

# Good news and bad news: the many revolutions impacting law firms

Ben Kent and Alastair Beddow, following their successful PSMG National Conference workshop, explore how the world of the in-house legal team is changing, and the strategic decisions law firms need to take to remain on the front foot.



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One of the highlights of PSMG's conference was keynote speaker Gareth Tipton – Group Director of Ethics and Compliance and COO at BT – who shared his experience of managing a rapidly changing in-house legal team. Within a short space of time the legal function at BT has radically altered how it spends its budgets, its process for choosing which legal services providers to work with and has trimmed its internal headcount significantly. Is BT's experience typical, and what does this mean for law firms? We examine the evidence to assess the future for law firms.

In short, Gareth's experience is far from unique. The significant change he described reflects how the vast majority of in-house legal teams at large corporates and banks across the global are revolutionising the way they do business. A significant proportion, including BT, now have their own ABS licence.

As the discussion at PSMG's conference proved, law firms are under pressure from all sides to keep pace with the changing world of their clients. Many revolutions are simultaneously impacting law firms: although there is a general uplift in demand for legal services, clients of law firms still want more for less from their legal advisers. At the same time the market has witnessed the rise of disruptive competitors thus offering greater choice to buyers of legal services. In response law firms need to make some tough strategic decisions.

## The good news

Let's examine the reasons to be cheerful. After a period of declining or flat-lining profitability since 2008, the last 12 months has seen a major year-on-year uplift in PEP (profit per equity partner). According to PwC's latest *Annual Law Firm Survey*, average chargeable hours are up year-on-year between 7% and 9% for the top 25 law firms ranked by revenue.

This suggests that law firms are busy again, driven in part by the rise in deal activity during 2014. In line with this trend, law firm hiring is now at its highest rate for many years, especially among banking, real estate and litigation practices.

Why should this be so? Despite budgetary pressures, the demand for legal advice continues to rise. Meridian West's research suggests the worry-list for heads of in-house legal departments is a long one. Issues such as an increased regulatory burden, data security and reputational risk are all top of the agenda for general counsel. As businesses globalise and become more complex, the need for external expertise and support to make sense of the legal issues and their commercial implications can only increase.

## The bad news

Although headline law firm profitability is on the rise again, a closer look at the numbers suggests something different. Average fee-income per chargeable hour has taken a sharp hit over the last year. Among law firms ranked 26 to 50 by revenue, the fall has been almost 10% year-on-year. Lawyers are earning less for every hour worked. This should serve as a stark warning to all law firms because it suggests fundamental flaws in the way legal matters are scoped, priced and managed. Margin pressure is real: it appears clients who want more for less are getting precisely that from their external law firms.

Perhaps the biggest pressure facing law firms is the transformation of the in-house legal function and the impact this has on buying behaviour. In many instances in-house lawyers have adopted hybrid legal and commercial roles with responsibility for broader risk management issues, not solely black letter law.

At the same time, in-house legal functions have become better managed, often with more sophisticated technology, knowledge management and procurement processes than their external legal advisers. The legal function in the largest corporates more often than not is now managed by a designated COO.

It is an exciting time to be an in-house counsel buying legal services. Disruptive competitors have shaken up the market, offering more choice and paving the way for multi-sourcing of legal services. Innovative business models such as document review services, contract lawyers, legal technology and managed legal services are attractive to in-house lawyers.

Meridian West's research suggests that usage of these services is set to increase. The threat to law firms is clear: as the legal market fragments, the traditional law firm is not always going to be the most appropriate or cost-effective choice to undertake all types of legal work.

## The law firm response

There is no magic strategy that law firms can adopt to succeed in this difficult and changing market. The approaches taken will vary by firm according to its priorities, culture, and, most importantly, its clients' needs. An ambitious regional firm and a global powerhouse may face a lot of similar issues, but their strategic responses should be very different.

However, it is possible to categorise the strategies available to law firms on a spectrum ranging from revenue growth to margin management. Figure 1 shows six of the many options. At the one end firms seek growth through globalisation, looking at new geographic markets or launching new legal services offerings to expand and diversify, reaching out to more clients. At the other end firms focus on process mapping and matter management to enhancing profitability or choose to exit unprofitable work types.

Each strategy is valid if the circumstances are right. Each strategy raises questions: What steps are necessary to implement the strategy? What areas should be prioritised? How will a firm create the necessary cultural change? How will success be measured?

## Where does marketing and business development fit in?

Marketing and business development professionals within law firms should play a central role in helping to define, communicate and implement the right strategies for their firm. This requires dialogue with both colleagues internally and clients externally. Who is better placed to help their firms understand clients' changing needs and behaviours or build a differentiated client experience and superior account management than marketing professionals?

In a world of many revolutions law firms cannot succeed by standing still. If they do they will be at the mercy of the market and the underlying trends of depressed profitability and more demanding clients. And while there are reasons to be optimistic about the future, it will be far from easy to meet the challenges on the horizon without a clear view of how your firm's clients are innovating how they do business and what they require from legal advisers.

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Figure 1. Six strategies available to law firms.