

Facing the Facts – Confronting the fallacies and half-truths which can delude law firms

By Nick Jarrett-Kerr

One of the biggest challenges facing law firms today is not an external threat but an internal problem. It is, in short, the capacity which lawyers have for self-delusion. The purpose of this article is to address and suggest solutions for the biggest areas of danger for law firms both large and small over the next few years – not necessarily the most obvious areas of competitive challenge faced because of the LSA, but those which carry the greatest potential for law firms and lawyers to continue to place their heads in the sand. After all, it has often been said that there are three basic types of lawyer – those who make things happen, those who watch things happen and those who say ‘what happened?’. Few and far between will be the firms which can say they have no partners in the last category

1. “We only do high level work”

I hear, for example, many law firms argue in the UK that the Legal Services Act will not affect them as they perceive the only interest to be by new market entrants such as Cooperative Legal Services and Tescolaw who are perceived only to be contemplating low level work at the bottom end of the market. It is the small High Street firms which will be affected, they argue, and comfort themselves that their firm will be immune from such new competition. In many cases this is a dangerous fallacy. Informal surveys at many firms reveal that contrary to partner perception, high level partner intensive work is the icing on the revenue cake and not the cake itself. Some estimates are that as much as 70% of the work of most general firms remains either bread and butter work or is work that can be done by relatively inexperienced staff, albeit under supervision and in accordance with sophisticated systems and matter management processes. Large firms are finding this truth out the hard way when their global clients increasingly challenge high charging structures for routine work which could be done in low cost centres at 20% of the cost of a junior lawyer at a London law firm. Probate practitioners are fast discovering. The challenge here is therefore not just from non-traditional legal service providers following deregulation, but from innovative law firms, some based outside the UK, and from the growth of internet-based DIY legal services.

2. “When the recession is over, all our work will come back”

I am worried by the number of lawyers who tell me that volumes of work and levels of profitability will normalize once the recession is over. The question is whether a rising economic tide will lift all boats. The problem is threefold. First, many law firms have cut their fees in order to keep work levels up and it will not be easy for them to raise those rates again if and when the tide turns. I hear of commercial property clients who have managed to negotiate fixed fee decreases of at least 40% over the last two years; those clients will refuse to see those rates go back to 2007 levels. The second issue here is that in many areas of commercial and property law, there is now a large oversupply of lawyers. This is already giving rise to intense competition for available work. It is likely to be some time before the supply-demand pendulum swings back. The third problem is that the demand for legal



services often lags some way behind any upswing. I fear therefore that better economic times – whenever they come – will take a long time to benefit law firms in general and will come too late to rescue many ailing firms or practice groups

3. “All our clients will remain loyal”

The maintenance of strong client relationships rightly remains a huge competitive weapon for law firms. The existence of secure personal bonds with leading clients has enabled small and medium sized firms to retain very significant clients who might normally be expected to use larger or better known firms. Again, however, I can identify at least three problem areas. The first is the obvious truth that although some friendships endure for a long time, many relationships tend to atrophy naturally over a period. Clients can outgrow firms, move away from the locality, or change jobs, and accordingly fresh relationships constantly need to be forged and new clients have to be sought. The second problem is that some client loyalties are to individual lawyers rather than the firm and can therefore be lost if the partner leaves, retires or dies. The third issue is that client loyalties seem to have become somewhat strained during the recession. One reason for this might be that whilst loyal and long-standing clients are not always as fee sensitive as new clients, nevertheless they may in some cases may feel that advantage has been taken of them, or that they have been taken for granted. Reliance therefore on the loyalty of an existing client base carries enormous risk as key clients may become impossible to replace.

4. “We are efficient at using technology”

There may be some firms who have managed to achieve optimal use of technology, but many firms are way behind the curve. High secretarial ratios in the legal profession still reflect a somewhat inefficient use of technology – there are still many partners who have one-to-one secretaries. The brutal truth is that anybody starting a law firm from scratch would staff the firm as leanly as possible, relying instead on heavy investments in systems, technology and sufficient knowledge management to enable menial and administrative tasks to be carried out by lower paid (and less qualified) staff rather than expensive lawyers. Working practices are hard to alter in existing law firms. Incremental improvements have proved to be slow and can easily stall at an intermediate plateau of efficiency.

5. “We are efficiently managed and well disciplined”

It is fair to say that over the last decade I have observed a steady improvement in law firm management and in partner behaviour and discipline. Nevertheless, there is huge room for efficiency gains in just about every law firm in the world. In addition, the way in which partners manage their people, their time and their priorities is in some cases embarrassingly poor. There are a few Private Equity Houses which are interested in investing in the legal sector and most of them see the imposition of strong management and appropriate accountabilities and discipline to be one of the key areas where they can add value with a view to gaining a return on investment. For the last fifty years or more, lawyers have led a fairly cosy existence with high profits continuing to accrue from traditional working practices and comfortable work ethics. The brutal truth is that these comfort zones are shrinking fast,

and the firms who have acted quickly to bring about efficiencies and accountabilities are steadily gaining both in profitability and in the ability to compete.

6. “Commercial law is our route to success”

It is good to see private client law coming back into fashion after some years of disfavour. Even so, I still encounter many medium sized and even quite large firms who think that they can and should field impressive teams in a wide-ranging portfolio of commercial legal services. This is by no means easy. Larger commercial clients are looking for depth both in expertise and resources. A single partner or small team in the heavy-lifting areas of commercial and corporate law does little to impress corporations. Clients and potential recruits both ask similar questions of firms – “why should I choose you, when I have a bewildering choice of leading firms in your area?”. Of course there has been room for some firms in cities and regions to have established a competitive position in many areas of commercial law, and those firms may well be able to continue to develop and prosper. The equation, however, for firms with only the beginnings of a commercial offering is that it is becoming more and more difficult to gain traction unless they have a very strong sense of ambition and vision accompanied by the appetite and ability to invest heavily in the long term

7. “We are well known and highly regarded”

It is very easy to get carried away by one’s own propaganda and to get fooled into thinking that our firm is well known and highly regarded. Firms who carry out independent name recognition surveys amongst their client bases and communities often find this a chastening experience. The legal sector remains very fragmented and there are very few well known law firm brands. Good branding enables potential clients to know who you are, what you do and how to get hold of you. However good their lawyers, a majority of firms in every region continue to be well kept secrets. Again, investment in branding can be a heavy cost which firms find hard to resource even where the case for investment has been agreed. But firms who proactively manage to make their voices heard in a noisy market-place will continue to stand out in the crowd. One way for smaller firms to achieve this might be to join one of the growing numbers of umbrella organisations which provide branding, training and quality support.

8. “The normal rules of economics don’t apply to us!”

Even despite the recession and growing pricing pressures from clients, many law firms still continue to base their budgets and business recipes on an old-style hours-times-rate basis. Under this cost plus methodology, the firm works out its probable overheads, calculates the profit it wants to make and then assumes that it can then target the resulting revenue figure by multiplying available hours by a set of market-based hourly rates. If the resulting calculations fail to produce the right results, the big discussion then turns to how the firm can improve utilization, increase rates, improve margin by cutting overheads, or somehow further develop leverage. The debate is usually entirely internal and inward looking and begs all sorts of questions such as how the firm is going to try to develop competitive and compelling strategies, increase its market share or provide true value to clients. What should be clear is that the laws of supply and demand, as well as the relationships between the challenges of

value, pricing and profit are faced by all businesses and law firms are no exception. . The problem is that the old profit-making formulae for law firms have served the profession so admirably for so many years, that some partners find it hard to adjust to the fact that law firms are businesses like any other, and may need to plan more strategically in the future.

9. “Clients always want a personal and partner-led service”.

There is absolutely no doubt that clients continue to value a strong relationship with their lawyers and the role of ‘trusted adviser’ is still a vitally important one. It is a mistake however to feel that any single partner is ever indispensable to any client. Clearly in many routine and commoditized areas or work, clients are more interested in efficiency and process than a strong partner-led relationship but even in complex matters, clients are very ready to be transferred on to someone who is more specialized or more cost effective to deal with their matters. Indeed, research shows that larger clients often become more tied in to their law firms where they have a relationship with more than one partner. The problem is that partners use this half-truth in order to justify client-hogging, as well as lack of delegation and cross-referral. In other words, every time a partner utters the words “this client needs me and nobody but me”, this can be a sign of partner paranoia rather than partner wisdom.

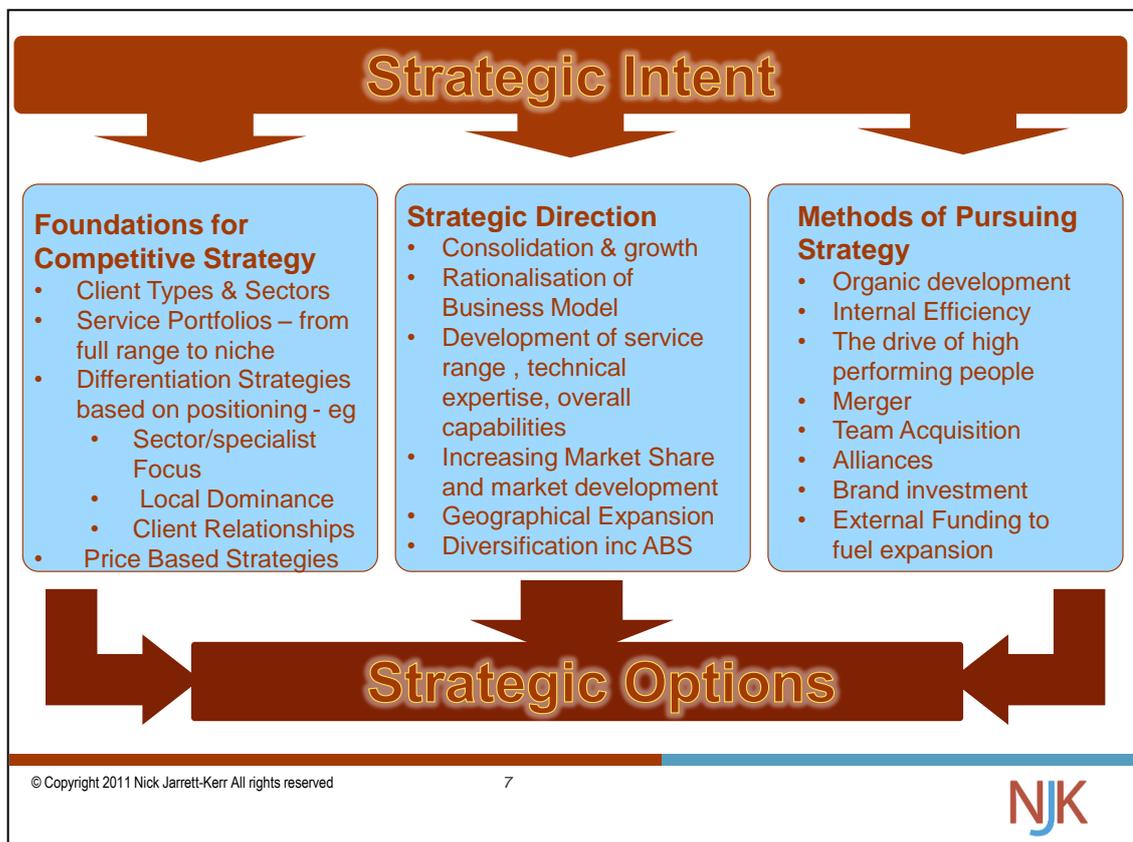
10. “The best business development is to do good work for satisfied clients.”

There is of course a lot of truth in these words, but at best it is a half-truth and a possible comfort zone issue of self-delusion. Many years ago I was a trainee lawyer at a firm in a suburb of London. It was the leading firm in its locality. I am sure it has continued to do excellent work for satisfied clients but the fact is that the firm has shrunk in size and has certainly failed to grow in substance over the last thirty years or more. It is now a very minor player in its market place. If a firm is to grow in stature and reputation, then it has to do more than serve an existing client base. Growth for growth’s sake is not a strategy. However, every firm needs to consider the minimum amount of growth necessary for the firm both to retain its existing market position and to develop its strength and ability to perform or survive. Clearly, all firms need to have a viable market standing. In a consolidating market, most firms therefore need a high minimum growth rate in order merely to stand still, or maintain existing competitive advantage and levels of profitability. Business development is one means of achieving such growth.

What can be done?

Despite the obvious problems, there are nevertheless huge opportunities for law firms and new entrants alike to take advantage of a fragmented and incoherent service sector. It is a time when the fast will overtake the slow. New entrants have the advantage of being able to start with a blank piece of paper to construct structure systems and brand and they come to the sector with possibly deep investment pockets to kickstart their operations. But they have no clients, no reputation and no people. Innovative and assertive law firms on the other hand have the huge advantage of an existing client base and established teams of people. A good place to start is to try to gain some degree of honest self-appraisal and if any of the delusions and fallacies which I have listed affect your firm, to ensure those delusions are analysed and

debunked where necessary. Part of the strategic planning process always involves then a thorough appraisal and assessment of the strategic options and choices which the firm can make to gain a decent competitive position. These options fall into three distinctive areas.



Step One – The Foundations for Competitive Strategy

First the firm should consider exactly what it is that makes or is likely to make the firm competitive. The questions here include “which of our services help us to compete, what specialist focus can we have which will win us work, and what is our pricing model that helps define us?”. Where the building and maintenance of strong relationships with clients and referrers is seen as a vital part of the firm’s recipe for success, those relationships must be nurtured and renewed, not just by being nice to clients but by providing them with services that they will continue to find valuable. The basis for a firm’s competitive strategy is largely client oriented and externally focused. If the clients can see no added benefit or advantage from the firm, then the firm is not likely to develop a winning competitive edge. What is clear is that the firm must decide how it wants to be seen in its marketplace, what position in this market it wishes to occupy and what type of client will provide its core as it goes forward.

Step Two – Strategic Direction

The second area which a firm needs to consider is the overall strategic direction the firm needs to take in order to build the competitive position which it has established it needs at step one. The firm needs to consider, for instance, the extent to which it needs to grow (if at

all) in order to have the depth of specialism that it needs to provide a compelling client proposition. It needs to consider the development of its resources and capabilities in order to service the clients for whom it aspires to act, and the required depth in each practice area. It needs to decide if the firm needs to expand into other towns or regions or whether it still has ample opportunities to build market share in existing areas. Furthermore, the firm needs to consider if it needs to diversify into other logical service offerings or even via Alternative Business Structures. The new regime heralded by the Legal Services Act in the UK will of course give both existing law firms and new entrants to the market the opportunity to pursue a strategy of unrelated or partially related diversification into the legal services market. The questions here include “what if any are the synergies with what we do? What are the entry barriers? What is the likely cost of the investment and what is the likely return? How difficult will it be to acquire the people and build the systems, processes and infrastructure? How easy will it be to build the brand and successfully to take our offerings to the market?”

Step Three – Methods of Pursuing Strategy

Once a firm has established its basis for competitive differentiation and has decided its overall strategic directions, it can then turn to the final of the three areas, namely the methods by which it can best pursue the firm’s strategy. This part of the strategic thinking will need a thorough appraisal of the firm’s existing resources and momentum in order to decide whether a combination of organic growth and operational improvements will suffice to carry the firm forward. In some cases, heavy investment capability will be needed to enable the firm to hire people expansively, to acquire teams or to build the firm’s brand. In many areas of private client and consumer law, for instance, firms are seeing the benefits of persistent and well thought out advertising campaigns, but the heavy cost of a long term marketing budget needs both resolve and access to funds.

Making it Count

I am clear from many conversations with Managing Partners that they are fully aware of the dangerous half-truths and fallacies which I have listed. It is mainly back bench partners who are tempted to delude themselves with any rationalisations by which they can justify a ‘do-nothing’ attitude. Managing Partners may therefore still be left with a “hearts and minds” issue as they seek to persuade their partners and staff to face the facts and move out of their comfort zones

Fortune favours the bold. If firms are to fight off their existing and threatened challengers and beat their rivals, they will do so by first honestly and openly assessing their strategies and by making sure that they are not deluding themselves into a false sense of security. They must recognise that a compelling competitive strategy will require risk-taking and a huge degree of change in attitudes, behaviours and working practices amongst partners, who will be required to experiment and learn new ways of doing things. Some firms and partners will discover, too late in the day, that they are saying ruefully to themselves “what happened to our practice?”.



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