



Out of this world?

By **Andrew Hedley**, director, Hedley Consulting

The past year has seen unprecedented turbulence for the legal profession, but is perhaps simply a portent of what is to come. Longstanding rules of competition and client relationship management have been cast to one side. A new, resolutely commercial, approach is to the fore, which is an anathema to those steeped in the longstanding traditions of the gentleman solicitor. For the vast majority of firms, it is a truism that future prosperity will be derived from being better at running a legal services business rather than by being better at the law.

While some see this as a time of great opportunity, others are frozen, not knowing which way to turn. For most the economic turmoil of the past eighteen months has resulted in a number of difficult, painful decisions and their consequences – redundancies, salary reductions

(whether directly, or through the proxy of enforced sabbaticals or reduced working hours), changed working practices and significant reductions in profit. The gravy train that had trundled merrily along a seemingly endless track for ten years, didn't just grind to a halt. It crashed full-square into something the equivalent of a reinforced concrete wall!

Of course any recession has a purgative effect, sorting out the wheat from the chaff and allowing the firms with a robust and balanced business model to come through stronger than they were before. On the other side of the coin, it also flushes out those who have benefited from the halo effect of a strong economy without having any true competitive advantage.

The timing of this particular recession, however, could not have been worse for law firms. The forces

of deregulation are mustered like dark hoards on the horizon, the pace of change accelerating to a dizzying crescendo and the assumptions about what it means to be a lawyer are splintering.

As we enter the second decade of the 21st Century I believe we are on the cusp of developments that will impact the way in which the profession operates more in the next ten years than in the previous two centuries.

A fundamental shift?

Management theory talks about a ‘paradigm shift’, a term used to describe a wholesale rewriting of the rules of competition in an industry, which leads to fundamental change. Is the profession experiencing such a phenomenon at the moment? Such an appraisal must be framed by the business context within which firms have historically operated – one in which development was measured, under the control of the firms themselves, and where an aura of inherent protectionism pervaded the regulator creating the rules by which the profession operated.

Looked at through this lens, most would agree that the rate and scope of the change being experienced are indeed sufficient to warrant the paradigm shift categorisation. Most importantly this phenomenon will continue, with the reforms that were already in train, to create the most deregulated legal profession in the world.

What now counts is the ability to respond to these new opportunities and threats. How fleet of foot can firms be in adopting new ways of working? Has the desired market position been thought about to offer services that target clients’ value, and which are also sustainable in the future?

Managing partners have the pivotal role to play. Over the next three years they must navigate with skill, balancing the risks, delivering acceptable profits and creating a market offer that is both compelling and can be delivered efficiently. How many are equipped to steer this course remains to be seen.

Client power as never before

Whether it be the blue-chip in-house counsel or the man in the street, the power balance between solicitor and client has shifted significant and irrevocably.

Consolidator brands (either pre-existing, such as the Co-Op, which has already nailed its colours to the mast by announcing it will place advertising for its legal services in its 2,000 food shops, or new entrants, most likely private-equity backed) will create a wave of powerful high-street brands. This will spark a period of intense competition for high-street law firms. They will

be faced with one of three stark choices – to be taken over by a consolidator, to go out of business (or accept an impecunious existence) or to develop a niche position. This final route will be attractive to many but impossibly challenging without the strategic and management skills to design and deliver such an approach.

Turning to the larger commercial firms, the developing role of in-house counsel over the past ten years has had dramatic consequences for the gamut of firms targeting corporate and commercial work. The message is straightforward – the client wants it better, faster and cheaper – but the impact is profound for firms’ competitive mix and economics.

The implications for the profession are hugely challenging as lawyers move from being masters of all they survey to cogs in the legal-services machine.

What value do our clients perceive we add? How much will our proposition support a differential pricing model? These commercial questions cannot be answered in most firms.

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The answers lie, not in the mind of the lawyer, but in that of the client. Far too few firms are externally facing and fall into the trap of defining their value proposition on the basis of what they believe to be important, rather than looking through the eyes of the client. This approach can work occasionally, but mostly it will not. This should not be a game of chance but one of rational and objective research.

Value is inevitably eroded, as imitators adopt the same (or better) tools, driving perceived differentiation down. When all appears the same, the client chooses on price. Low capital requirements and minimal protection of intellectual property ensure that any competitive advantage will be short lived. Those wishing to be synonymous with added value will also need to be innovators if they are to maintain their position. I anticipate that over the next year leading firms will move to articulating and (crucially) delivering value propositions that are increasingly difficult to imitate, and which have super appeal to target clients.

The broken psychological contract

The legal profession has held dear the concepts of loyalty and tenure – of partners to staff and of partners to one another.

Over the past ten years, however, the desire to drive rewards for those judged most critical to the firm's future success has seen the invention of a plethora of methods of dividing up a profit pool of a finite size, from meritocracies, to bonuses to de-equitisations. In many firms, the message to partners is clear – the old ways of rewards-based on tenure are gone. In the future, it seems, a performance-based culture will prevail. Quite naturally the bonds of loyalty in partnerships are not what they were. Let's be clear that this is not a wholly regrettable position. Too many firms carried underperformers, who would take a disproportionate share of the profit, while those with less tenure toiled towards their day in the sun.

Over the next year, this trend will impact associates too as firms end 'associate lockstep' (a system in which, every year, an associate is given a tenure-related pay rise and a hike in hourly rates). The historic, arbitrary approach was always profit-positive for the firm in a model based on hourly charging – any increase in salary being more than compensated for by an increase in hourly rate. The ratchet worked strongly in favour of the firm. Today, with clients demanding fixed fees, recovering increased salary costs by simply increasing charge rates is untenable. Promotion must be accompanied by increased value to the firm, and ultimately, to the client. Unpalatable as associates may find this, it is simply one economic consequence of a changed paradigm.

Legal process reengineering

The drive for fixed fees means that work must be done at the lowest level of competency. Partners should only do the elements that require their expertise. Moreover, the same logic should apply at each level of seniority within the firm.

In a parallel path, legal process outsourcing is gaining significant momentum as firms begin to manage the process of delivering legal services better.

My view is that these trends will converge into a much wider drive towards the disaggregation of the legal process, the completion of the components at their place of maximum economic efficiency and the reassembly of the service product at the point of delivery to the client. The technology and project-management skills now exist within the profession to make legal process reengineering a viable business model.

To work effectively, trust here is key – within firms, between firms and clients, as well as between firms and suppliers. Quite how the partner who has struggled with the concept of work leaving his desk to a colleague in the next office will cope with the idea of it being

carried out thousands of miles away remains to be seen. However, economics this compelling are a huge motivator for change.

There will also be a more flexible approach to HR akin to the core and portfolio worker model now commonplace in many organisations outside the profession. Some of these non-core workers will be contracted through outsourcing agencies, but others will be engaged directly, drawn from the pool of those who prefer a portfolio life, or those who do it as a matter of necessity to balance their other priorities.

Building clocks, not telling the time

As I write this, Mervyn King, the Governor of the Bank of England has just predicted that the worst of the UK recession is over and that GDP growth of around two per cent can be expected in 2010.

Assuming that the economists have got it right, one would expect the profession to see some benefit from an improved economic climate. Any optimism should be tempered by a realisation that clients have undergone a fundamental (and irrevocable) shift in the manner in which they engage lawyers. Those firms unable to adapt can expect no increase in prosperity. For those able to create a new approach, however, there are many opportunities to be harvested in running a 'new age' legal-services business.

I hope that you enjoy this review and are able to use it to inform your thinking as a leader of your firm. The weight of responsibility rests on the shoulders of the managing partner, not just for the performance of the firm today but for the legacy that it built for the future.

I am reminded of the academic work of Jim Collins and Jerry Porras, which analysed the ways in which great leaders go about their job. These people are able to build enduring brands and organisations that outperform the competition year after year. Leaders such as these are concerned with "building clocks rather than simply telling the time".

This is a powerful metaphor with which both to end this introduction and to encourage you to be courageous in developing your firms by creating a vision for the future, building on the strengths that you have today as well as being prepared to challenge every aspect of your business in order to create an enduring legacy for those yet to come. Managing PARTNER



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