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**LAW SOCIETY BREAKFAST ADDRESS:
The major disruptive forces faced by law firms**

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My brief for this morning is to offer some thoughts about the ‘forces of discontinuity’ and their effects on the planning of major law firms.

Discontinuity is necessarily about change. I doubt we’d struggle to agree on a core list of fundamental change affecting the legal world. But we might struggle to agree a *definitive* list – because change affects the market in different ways, and therefore affects individual firms in different ways.

The challenge for this morning, however, is not simply to identify change, or even fundamental change. It’s to identify the point at which incremental change becomes a *discontinuity* – that is, the point at which the change becomes so profound that it rewrites the rules.

We will probably all have our own pet theories about this. For example, some might suggest that the financial crisis and globalisation have led to a discontinuous reconfiguration of capital and client relationships.

Others might say that the combination of globalisation and technology has created the business process and legal process outsourcing phenomenon, resulting in the discontinuous shifting of work out of law firms and the consequent need to reengineer case management as well as to find new training opportunities and engagements for junior lawyers.

For some, it will be the discontinuous redistribution of legal aid contracts.

Still others might point the finger at the emergence of ‘outcomes focused regulation’ and the discontinuous uncertainty of compliance.

And then we might look just around the corner to the advent of ABSs, and the discontinuous possibilities of new entrants, new owners and new financing.

So there are many things – and many more I haven’t mentioned – that we can say have created or will potentially create a discontinuity in the world of legal practice.

It's perhaps worth observing that not all of the consequences of discontinuities are negative: much depends on your standpoint. For example, the City's 'Big Bang' in the late 1980s brought unwelcome change for some and welcome opportunity for others. Higher rights of audience for solicitors represented a discontinuity (not welcomed by the Bar); the combination of litigation and advocacy in one firm could be another (with potentially both positive and negative effects for law firms and barristers' chambers).

But for me, the real challenge arises not from the change or the catalyst, but from the *reaction* to it. Any discontinuity or disruption calls for decision and action. Discontinuous change is not part of a pattern; the past does not remain a reliable guide to the future.

Just over 20 years ago, Charles Handy wrote a book called *The Age of Unreason*. In it, he talked extensively about discontinuities, and referred to many – including, for instance: wars; the advent of the chimney and its effects on the cohesion of family or tribal life as people no longer sat around a fire together; and how the later emergence of central heating made the building of multi-storey apartments possible. We could now add, say, mobile telephony and computing, Tesco, and the ban on smoking in public places.

But he also tells this story (which I'm sure many of you will have heard before) about the nature of reaction to change:

“a frog if put in cold water will not bestir itself if that water is heated up slowly and gradually and will in the end let itself be boiled alive, too comfortable with continuity to realize that continuous change at some point becomes discontinuous and demands a change in behaviour”.

Somewhat gruesome in its imagery, perhaps, but it makes a strong point. Interestingly, if you drop a frog into boiling water, apparently it will jump straight out.

Now, if you think about it, in both cases, the water is eventually at the same temperature, whether the frog is in from the start or is dropped in later when it's boiling. In other words, the environment is the same; it's the reaction that's different – jump or stay put.

To put it another way: it's quite possible not to notice discontinuities or appreciate their effects until it's too late. More than this: it might be that by seeking to preserve the *status quo* and continuity in the face of further change, the discontinuity – when it comes – leads to a far greater rupture with the past than would otherwise have been the case.

We tend to look for discontinuities on the outside of ourselves or our organisation; but the reactions are internal – either personally or collectively. So rather than going on a 'discontinuity-spotting' exercise, what I want to concentrate on in the remainder of my time are the four questions that I think law firms should ask themselves – regularly – as part of the strategic and planning reviews, that might help them spot potential discontinuities and react before they become disruptive. I'm afraid that time constraints don't give me much opportunity to elaborate on each.

The first question would be: '**How can we create value for our clients?**'. I'm not talking about *added* value like newsletters, seminars and free visits. But successful firms understand the value that goes to the essence of the client's transaction or dispute or conception of success – which might or might not be the killer legal point, but could equally be something of practical importance (such as enhancing the working relationship between the parties for

the future). Lawyers often *claim* that they understand what success and value look and feel like to the client; but talking to clients suggests otherwise. No business can survive without creating value for its customers. It's not surprising that the retail legal market is due for a discontinuous shake-up: too many lawyers have lost touch – or indeed were never in touch – with what clients (or those who fund them) are really looking for.

The second question is: **'What is the nature of our competitive advantage?'**. Most law firm strategy appears to be conceived in a vacuum that takes too little account of the size and nature of the various marketplaces in which the firm operates – and virtually no account of the position or responses of competitors.

Despite years of increasing competition, ours remains a fragmented and relatively undifferentiated industry. Firms are often hard-pressed to explain why clients should choose them rather than another: witness the eternal same-ness of law firm strategies, websites and marketing materials. If firms cannot articulate in what sense they are different and justify why clients should use them, they shouldn't be surprised if clients make their own minds up and go elsewhere.

The third question is: **'Are we truly managing for efficiency and profit?'**. There might be mixed views on this, but mine is that very few firms do. *Legal Business* published its latest figures recently for the largest 100 firms. For the first time since these records began, both total fee income and total overheads fell. Fortunately, overheads fell faster than fee income, so aggregate profits rose, slightly. So the reason for increased profit was principally down to stripping out cost.

There's arguably not much wrong with that approach in the present climate. But let's dig a little deeper on two other numbers – revenue per partner and revenue per lawyer. Again, both fell. In other words, both partners and fee-earners were less productive in generating and doing work in 2010 than they were in 2009. Indeed, both 2009 and 2010 were lower than 2008. So we've had two consecutive years of lower productivity. Actually, it's even worse than that: in real terms, revenue per lawyer has barely kept pace with inflation for the past *five* years – that is, including the 'super-growth' years of 2006-2008.

Let me put it another way: these numbers suggest that firms have carried too much human capacity. If firms were truly managing for profit, they could have stripped out additional partners and fee-earners to restore their productivity to at least 2006 levels, removing even more overhead and improving profitability further. Carrying relatively unproductive capacity through all phases of the economic cycle cannot be a route to sustained profitability: it's probably not a route to motivated staff who care about creating client value and competitive advantage, either.

But where's the motivation to change? This particular cauldron of boiling water still produces £4 billion of profit for 6,700 individuals to share (an average of £600,000 a head): it's easy to speculate how these individuals might, in Charles Handy's words, be "too comfortable with continuity"!

So the cost base of major law firms has probably reached a point of discontinuity. Stripping out cost, based on the traditional ways of working, has gone about as far as it can. A further re-think is required about the balance of lawyer and non-lawyer capacity; of human and technological capacity; of internal and external resourcing (as BPO and LPO extend their

influence); and of financing through debt or equity, and with either being provided internally or externally.

My fourth question then is: '**How do we connect strategy to personal action?**'. Successful firms realise that strategy implementation is not about voting for the strategy, but about individuals *doing* things. They articulate and agree with individual partners what their contribution should be to that implementation.

They link personal planning, performance and personal rewards in some way to the achievement of the firm's strategy.

There are other important questions, but as I celebrate my Silver Jubilee of consulting to the legal profession, these are the four recurrent questions that single out the purposeful and successful firms from the rest. They require environmental scanning, and conversations with clients, to give advance notice of impending disruption; they encourage reviews of activities and resourcing to maintain their currency and value; and they connect individual action to intended strategic outcomes and rewards.

The temperature of the water continues to rise. But there remains a choice: jump or die – survival *is* optional!

Legal Services Institute

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- (a) seek a more efficient and competitive marketplace for legal services, which properly balances the interests of clients, providers, and the public;
- (b) contribute to the process of policy formation, and to influence the important policy issues, in the legal services sector and, in doing so, to serve the market and public interest rather than any particular party or sectional interest;
- (c) alert government, regulators, professional bodies, practitioners and other providers, and the wider public, to the implications of these issues; and
- (d) encourage and enable better-informed planning in legal services by law firms and other providers, government, regulators and representative bodies.

The Institute seeks to form and convey independent views; where the College might have views as a provider of education, these are expressed separately.

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