FROM RECRUITMENT TO ROBOTS: GROWTH STRATEGIES FOR LAW FIRMS

SEPTEMBER 2016

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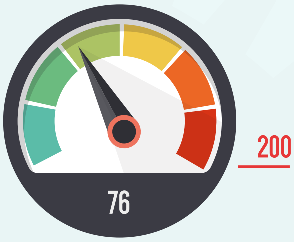
FROM RECRUITMENT TO ROBOTS: EXECUTIVE SUMMARY

THE RESPONDENTS



76 of the top 200 UK law firms responded to our survey

41 of those law firms are ranked within the top 100 UK law firms

MERGERS

73% of respondents have not merged in the last two years. In our 2015 survey 95% of respondents forecast major consolidation over the next two years.

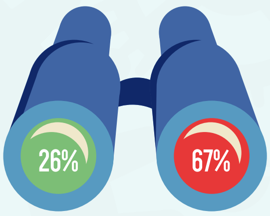
As a result 79% of merged firms have experienced more instructions from clients

63% of merged firms experienced a boost in combined profitability

£££££ 53%

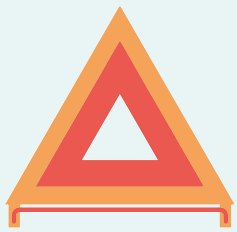
Over half of the merged firms have experienced better financial stability since merging

PREDICTING THE FUTURE



Only 26% of respondents are looking to merge in next two years

Only 3% of respondents plan to become an ABS in the next 12 months



Nearly 40% see alternative providers as the biggest threat to the profession

28% of respondents foresee a time when solicitors will no longer be the primary providers of legal services in England and Wales

INTERNATIONAL

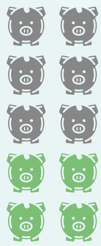
59% of firms felt that merging would give them the best prospect of improving their international offering

Although international networks were viewed favourably, only 8% said they would be likely to join a network in the next 12 months

PEOPLE

71% said that acquiring a team would give them the best prospect of increasing their firm's profitability if successfully implemented

62% of those who took part in our survey do not believe that organic growth will be enough for them to achieve their objectives



42% of respondents have invested >£100k in acquiring teams in the last 12 months.

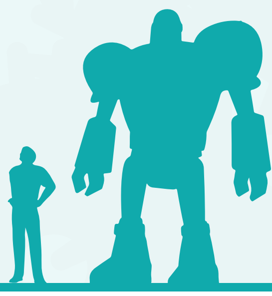
TECHNOLOGY

More than four fifths of respondents consider investment in technology to represent the best prospects for increasing their firm's profitability

Only a quarter consider it to represent a high risk to profitability if implemented unsuccessfully

55% have invested >£100k in technology in the last 12 months in order to commoditise aspects of legal work

50% see technology as the biggest threat to the profession



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FOREWORD

The legal services market is more diverse than it has ever been.

Decision-makers at the UK's leading law firms can still follow traditional models of growth, such as through merger or the recruitment of star lawyers, but those options now compete with more radical changes to law firm strategies, which emphasise technology, commoditisation and the provision of non-legal services.

Lawyers may be compelled to consider fresh options. Our new survey indicates that far fewer leading law firms than was indicated by our survey 18 months ago are looking to merge as the path to achieve their ambitions. In our view, this illustrates not a change in ambition but the difficulty firms have in locating suitable merger partners and their natural unwillingness to merge at all costs. There has been a renewed focus on investment in people, global footprint and technology.

We have sought in this report to highlight not only where the leading firms are focusing their resources but also some of the pitfalls associated with those strategies. Recruiting a top team from a rival firm may seem to offer instantly increased market share, but the path can be strewn with legal trip wires that can mean delay and additional cost. Technology may appear to be a 'must have' but how might it improve efficiency and profitability; is it the best in class; will it be obsolete no sooner than acquired?

Not every firm will make the right strategic decisions all of the time, but all firms can take inspiration from the leaders in our market.

TINA WILLIAMS

CHAIR AND HEAD OF PROFESSIONAL PRACTICES, FOX WILLIAMS

Our latest research presents original data about the growth strategies currently being used and contemplated by law firm leaders within the UK's top 200 law firms.

As law firms continue to swim for clear water in an increasingly competitive sea, they will seek to implement strategies that will give them the best chance to achieve growth and stand out in a crowded market place. Finding a merger partner could be seen as the greatest immediate way to achieve those aims. However, our research shows that merging is perceived to carry – by far – the most risk to a firm's reputation if not implemented successfully, over and above other growth strategies. That could be a strong reason why law firms are looking for growth strategies that are less risky to their brands.

Whatever growth strategy a law firm undertakes, it will inevitably carry some risk to their reputation. With the legal press and others closely scrutinising law firm growth initiatives, law firm leaders increasingly need to be aware of how much reputational risk – as well as financial – each strategy carries. Swimming too far into uncharted waters might be seen as a reputational risk too far, but clearly this report and the interviews we carried out for it show that simply treading water is no longer an option.

Achieving true market differentiation for law firms is easy to conceive – but much harder to successfully implement. As law firm leaders look for growth strategies that will help them acquire that much needed edge, we hope that our latest research helps to inform their thinking.

GUS SELLITTO

MANAGING DIRECTOR, BYFIELD CONSULTANCY

STRATEGIES FOR GROWTH

The UK legal sector has never been more dynamic than it is today. This report examines the growth strategies that forward-thinking law firms are using as they seek to pick a winning formula. It includes insight from leaders in the field and the results of an in-depth survey of the growth strategies employed by many of the top 200 UK law firms. Our analysis will help lawyers and businesses working with law firms understand current strategic thinking in the legal market.

INTRODUCTION

Good people and a good client base are the starting point for any successful law firm, but the choices that must be made to secure and build on those fundamentals have become more complex. Strategic decisions are no longer just about recruiting in the right practice area; they require careful thought and action which go to the very heart of the modern law firm business model. It is clear that standing still is a route to underperformance or worse.

The results of our 2015 survey, analysed in our report, The Dating Game, revealed that 95% of 101 of the top 200 UK law firms forecast significant consolidation in the UK legal market over the following two years. And 45% of those firms that had not merged said they would consider merging in the next two years. Eighteen months later and although consolidation has taken place, mergers have not completed in the numbers envisaged.

Our research points to firms ultimately taking a different tack. When it comes to mergers, firms have proven to be cautious. In our exclusive survey of 76 of the top 200 UK law firms produced for this report, 86% of respondents identified merging as having the greatest risk of reducing profitability when compared to other growth strategies. Of the 55 respondents which have not merged (72%), only one quarter are seeking a merger (26%), whilst over two thirds (67%) are not looking to merge in the next two years.

Conversely, 83% chose increased investment in technology as having the best prospects for increasing a firm's profitability, followed by recruiting a team (71%). Firms appreciate that the future does not lie merely in increasing size for its own sake but in gaining a competitive edge by selectively recruiting and using technology to drive service up and costs down.

Although a large majority of respondents believe solicitors will continue to be primary providers of legal services in England and Wales, it is telling that a sizeable minority (28%) foresee a time when solicitors no longer hold a dominant position in the legal market place. Technology is seen as a double-edged sword, with 50% of respondents ranking it as a bigger threat to law firms than alternative legal providers and in-house legal teams.

There will be winners and losers, both at a firm and individual level. As technology and paralegals reduce the demand for trainees and junior lawyers, this may be creating a future shortage in senior lawyers. The prospects for aspiring solicitors are bleak, but potential winners include those with skills hitherto rarely employed by

> The UK legal market is mature. Firms are striving to gain a footprint in alternative markets. Globalisation has changed the nature and the size of the market place for legal businesses.

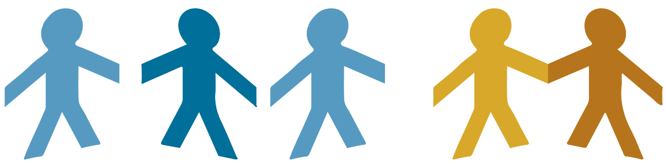
law firms in the mid-market, such as project managers, software developers and data analysts.

A MATURING MARKET

The UK legal market is mature. Firms are striving to gain a footprint in alternative markets. Globalisation has changed the nature and the size of the market place for legal businesses. Our research points to international networks as being a cost effective way to achieve an international footprint quickly, but joining one – or making the most of one of which they are already members – is not an objective that many law firm leaders have at the top of their agenda.

By contrast, it is technology which is keeping many law firm leaders both excited and apprehensive. Over four fifths (83%) of our respondents believe investment in technology to have the greatest potential to increase their firms' profitability. Understanding what the various technologies do and their potential applications within law will be essential. One respondent to our survey believes that: 'We may see a technological arms race between law firms where it will be important to invest in the right products.'

All firms are hunting for improved profitability. Although there is no shortage of potential routes available to firms to achieve that goal, the level of investment required for each is such that no firm can pursue all of the possible strategies at once. Strong leadership with a clear strategic vision is essential. Decisions are required about whether a firm should aim to be technology-led, international, to have more of the best lawyers or simply to be differently focused. Making the best use of resources is key. But how to do this when technology, geo-political and economic events, client expectations and inter-generational differences are all changing the world at such a dramatic pace? Our report highlights the strategies being deployed by the top 200 law firms to compete and grow their businesses.



Only **26%** of the firms that took part in the survey said that they are **looking to merge within the next two years**.

PART I
GOOD PEOPLE

"Remember clients pay for a relationship with a human being who provides them with assurance."

A UK TOP 200 MANAGING PARTNER SURVEY RESPONSE ON HOW LAW FIRMS GROW

HOME GROWN, ORGANIC PRODUCE IS BEST

Almost three quarters (72%) of managing partners responding to the survey believe solicitors will continue to be the primary providers of legal services in England and Wales for the foreseeable future. As long as that view prevails, the need for firms to grow organically must feature in legal businesses' long-term expansion strategies.

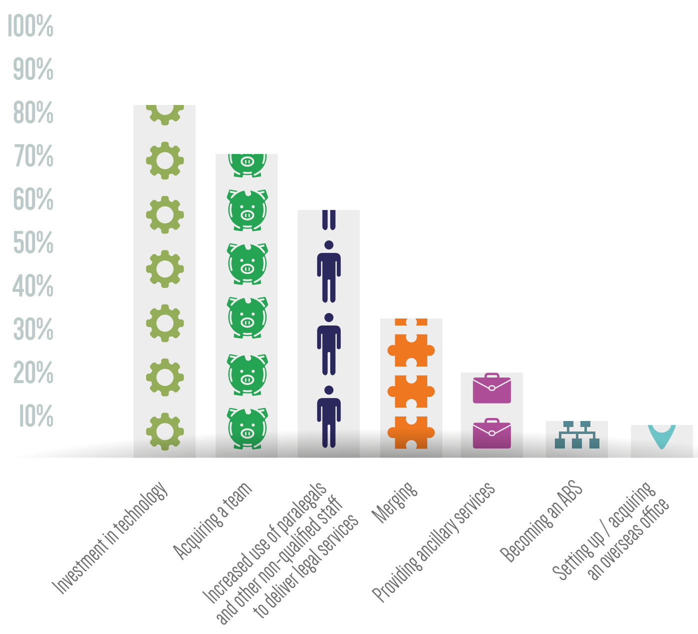
One reason law firms prefer organic growth is because it is perceived to be the path which carries the least risk. In-house growth can be efficiently targeted to fill specific skill requirements and will be less disruptive than other options to the culture of the firm. But a strong organic growth strategy requires years of investment in management time and in direct costs. And even then there is no guarantee that such an investment will sustain a healthy trainee to partner cycle. Susan Bright, regional managing partner UK and Africa at Hogan Lovells, sets out the nature of the challenge: "When I started out we were 39 trainees and 26 years later there are three of us left. Well that is pretty normal. And of course the other 36 made a valuable contribution while they were here and there is a strong relationship between the firm and many of our alumni."

Simon Slater, chief executive of Thomson Snell & Passmore, believes that three important principles underpin a firm's successful organic growth: "The first principle is having a crystal clear strategy which can be simply stated and which people want to be part of. The second principle is being prepared to invest in areas identified within the strategy for growth. The third principle is having realistic timescales attached to any investment."

Competition among top law firms to attract the best trainees and junior lawyers is hotter than ever. This is reflected in the huge pay packets routinely being offered to twenty-something graduates. It was reported this year that one US law firm was offering its newly qualified lawyers an annual salary of £137,500.

Securing the right quantity of high calibre candidates is only the start of the process. Young, talented lawyers must be brought on to develop the skills necessary to enable them to make the most effective contribution to the business. James Roome, senior partner of Akin Gump's London office, comments that "the key for us is to focus on educating people." Bespoke training courses and in-house business schools are growing in the sector and are seen as essential to nurture talent. Last year, Hogan Lovells

Q Which of the following do you think have the best prospect of increasing a firm's profitability if successfully implemented?



launched a pioneering global business skills training course for lawyers at the start of their careers, which provides trainees with a greater understanding of the workings of the City as well as the importance of social impact, both to the firm and to its clients. While Shirley Brookes, UK senior partner of PwC Legal, also stresses that lawyers need to build broad marketing skills early on in their careers: "Our people need to learn networking, business development and presentation skills very quickly, whoever they are," she says.

But training a crop of bright, young, talented lawyers is only half the job done. After investing all that time and money, the challenge is to keep them at the firm, especially at pinch-points in their careers like post qualification and return to work after maternity breaks. There are three stages at which an organic growth strategy can be de-railed: recruitment, training and long-term retention. High rates of attrition and levels of investment mean managing partners are acutely aware of the need to monitor the profitability of their organic growth strategy. The quicker trainee lawyers can start earning their keep, the less risk to a firm's profit margin.

PARALEGAL EAGLES

Our survey showed almost 60 per cent of respondents (59%) felt that the increased use of paralegals and other non-qualified staff to deliver legal services had one of the highest prospects for increasing a firm's profitability (after investment in technology (83%) and hiring a team (71%). This high figure could be explained by the significant investment law firms need to make in qualified and trainee lawyers. But it could also point to more efficient ways of delivering legal services, in line with client needs and the nature of the work and levels of expertise required.

Some of the newer entrants to the market, including PwC Legal, offer a very different business model to that of the traditional law firm. Whilst a large law firm will have a ratio of four or five fee earners per partner, PwC Legal has around 15 partners for 250 fee earners, many of whom are paralegals. For commoditised transactional and support work that will not bear the cost of qualified lawyers, both paralegals and contract lawyers allow firms more flexibility in matching resources to need and a cost base that can fulfil clients' demands for more for less.

The full potential of the paralegal lawyer has not been fully realised by law firms with rigid employment policies. By giving paralegals, many of whom have been unable to secure a training contract, valuable career progression law firms can benefit from experienced lawyers already in tune with the firm's working culture.

As this report was going to press, Freshfields announced a new Paralegal Apprenticeship Scheme, which offers aspiring paralegals an alternative route into the profession. The firm will offer two year apprenticeships at its legal services centre in Manchester. In The Lawyer's article on the announcement, Olivia Balson, Freshfields' head of the legal services centre stated "We want to encourage wider access to law and possibilities for progression for the very best talents." But Derek Southall, partner and head of innovation and digital at Gowling WLG, sounds a note of caution about both the rise of the paralegal and the way in which law firms should think about growing organically: "What will be the effect [of technologies] on Legal Process Outsourcers and the raft of lower cost delivery centres set up by City law firms? Will they need the same number of people? Will their skills requirements shift too? Some roles will disappear in law firms and some will emerge. For example, we may see more opportunities for data scientists." Factoring the technological revolution into growth strategies is already the big issue keeping managing partners awake at night.

BUYING BRAINS AND REPUTATION

Sixty two per cent of respondents said that they did not consider organic growth alone to be sufficient for their firm to achieve its objectives in the medium to long term. Organic growth takes a long time and is costly, which means that firms need to have a flexible lateral hiring policy to complement their internal growth strategy. Leading commercial and private client firm Wedlake Bell completed a merger with Cumberland Ellis four years ago. Since then the firm has seen its turnover increase from £24m to £36m. The firm's managing partner, Martin Arnold, says this growth has been boosted by a series of lateral hires. "Our lateral hiring policy has injected energy, different ideas and opportunities into the practice. It tends to be just single partners."

Many firms have a member of the management board in charge of lateral hires as it is simply too important a growth strategy to be left to chance. Managing partners told us that when formulating a lateral hire policy it was important to be clear about which areas of specialisation and skill requirements their firm was focused on. All of them said the most important aspect of this strategy was achieving the right cultural fit, because untangling a mismatch of lawyer and law firm can not only be expensive in terms of cost and management time but it could also lead to reputational damage.

A firm which makes too many mistakes will soon gain an unwanted reputation for being a law firm with a revolving door and will find it increasingly difficult to recruit the highest calibre or even suitable laterals. Shirley Brookes of PwC Legal points to the importance of culture in attracting and retaining the right recruits: "Our ambitious growth plans and the high awareness of the broader PwC brand means we get a lot of approaches. But you can usually tell within half an hour if that person will be the right fit here, often through the words they use. Our culture is very collegiate and about developing broad rounded people, not one trick ponies. If you come from an 'eat what you kill' culture, you're unlikely to fit in here."

In recent years it is big American law firms breaking into or consolidating their position in the London market that have been employing the most aggressive and successful lateral hire policies, taking many partners from firms in the UK top 100. By contrast, relatively few laterals move from US firms back into UK firms.

A lateral hiring policy is not without risk. For all the success stories of high profile captures there are many failures too. The Lawyer magazine commissioned research two years ago that analysed the fates of nearly 2,000 lateral partner moves. Astonishingly, it found that within five years, a third of those partners had left their firm. Bryan Cave managing partner for the London office, Carol Osborne, concedes that making the right choices is not easy: "It's very tough and there are a lot of barriers to success. The process is time consuming and labour intensive, and each lateral hire can take a month or two or longer. And then there's the integration process – which often has its own challenges."

Alastair Beddow, a director at Meridian West, a consultancy advising professional service firms, says that there is a whole range of reasons why lateral hires can be unsuccessful: "Often the business case made for that kind of move is less clear-cut than many firms believe. Firms assume that if they bring across some heavy-hitting rainmakers, then they'll be able to bring all their clients across with them and that's not always the case. To make lateral hires successful, firms need to pay close attention not only to the capabilities fit but also to the cultural fit for the lateral hire and potential new clients joining the firm as a result of the move."This may be because not enough due diligence has been undertaken to discover when a partner's professed portable client following has been exaggerated. Alternatively, argues Carol Osborne, the new law firm can sometimes simply not be the right place for the lateral hire to be successful "Sometimes you end up choosing someone who just isn't going to be successful on your platform. They could be coming from a very well-known or well-established firm, for example, and joining a firm that is still building its brand or not as well known in a particular practice area. People often underestimate how much their former firm really delivered to them in terms of firm brand."

Derek Southall of WLG Gowling raises a more fundamental issue about the need to factor new technologies into lateral hiring strategies. "Some of these technologies are able to process a huge amount of information. So what does that do for the role of a law firm partner and their value?", he asks. "Often their experience will have been key but will there be the same value to this when technology can analyse wider banks of information? Whose judgement do you trust when a piece of technology provides access to so much information? You need to ask yourself what will the role you are hiring for really look like over the next five years and how will this affect your recruitment criteria? To what extent should all new hires have proven digital skills too? Finally when taking these decisions you need to think about who your competitors will be tomorrow? Law firms, accountants or say software giants? What does great hiring look like to address these challenges?"

TEAMS, TALENT AND TAKING RISKS

In general, Carol Osborne, in common with many others in leadership positions, prefers to hire a team rather than a single partner for a number of reasons. "First, it's

Q How much of a potential risk to reputation would failure of the following be?

> "You can look at a team move as a merger with the benefit of cherry picking. A large firm might eye up a smaller one but want only its very best departments. It can take those teams without picking up any of the liabilities of the other firm."
>
> TINA WILLIAMS, CHAIR OF FOX WILLIAMS

simply more efficient because it's a bigger step forward for an office that's trying to grow," she says. "Secondly, the integration process is always much smoother. Finally, it's often more immediately accretive to the new firm because they are able to carry across with them the brand they had at their former firm." Forty two per cent of respondents said they had invested in excess of £100,000 in the last 12 months in acquiring a team, 71% said that their firm intended to initiate a team acquisition in the next 12 months, the most popular growth strategy of all those polled.

Senior and managing partners responding to our survey placed team hires second (71%) (behind investment in technology (83%)) as a preferred strategy for boosting profitability. This strategy was also considered to carry a relatively low risk (particularly compared to merger and setting up or acquiring an office overseas) of damaging a firm's profitability if the new recruits don't work out.

James Roome led a team of lawyers out of Bingham McCutchen to Akin Gump. "A key issue for clients was whether their current transaction would be affected. It was important to them that the team stay together. Continuity of service is hugely important to client relationships," he comments.

Paul Deacon of London-based recruitment consultants, Deacon Search, has been involved in a number of high profile team hire recruitments. He argues that if winning new clients is the objective behind the appointment strategy then team moves can achieve this best. He adds: "If you've got a good team coming over it can really raise the bar for the new department and the acquiring law firm as a whole."

Team hires provide an effective means of growing, particularly for firms that want to expand into new areas or want to enhance work they are already doing in a particular area.

Tina Williams, chair of Fox Williams, specialises in advising businesses in the professional services sector and has advised on some of the highest profile team moves. She says "You can look at a team move as a merger with the benefit of cherry picking. A large firm might eye up a smaller one but want only its very best departments. It can take those teams without picking up any of the liabilities of the other firm." She has noted a marked increase in client firms instructing head hunters to find them a team rather than a single partner.

Team hires really come into their own when firms look to set up offices overseas. Many US law firms have poached teams from top 20 firms as a way of establishing their own office in London. Dan Sutherland, Fox Williams partner who has advised clients on many of these issues, says that there is a "massive increase" in this kind of bolt-on growth taking place in jurisdictions all over the world. Recent cases in point include Greenberg Traurig which recruited the entire Berlin office of Olswang and Cooley, which in July hired 11 life sciences patent professionals from Morrison & Foerster in Palo Alto, California. However, 41 managing partners responding to our survey considered organisational culture to be a 'critical' factor to the success of acquiring a team, with the remaining respondents calling it 'important'. If a team cannot successfully be integrated into the acquiring firm's culture, the danger is that it will remain a firm within a firm, biding its time until it moves again.

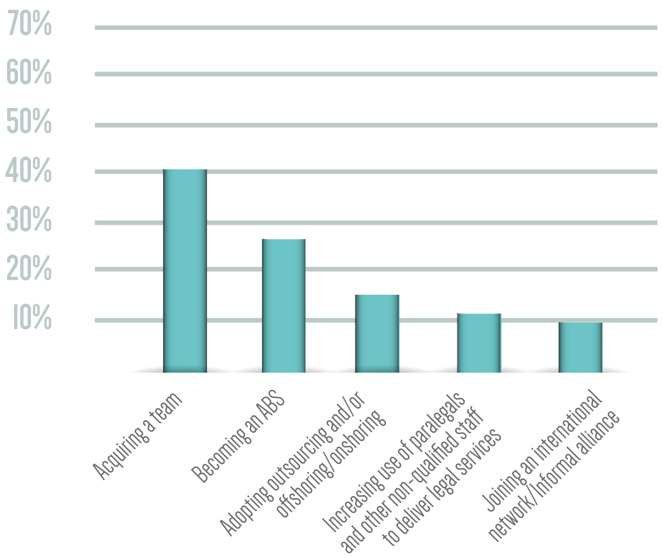
Explains Paul Deacon: "They can come in, stay amongst themselves and leave three years later. That's why a lot of firms, particularly white shoe US firms, do not want teams because culturally it can be difficult to integrate them."

Nevertheless, managing partners told us that an unsuccessful team acquisition was considered to carry only a medium risk to a firm's reputation compared with the high risk to reputation of a failed merger.

Team moves are, however, notoriously difficult to pull off without some legal risk. Dan Sutherland says it is surprising how many recruiting firms and moving partners are "blissfully unaware" of the legal dangers.

Q How important is organisational culture as a factor when implementing one of the following?

Proportion of respondents who considered culture to be critical



SEE YOU IN COURT

Jeremy Callman is a barrister at Ten Old Square, where he has established a reputation in advising on partnership and LLP litigation. He refers to the emotion that can accompany the loss of an important team: "Losing a team is potentially a big financial hit – and often there is a feeling of betrayal; a feeling that the departing partners have been conspiring behind the backs of management. There is also a need to set an example to prevent other teams from following suit. So they do often end up in disputes, although usually commercial discussion follows."

Departing teams can run into problems by disclosing their firm's confidential information in the course of recruitment negotiations with the new firm, or can breach contractual and fiduciary duties (such as a partner who acts as the recruiting sergeant to encourage others to leave) and even be guilty of conspiracy to harm the business of their existing firm. Says Tina Williams: "Even if they successfully navigate these minefields they are often faced, post move, with the blanket restrictions on acting for clients of their former firm to which they are subject under that firm's members' agreement. Nor is the recruiting firm free from risk. If it is aware of the contractual restrictions to which the team is subject it can unwittingly stray into the area of inducing a breach of contract or fiduciary duties or an economic tort against the other firm."

These are not trivial matters, a sentiment echoed by Callman: "Most LLPs have a members' agreement, which will have a series of obligations. Additionally, depending on what the agreement says, statute may imply general obligations. In effect, it is extremely difficult as a member of an LLP (or indeed as a partner in a traditional partnership) to actually pull a team together without breaking your obligations to your own firm." Should a firm facing the loss of a team choose to play hardball it can seek an injunction for what is called 'springboard relief' to prevent the new firm from gaining the advantage of the wrongdoing of the team members. Other options include holding team members to their notice periods, separating them from clients by placing them on garden leave and strictly enforcing restrictive covenants.

Normally disputes end up settling out of court, since neither firm wants the adverse publicity. "Negotiations between firms most commonly result in the poaching firm making a significant lump sum payment to buy out the team, or agreeing to pay over a percentage share of the revenue from that team over a given period," says Sutherland. "We are potentially talking about millions of pounds" agrees Callman. A substantial pay-out for a botched recruitment move is a significant setback to a growing firm's profitability, so managing partners seeking to poach perceived rainmakers and their teams should proceed with extreme caution.

> "Negotiations between firms most commonly result in the poaching firm making a significant lump sum payment to buy out the team, or agreeing to pay over a percentage share of the revenue from that team over a given period"
>
> DAN SUTHERLAND, FOX WILLIAMS

WHERE ARE THE MERGERS?

In our 2015 report, The Dating Game, mergers were found to be on the agenda over the next two years for 45% of law firms who hadn't merged. Although 2015 and 2016 saw significant merger activity, particularly internationally, consolidation has not yet reached the levels our 2015 survey predicted.

This may be because there are numerous obstacles to concluding a successful merger, not least the reliance on there being a suitable, willing and able third party with which to merge.

In our 2016 survey, mergers seem to be far less popular than in 2015, with 67% of respondent firms which haven't merged, saying that they are not looking to merge in the next two years.

However, for those that have merged, the results seem to be positive. Of the 19 respondents who had undertaken a merger, just one confirmed they had not achieved greater financial stability as a result, with the remainder finding either that they had achieved this, or that it was too early to say.

None of the 19 respondents reported that the merger had reduced profitability, with 12 reporting that it had increased combined profitability and seven reporting that it was too early to say.

So while mergers are perceived to be difficult they can also bear fruit.

67% OF RESPONDENT FIRMS WHICH HAVEN'T MERGED, SAY THAT THEY ARE NOT LOOKING TO MERGE IN THE NEXT TWO YEARS.

ONLY 1 OF THE 19 RESPONDENTS WHO HAD UNDERTAKEN A MERGER CONFIRMED THEY HAD NOT ACHIEVED GREATER FINANCIAL STABILITY AS A RESULT

12 REPORTED THAT MERGING HAD INCREASED COMBINED PROFITABILITY AND SEVEN REPORTED THAT IT WAS TOO EARLY TO SAY

PART 2
GLOBAL REACH

"In a shrinking market, growth can only come by taking market share from others."

MANAGING PARTNER RESPONSE TO SURVEY

INTERNATIONAL APPEAL?

A slew of recent media reports featuring top 200 law firms opening high-profile offices all over the world have helped create the impression that international acquisition is a dominant part of UK legal growth strategy. But an analysis of responses to our survey suggests this is not the full story.

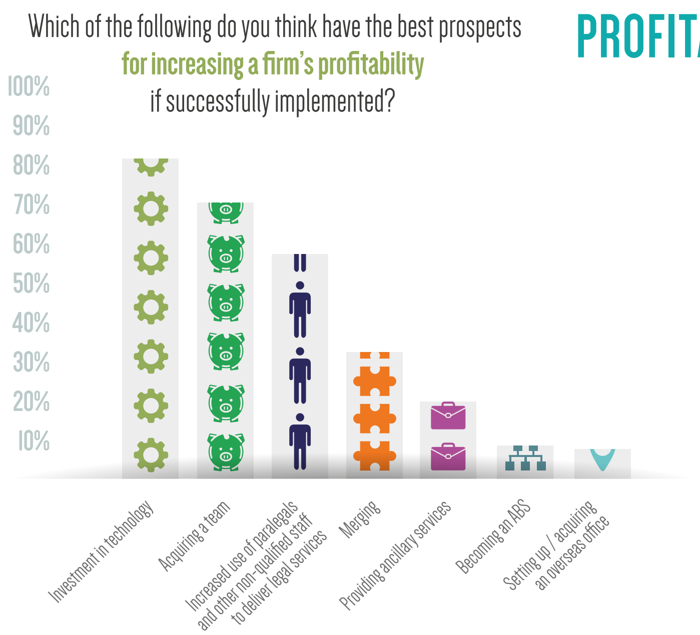
Instead, our survey ranked opening overseas offices as being the least popular means of increasing a firm's profitability, with fewer than one in 10 firms identifying the move as a top three growth strategy (8%). Moreover, not only was opening an overseas office viewed as less likely than other strategies to improve profits, it was considered as posing a greater risk to profitability than other growth strategies (nearly as high as that for an unsuccessful merger).

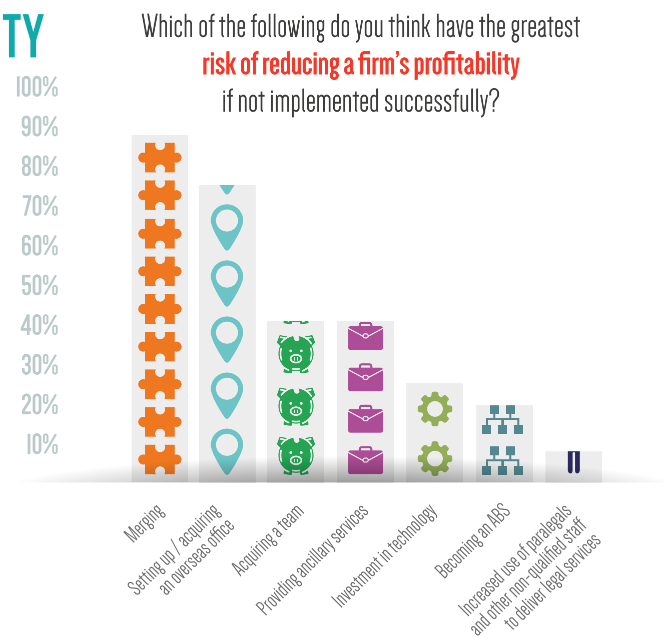
Despite many managing partners being, at best, lukewarm to the idea of opening overseas offices as a route to increasing profits, it is undeniable that firms are choosing to become more international in their outlook. It may be that even a marginal business case will justify an overseas office, if it avoids a key client going elsewhere in that jurisdiction, which could risk losing the client altogether. Also, irrespective of whether an overseas office generates significant profit, there is prestige and commercial advantage in extending a firm's footprint. To partners, size may matter less than profits, but clients will pay more attention to global reach than profit per equity partner (PEP) league tables.

DOMESTIC OR IMPORTED?

Undoubtedly globalisation and increased competition are forcing firms to seek international growth. But how

PROFITABILITY





should this be best achieved? Although nearly four in 10 managing partners responding to our survey saw organic growth as one of the best routes to improving a firm's international offering, eight in 10 would say the same of hiring a team. Acquiring a ready-made team to staff an international office can bring results more quickly than building out an office organically, one partner at a time, plus it has the prospect of bringing a mature book of local business, both of which are obviously appealing.

Finding a suitable team in an overseas jurisdiction can be tough, but as Tina Williams, chair of Fox Williams, points out: "Often the most fruitful approaches are to teams already working for international firms. Whereas team moves within the UK may be inhibited by restrictive covenants and lengthy notice periods, such restrictions are less common in other jurisdictions, removing some of the typical hurdles English firms are used to dealing with." However, Williams adds a note of caution: "There has to be a worry that a team that has moved once will do the same again if they are not happy in their new home. Ensuring a cultural fit is no less important than if the team was UK-based."

Law firm mergers were covered extensively in our 2015 report, The Dating Game, which found that increasing geographical reach (both at home and abroad) was cited by firms as a key reason for merging.

WHAT'S IN A VEREIN?

Taking a team or office may in some cases amount to an international merger where the target is a small single-office local firm, but large-scale international mergers have also been a significant feature of the UK legal landscape.

Large firms have pursued two distinct models of international merger: a single global partnership (or an approximation of one) or, increasingly, a looser affiliation, which appears to the outside world as a single unified business, but where each member firm retains its own regional profit pool, tax arrangements and partner compensation. The latter are often organised through a Swiss verein or similar.

The verein structure has many of the reputational benefits of a true merger, but as Tina Williams notes: "There is generally not total economic unity between the firms. There may be marketing under a single brand, an exclusive referral relationship, joint training, consistent quality control standards, a certain amount of cost sharing and alignment of profit sharing principles, but each firm will generally retain its own profits and independence and will seek to avoid liability for the acts and omissions of the other member firms. In that sense it is a merger in name only, avoiding the complexities of full operational and economic integration."

NETWORKS AND ALLIANCES: UNDERRATED ASSETS?

International networks and informal alliances rarely make headlines, but when it comes to improving a firm's international offering, our survey found them to be both popular and low-risk. Joining an international network can be an extremely cost effective way of achieving a global footprint. Our survey found that the matching of organisational cultures between member firms is perceived as an important but not critical factor for the success of this strategy. Some firms use it as a stepping stone, enabling them to get to know a market before launching their own international offering.

Hogan Lovells, for example, has in recent years extended its activities in Africa. As well as having its own office in Johannesburg, the firm undertakes considerable amounts of additional work across the continent and has in recent years deepened its relations with firms in Kenya and Nigeria, for example, developing and managing a network of relationships.

"In the past we may have had more relationships, but less closely managed," says Susan Bright, the firm's regional managing partner UK and Africa. "What we do now is encourage partners to manage these relationships much more closely and focus on two or three firms that we get to know really well in each country. So this is another way where you don't merge or have an alliance, but you do develop a close relationship to help deliver a better service to clients."

And, she adds: "My guess is that things will move on in the region. I expect international law firms that have developed those close relationships will ultimately merge with local firms over the next few years. But some firms in Africa won't want to join an international firm because they get significant referral work from firms around the world."

As far as filling gaps, a network can be created overnight, but does not compensate for what can take decades to accomplish organically. Lex Mundi, established in 1989, lays claim to a network of more than 160 member firms. As Eric Staal, the network's head of business development, points out: "Our policy in each situation is that member firms should first and foremost choose to refer work to firms overseas depending on what is in the best interest of the client, irrespective of membership in the network," he says. "Firms look for referral relationships – non-exclusive – and the network model offers greater flexibility for clients than the one firm model."

But can a successful network ever evolve into something more cohesive? As Staal admits: "Law firms opting for a network approach often are not interested in setting up an exclusive alliance with law firms across a range of jurisdictions. Exclusive alliances do tend to be much rarer – and tend to focus on very specific target markets – but networks can achieve a lot if the member firms make the necessary investments and have the right strategic focus."

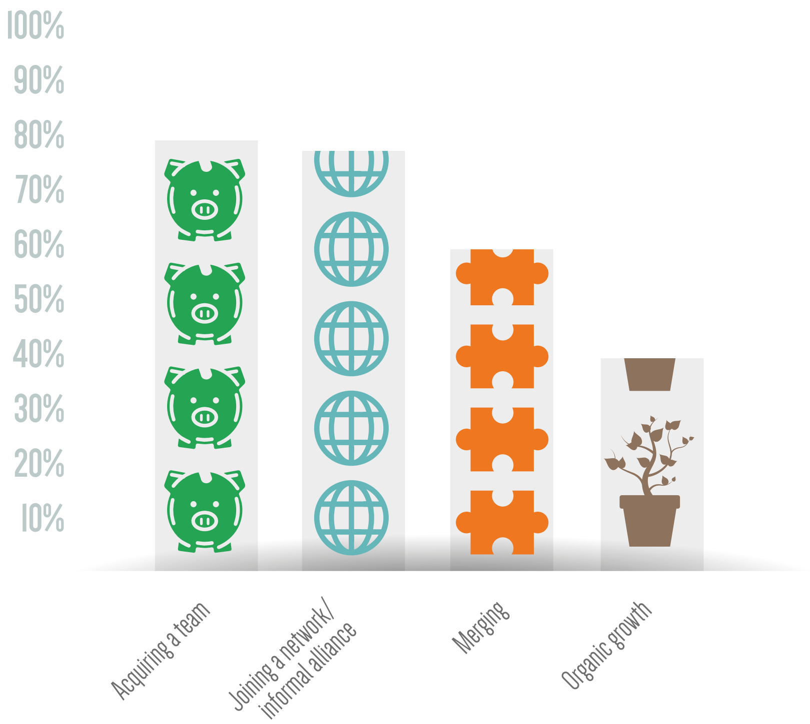
SO YOU WANT TO BE IN MY GANG?

There are nonetheless potential pitfalls within the network scenario. As ready-made entities they can suffer from patchy quality across their membership and it is not unknown for members of some networks to say they are happy to refer clients to firm A in their network, but would never entrust a client to firm B.

Because most networks are non-exclusive, individual partners within the member firms who have long-established relationships with foreign law firms outside the network may continue to work with those other foreign firms. This can then inhibit the strengthening of the relationship between network members. So whilst they may work, a lot of them don't work as well as they might. Networks may be low-risk, but they can also be low-reward.

But Staal says networks are not all the same. Some member firms have more of a proven track record for high quality work and coordinated advice than others. "We've come quite a long way over the years and invested in things like joint professional development as well as approaches to client service and management of client relationships. Client service and relationship management is a big challenge even for international firms, but most networks lack the resources to make these investments. I used to work for a magic circle firm and when I compare our programmes to what we did at the magic circle firm, our work is certainly of the same calibre."

Despite many managing partners publicly claiming to be interested in signing up to networks, only 8% of respondents to our survey envisaged their firm joining a network in the next 12 months. Perhaps those firms which see value in networks are already part of one and the strategic goal for networks is about getting value from what they have, rather than finding the right one to join.



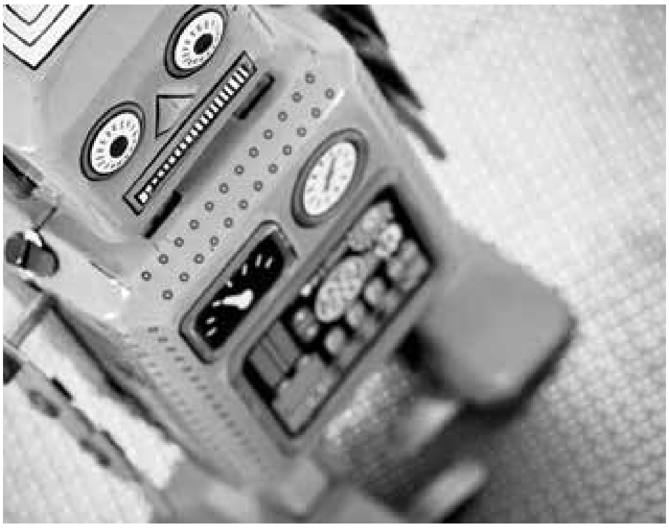
Q Which of the following do you think have the best prospects of improving your firm's international offering?

77% of respondents chose a network

PART 3
THE FIRM OF THE FUTURE

"Law will become commoditised and free legal services will undermine growth."

MANAGING PARTNER SURVEY RESPONSE



WE HAVE THE TECHNOLOGY...

Today's law firm offices may bristle with the latest computer hardware and give every appearance of being cutting-edge modern working environments, but managing partners are still fixated by the same concerns as their 20th century predecessors – billing rates, utilisation and fee-earner ratios. As much as commerce has moved with the times, these established building blocks of a successful and profitable law firm have remained consistent. This looks set to change, as some law firms diversify away from traditional legal services into packaged products and non-legal sectors, whereas yet others invest in technologies with the potential to revolutionise law firm economics.

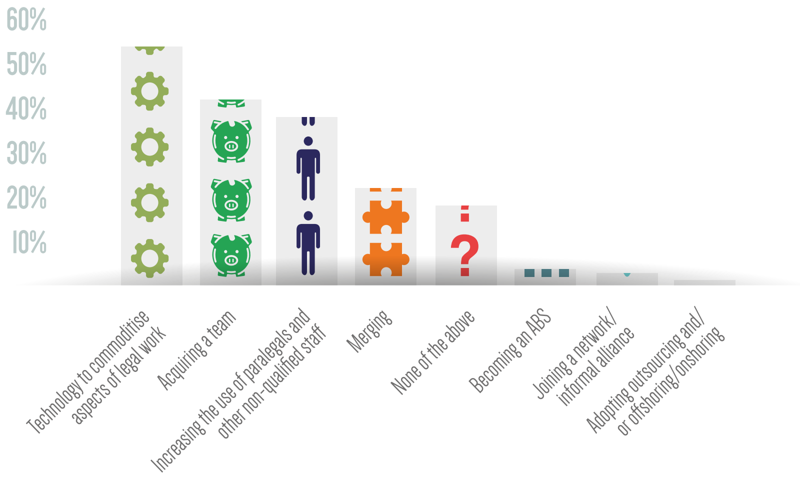
The traditional law firm business model will not disappear overnight, but there are now other options which challenge the orthodoxy of how law firms make money.

IN WITH THE NEW

In our survey, investment in technology, properly implemented, was identified by 83% as being one of the essential strategies for boosting a firm's profitability. And many managing partners are putting their hands in their pockets to back up their commitment. More than half (55%) said they have made a substantial (over £100,000) investment in technology within the past 12 months.

Transformation is already happening in the legal profession and, as Jonathan Watmough, managing partner of RPC, suggests, it will bring with it opportunities. "It is very exciting," he says. "This is probably the most exciting time I've seen in my career – as long as you're prepared to accept change."

Q In the last 12 months has your firm made a substantial investment (more than £100,000) in the following?



A willingness to accept change is an important qualifier. Historically, lawyers have been reluctant to embrace change, but now there is a common acceptance among managing partners that a failure to innovate risks hitting profit margins. Yet although most law firms have committed big investments to technology others are still playing catch-up.

Some law firms have embraced technology as 'early adopters' while others are watching their competitors to see what works and what fails. Some firms are developing bespoke in-house products, whereas others are choosing off-the-shelf. An example of a good bespoke product is PwC Legal's Entity Governance and Compliance Portal which provides clients with instant access to entity governance and compliance requirements in over 70 territories around the world: "We have embraced technology to a much greater extent than most law firms, employing a wide range of proprietary online tools, programmes and databases and – wherever possible – we are using technology to deliver our services to clients," says Shirley Brookes, UK managing partner of PwC Legal.

Firms cannot invest in every new technology that shows promise, but nor do they have the luxury of taking too long in choosing where to put their money. Nyembo Mwarabu, vice president, EMEA, Xerox Legal Business Services, recognises the challenges: "Law firms generally have been more cautious about change than other industries. For example, while artificial intelligence (AI) has advanced in certain fields, such as marketing and advertising, legal teams have been slower to embrace analytics."

Mwarabu adds: "A perfect storm is brewing – explosive growth in volume and sources of data requiring legal review, increased regulatory scrutiny and unprecedented fines and legal settlements. Leading law firms are adopting new 'big data' analytics systems to stay relevant and competitive. Plus, as they see AI and machine-learning take off in other areas, we'll see faster adoption than in the past, based on the paths these firms are taking."

If, as is the promise, technology can increase profits and improve client service at the same time, it is unsurprising that firms want to jump on the bandwagon. But those firms coming at it from a standing start will struggle to turn their investment instantly into profit.

PRESSING THE RIGHT BUTTONS

The risks of a botched technology implementation are well understood in the wider business world. It is questionable whether lawyers, even those who embrace change, have the skill set best suited to implementing new technologies and running businesses which are centred around them. Surprisingly, just 16 respondents identified a failed technology implementation as carrying a serious risk of reducing profitability.

Derek Southall, partner and head of innovation and digital at Gowling WLG notes: "The technology has shifted up a gear and it will be fascinating to see how people will exploit it. Law firms may find they need fewer people, but the technologies aren't cheap. If they get their decisions and the implementation right the technology could bring with it considerable profitability, but if they get it wrong the opposite could be the case." He adds: "The challenge for law firms is not that they don't want to change, it is understanding that they may not be able to do everything and making the right judgement calls when investing. They may have to decide which areas of business they will support and which they won't. It's a bit like asking someone which of their children they want to feed. It is much easier for a niche firm just focused purely on one area, for example, but if it's involved in multiple areas the decision making process will be much more difficult. Law firms will increasingly distinguish themselves by the decisions they make and even within specific practice areas it may become harder to compare law firm's offerings."

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>
> NYEMBO MWARABU, VICE-PRESIDENT, EMEA, XEROX LEGAL BUSINESS SERVICES

What is important is that law firms recruit new technology experts who fully understand the legal market. One senior IT and digital services manager at a top 100 law firm told us that he had spent the last 15 years working in accountancy practices bringing their IT platforms up to speed. "Law firms are always behind the accountants when it comes to technological innovation – now the same IT experts who got the accountants working with digitalised services are doing the same thing for the law firms. We have basically moved across professional service sectors and are being paid to reinvent the wheel."

SOUND INVESTMENT

As law firms move towards using technology as a means of delivering their core services, rather than just supporting their lawyers in doing so, they will inevitably become more capital intensive businesses. At present, a senior law firm equity partner may have to contribute several hundred thousand pounds to his or her firm, but will expect to reap profits from that investment many times over. Such returns on business investment capital are rare in other industries.

The suitability of the traditional partnership model for making investments in technology is questionable. Although regulatory changes have in theory allowed for outside investments, perhaps even a stock market listing, to date, Gateley aside, no major UK law firm has taken advantage of those rules. A further push towards deregulation due in 2017 may remove the regulatory hurdles that are preventing firms from raising capital in this way. Without outside investment, firms may well struggle to realise their ambitions without taking on large debts or requiring partners to contribute substantial capital.

For start-up firms and many on the high street, there is no realistic prospect of ever raising the capital needed to develop bespoke systems. These firms will continue to buy off-the-shelf technology to enhance their legal service to clients. Ed Turner, managing partner at Taylor Vinters, observes that the Cloud's limitless digital storage capacity has evened out the legal services playing field: "It costs a relatively tiny amount to start up a law firm. You can scale it very easily. You can buy Xero for your accounting package, Dropbox for your document storage and away you go."

Derek Southall agrees, "The increase in cloud based machine learning as a service model (MLSaas) effectively allows pay as you go AI. Blockchain could also be game changing for the profession with smart contracts and more. A lot of investment is going into this area but many in the market are struggling with understanding the extent to which this will impact and where the sweet spots are."

Although digital legal services platforms offer a lower-cost access to better technology, they risk firms losing their distinctiveness. As banks have found, it is the tech companies, rather than the core banking businesses, which ultimately benefit from disintermediation. This is because there is a risk that savvy clients will simply go directly to the legal service platform and avoid hiring a lawyer at all.

Says James Roome, London senior partner at Akin Gump: "There may be fewer in-house lawyers who have to go outside for legal advice because the technical materials will be much more available online. There are advances being made in technology, such as increased customisation and user friendliness." Derek Southall agrees, saying of clients: "If they can then purchase the technology as well, it begs the question what work will law firms be given?"

WHAT'S THE LEGAL ALTERNATIVE?

The bigger law firms have packaged some of the repeat transactional services which are delivered from cheaper off-shore and on-shore centres. Many law firms have opened low-cost centres to handle all of their process-driven legal work.

So called 'disruptor' legal businesses have entered the market and are competing with traditional law firms by offering clients a more streamlined and tech-enabled service. A good example is Axiom, with over 1,500 employees across three continents. It focuses on improving the way legal, compliance and contracts work is done.

Nevertheless, Roome predicts: "The winning firms will be those with a high advisory element and a reputation for having excellent people, rather than those who dominate volume transactional work. I suspect that large parts of bond issues, M&A and private equity transactions will become more commoditised than they are today." But remember Derek Southall's questioning of whether there will be the same value to a partner's expertise when technology can analyse wide banks of information.

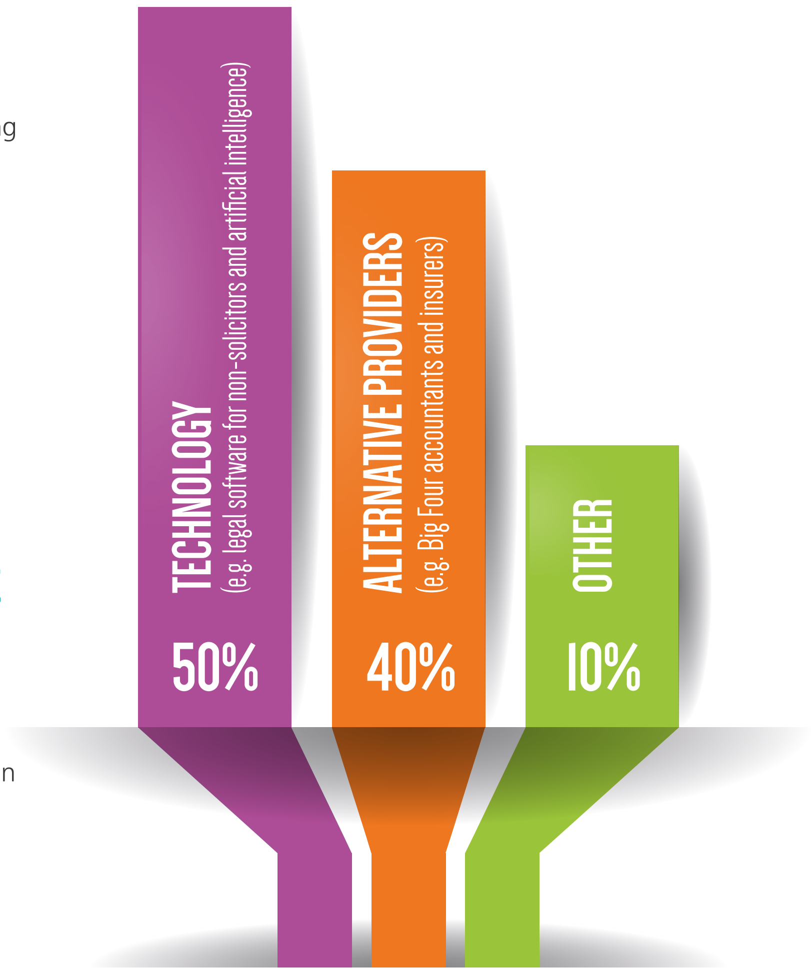
DIVERSIFICATION IS THE NEW NAME OF THE GAME

Rapidly evolving technology is not the only change law firm leaders are grappling with today.

Perhaps the most pressing challenge facing mid-tier practices is the growth potential offered by diversification into parallel services. Again it is the accountants and international consultancies which have led the way, offering clients new in-house or bolt on services – including discrete legal advice and legal business transactional work. So what managing partners may have first considered a business opportunity is also being turned to present a direct threat to their own offering.

RPC has diversified its business along three discrete service offerings: RPC, RPC Consulting and GC Services. RPC Consulting advises those in the insurance or related sectors, utilising a team of actuaries, accountants, MBAs and PHDs, all of which specialise in insurance. Last year it acquired UK-based software and consultancy business, Marriott Sinclair, which provided software and actuarial consultancy to the insurance, banking, and wider financial services communities. The deal saw three of Marriott Sinclair's principals become partners in RPC Consulting.

Q What do you think is likely to be the biggest threat to the profession?



> "Our primary business happens to be the law, but we are increasingly a broad-based City professional services firm. People think what we've done is tremendously innovative – and it is if you're looking from a traditional law firm perspective – but it was a logical thing for us to do."
>
> JONATHAN WATMOUGH, MANAGING PARTNER, RPC

Marriott had developed a software solution called Tyche, a state of the art financial modelling tool that explores the many uncertainties affecting the financial outcome of projects, strategies or business opportunities. It helps to empower clients struggling with decision making, particularly in a regulatory environment demanding an ever greater awareness of risk.

"We wanted massively to magnify the law firm brand and offer a wider range of services to our legal clients," explains Jonathan Watmough, managing partner of RPC. "This is the first time a commercial law firm has provided insurance clients with a full menu of actuarial, risk and management consulting services," he adds. "Our primary business happens to be the law, but we are increasingly a broad-based City professional services firm. People think what we've done is tremendously innovative – and it is if you're looking from a traditional law firm perspective – but it was a logical thing for us to do."

THE NEW MODEL LAW FIRM

As the traditional law firm structure adapts to meet the twin challenges of new technology and alternative business models, the need for non-lawyers in senior positions is intensifying.

Alastair Beddow, of professional service consultants Meridian West, says: "Some law firms are realising that delivering change to their business models may need experience from the wider business world. A variety of different types of law firm, from Nabarro to Ashurst to Weightmans, have added non-executives to their board who are not lawyers in recent years, but who bring commercial experience and expertise around strategic planning, innovation and change to help firms unlock opportunities for future growth."

RPC's Watmough says: "After the Marriott Sinclair deal our offices suddenly contained 16 people with PhDs in maths – that provides an idea of the calibre of those involved. Lawyers think they're smart people – and they are – but these are a different type of smart person and their presence has changed the place for the better."

That said, he feels RPC's approach may not appeal to others; at least for now. "I don't get much of an impression other law firms would necessarily do what we've done," he says. "I think part of the reason for this is that we're taking a very long-term view in developing this part of the business. Our investment in Marriott Sinclair represents a very, very long-term commitment."

So it is not difficult to envisage the law firm of the future being staffed by people with a more diverse skillset, fewer lawyers and more technology experts. Law firms will be replacing selling the services of solicitors with, at least to some extent, charging for access to their technology. The degree of human intervention required to address those aspects of a matter with which computers will struggle is not yet clear, but it seems inevitable that the need for human input, and thus jobs for solicitors, will be reduced. Ultimately, investing to adapt to this changing world may prove to be more important than sheer size or today's profitability. The chilling factor is that, whilst lawyers in the past may have had a monopoly on legal knowledge, clients can already access that knowledge directly by buying the technology for themselves.

CLOUD COMPUTING

The 'cloud' may be a prosaic name for a collection of anonymous data centres, but the resilience and flexibility gains in putting IT infrastructure in the hands of external experts has generally been a success for firms, notwithstanding the security worries many law firms initially had.

EXAMPLES

Dropbox, Salesforce.com, Google Apps

WHERE WE HAVE BEEN...

AGILE WORKING

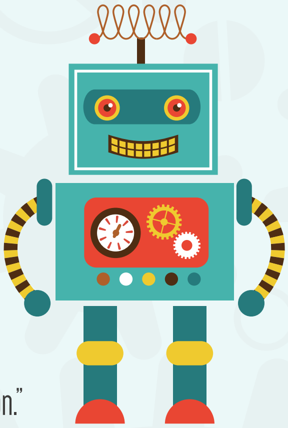
High real estate costs, the expectations of a new generation of lawyers and the demands made by lawyers who wish to balance a family life with their career have made agile working a reality for many lawyers. The ubiquity of agile working should not detract from the fact that technology has empowered lawyers to work seamlessly anywhere there is an internet connection.

EXAMPLES

Citrix, Good, Skype for Business

AUTOMATED DOCUMENT REVIEW

Reliance on computers to judge the importance of documents is gaining traction in both contentious and transactional matters. Xerox Legal Business Services' Nyembo Mwarabu explains: "as data volume and complexity grows, innovative firms will look to AI-based solutions capable of performing much of the work manually completed by lawyers today to automate workflow and quickly sort document collections to just those that their clients should set eyes on."



EXAMPLES

Xerox Document Review, FTI Ringtail, Kira Systems

ROBOLAWYERS

Humans may consider themselves to have a monopoly on giving sound legal advice, but artificial intelligence is catching up. Versions of IBM's AI product Watson can already accept questions in plain English, review all relevant law and deliver a a fully referenced answer. It is not a huge step from today's systems to a consumer-facing product with zero or minimal human lawyer input.

EXAMPLES

IBM Watson (AI), Arria (natural language processing)

...WHERE WE ARE TODAY...

...AND THE INVESTMENTS OF TOMORROW...

LEGAL ANALYTICS

Data analysis is replacing subjective metrics in guiding law firm and client decision-making. Patent litigation in the US has been at the forefront of these developments. Derek Southall, partner and head of innovation and digital at Gowling WLG notes of market leader Lex Machina: "[it] can be used to schedule all IP decisions related to patent technology. If looking to bring a case against a company, for example, you can see what has happened previously and determine in which state to bring a case and which law firm to use to deliver the maximum chances of success."

EXAMPLES

Lex Machina, Premonition

BLOCKCHAIN

Most closely associated with Bitcoin, blockchain technology has the potential to provide a trusted non-governmental ledger. The potential for e-currencies has been recognised, with the potential for using the technology for contract execution and public registries yet to be fully explored. Jon Segal, partner and FinTech specialist at Fox Williams, notes: "a blockchain could be used for a negotiation process for complex contracts and projects, be highly resilient against unauthorised amendments and offer a self-managing record of the entire negotiation, potentially without any manual inputs from junior lawyers."

EXAMPLES

Bitcoin, Eris Industries, Smart Contracts

ABOUT THE AUTHOR

ROBERT VERKAIK

Robert Verkaik has been reporting on the law for more than 25 years. First as a court reporter then as City correspondent for the Law Society Gazette, more recently as legal affairs editor of the Independent newspaper before taking over the legal affairs and security briefs at the Mail on Sunday. He was the Bar Council law reporter of the year in 2002 and was called to the Bar in 2006. He is currently working as a freelance writer.

He was assisted on this report by Daniel Hayes. Daniel began his career as a reporter on the Law Society Gazette before working for several leading contract-publishing companies. His recent writing credits include national newspapers, such as The Daily Telegraph and The Independent, in addition to a wide range of consumer and business-to-business magazines. Dan is also a former production editor of the online legal news and comment digest, The Global Legal Post.

ABOUT BYFIELD

Byfield Consultancy provides insightful communications campaigns for law firms that enhance their commercial success and protect and grow their reputation.

Byfield also work with law firms to protect the reputation of their clients during litigation and other high profile risk events.

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