronger firm, to be able to compete with the best in its chosen markets.

Building a new 'national' firm to achieve these objectives could be implemented in a number of ways. For example:

- by bringing together firms which in their own regions are regarded as market leaders, which share such a vision as set out above and are prepared to work hard to make that vision a reality; or
- alternatively, because being competitive will increasingly require firms to be more focused on their client-type / work – type / value mix, then it would make sense to bring together a group of already highly focused firms into a larger, better resourced and market – leading specialist national firm.
- Any combination of the above, with the added element of involving non-lawyers (whether financial investors or professionals from other disciplines) in an ABS.

A law firm is about people and getting people working together would be the key to building a successful new national law firm in this way, however structured.

Such an idea is just one of many possibilities now open to law firms in a new legal landscape which beckons for those with the vision, ambition and determination to grasp the opportunities to achieve their destinies.