

REINVENTING THE LAW FIRM BUSINESS MODEL:

Making the Most of Business Development Opportunities and Driving Long-Term Growth

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INTRODUCTION

Factors such as global competition, legal process outsourcers, changing regulatory requirements, rapid mergers and dissolutions, and alternative fee arrangements have shifted the legal marketplace into one of seemingly constant evolution.

A great example of this evolution can be found in the pressure general counsel and corporate legal departments are placing on firms to deliver services at lower, more predictable costs. On one hand, firms are being asked to re-evaluate processes from back-end operations to matter-based project management, while on the other they're being expected to create and implement new strategies on everything from budget forecasting to reducing costs.

To drive business growth, law firms must adapt to these challenges and opportunities by defining unique relationships that set their firm above the rest. It is not enough to simply provide the same services to the same clients but simply bill for them on a flat fee basis instead of by the hour. Law firms need to differentiate themselves and re-envision how their business is constructed – from the services they offer to the clients they serve – to evolve.

Rather than proceeding with business as usual with a different price tag and hoping for a positive outcome, many of today's most successful law firms are to undertake an examination of how their business model is built for the "new normal". By designing a practice tailored to fit today's marketplace, law firms can position themselves to better create and protect future profitability. Such an approach involves focusing on but is not limited to four key dimensions: Client Selection, Pricing and Profit Model, Scope of Activities, and Winning and Keeping the Business. This framework can help attorneys capitalize on business development opportunities and drive long-term business growth.

CHAPTER 1

Client Selection: Finding Your Niche

Client Selection – targeting specific clients and building a practice around a niche – involves a shift in the law firm's traditional notion of the client.

A good portion of firms today play to their strengths, focusing on what they do best and trying to find clients who need those services. The concept of Client Selection in a business design puts clients' needs at the forefront, vs. firm assets and core competencies. By building a firm around client priorities empowers a firm's practice areas and skillset to be congruent with client needs.

This for example may mean placing a greater focus on a smaller share of the market than many firms do today. Some attorneys are concerned that creating a niche means losing out on business from clients who are outside of their focus area. They operate under the belief that any client who comes to the door represents a potential revenue opportunity.

But even a general service law firm needs to focus practices around clients' needs. Simply offering a range of practices, and hoping clients are out there, won't build a profitable practice.

The essence of client selection is not about excluding clients, but about homing in on a particular segment of clients that yields the greatest potential for profit. It's foundational to developing a long-term growth strategy. Attempting to be all things to all people will not automatically translate into a greater number of profitable business development opportunities.

The Law Tigers (see sidebar) provide an interesting example of how targeting specific clients is beneficial in more ways than one. Focusing on a niche allows a firm to realize strong marketing efficiencies, while building a business that leaves competitors out of the running.

Beyond losing a chance to focus more completely on truly profitable clients, attorneys who are not specialized may lose out to those who are. With firm reviews and lawyer rankings at potential clients' fingertips, clients can easily find the firm or attorney with the expertise they need. Attorneys in today's market simply cannot afford to be seen as the cliché "jack-of-all-trades but master of none."

LAW TIGERS: Client selection is at the heart of the Law Tigers' business model. The network of attorneys has a specialized niche: plaintiff suits involving motorcyclists who have sustained personal injuries in traffic accidents. To attract clients, the national association advertises in bike owner organizations, such as the Harley Owners Group. Law Tigers even offers a free Rider Benefit Card. Cardholders get free phone advice on legal matters involving motorcycle ownership, motorcycle insurance disputes and state motorcycle laws.

TAKE FIVE

These questions can serve as a starting point for determining your firm's customer selection.

1. Who are our current clients?
2. Who do we want as clients going forward, and who don't we want as clients in the future?
3. Which clients, industries and practices are most profitable for us and represent the greatest growth opportunities?
4. What do our target clients do for themselves, and which needs of theirs can we help meet?
5. How do we need to change to best handle our target clients' needs?

¹Variations of these dimensions and the associated concept of an overall business design were first enunciated by Adrian Slywotzky and David Morrison in their book *The Profit Zone*.



CHAPTER 2

Pricing and Profit Model: Choosing a Sustainable Profit Model

Traditionally, law firms' profit models have been based on the billable hour. With clients paying an hourly rate that exceeds the variable cost of labor, and the gross revenue generated is offset by fixed costs, including real estate expenses, non-attorney labor, and marketing and business development.

As long as the firm's fixed cost base is well-controlled, and hours are routinely captured and billed effectively, the firm is profitable. This model uses the classic "bill more hours at higher rates" approach to increase firm profitability.

The risk in today's landscape with this approach comes when the total demand for services falls below the supply; a firm can only do so much to reduce its fixed costs. Firms facing market pressures may try to win business by cutting rates or offering substantial discounts off of standard rates, which can quickly undermine profitability and result in a death spiral as equity partners take their billings to better-performing firms.

Focusing on a sustainable pricing and profit model can help to ensure that firms avoid the death spiral. Several profit models offer ways for firms to capture a portion of the value they bring to clients that do not depend on the traditional billable hour. While several models exist, the following four may be particularly useful for law firms looking to evolve their business.

Total Solution

The Total Solution profit model involves addressing the full range of clients' needs – legal issues and allied business concerns. Developing solutions requires a major initial investment to understand clients and their needs, create the solutions, and cultivate a client relationship. But the end result is a client that relies heavily on the firm, which ensures long-term profits.

Consider the approaches of two firms targeting clients in the food industry. Firm A is a traditional firm focused on the food industry, helping its clients with litigation that arises from recalls and poisonings. Firm B positions itself as business partner that provides food safety solutions, helping clients assess risk, create new systems and processes based on best practices, and audit compliance. By following the Total Solution model to capture value, Firm B is better positioned to drive long-term growth.

The Total Solution approach paid off for WeVorce, an online service with the slogan, "Divorce is more than a legal problem." WeVorce generates the legal documents couples need to complete the divorce process, and promises clients the tools they need to begin again. The company invested significant time and effort to develop tools by which spouses can split. The company promises "a lifetime of tools, knowledge and agreements as you begin again." WeVorce now has well-established mechanisms that can be applied quickly, efficiently and repeatedly, to drive business growth.

First Mover

First-to-market firms can command premium pricing. This can be sustained until viable competitors enter the market. In the legal market, first movers may be those that address new legislation or regulations, such as Dodd-Frank, or those that establish a task force on an emerging issue, like cybersecurity breaches.

Given the ready accessibility of precedent in the legal space, the window for first movers is small. But for genuinely innovative firms, it can be highly lucrative. See the example of Wachtell Lipton in the sidebar.

This increased notoriety among the clientele has also allowed Wachtell Lipton to employ another unique aspect to its pricing and profit model: Rather than sending a bill based on hourly rates and time worked, the partner who oversees a client relationship simply invoices for the perceived value of the advice provided. The firm's innovative reputation gives it permission to bill in this manner, and leaves clients with little choice but to pay. The firm consistently ranks at or near the top of AmLaw's league table of the "Profits per Equity Partner," with PEP in excess of \$5.5 million in 2014.

Spin-Off

Seyfarth & Shaw offers a prime example of the Spin-Off model. The full-service law firm with a focus on labor and employment, or L&E, found that many L&E matters lend themselves to streamlining. Seyfarth applied "Lean" principles – which originated in the automotive manufacturing industry – to its practice, significantly reducing costs in certain L&E matters. The firm's expertise in applying lean management to professional services led to the creation of SeyfarthLean, a subsidiary that advises other professional services firm, excluding law firms, on how to improve the efficiency of their own processes. SeyfarthLean provides options to the wider firm of new ways to serve clients, and a wider pool of potential clients.

Product Pyramid

The Product Pyramid model focuses on providing high-price products that may be low-volume but with a high profit margin. It also works with lower-price, high-volume products, where the per-unit profit margin isn't high, but the volume of units moved drives the overall profitability.

Many law firms, particularly mid-sized firms, are increasingly concerned about the potential impact of emerging businesses like LegalZoom, as these new business models are starting to steal business away from the traditional brick-and-mortar law firm. LegalZoom and other non-traditional legal services providers have allowed some clients to bypass attorneys for basic transactional needs. Clients are drawn to the cost effectiveness of this model and the convenience of generating legal documents without paying a lawyer.

It is not impossible for law firms to combat this disruption, though. Few if any firms have taken the step yet of creating a competitive online offering, but were a firm willing, the firm could create an online library of documents for low margin, high-volume transactions, like business entity creation or will drafting. The firm could charge a modest fee for the documents, and the firm would then be the logical choice for any follow-up support the client may need. This is the quintessential lower-price, high-volume Product Pyramid model.

An example outside of the legal environment comes from H&R Block. As the company has faced increasing pressure from market disruptors offering software and online tax preparation tools, H&R Block employed an example of the Product Pyramid model to fight for its place in the market. Known primarily for its in-person tax preparation services, H&R Block developed its own software solution, originally called TaxCut. H&R Block began offering several versions of the software, each with an increasing level of sophistication and features that allow users to upgrade their service and purchase add-ons, capturing additional revenue. While H&R Block continues to offer its traditional tax preparation services, its broader product pyramid helped the company avoid a significant decline in its share of the tax prep market.

Introducing a new profit model concept in the legal space is challenging. The Total Solution, First Mover, Spin-Off, and Product Pyramid models are among those helping law firms to flourish. How a firm captures profit is a critical dimension of its overall business design that must be carefully considered alongside its client selection, scope of activities, and strategy for winning and keeping the business.

POISON PILL: Martin Lipton, a founding partner of Wachtell Lipton, is a highly sought-after advisor to the boards of the world’s largest corporations, due primarily to his reputation of bringing elegant innovations to bear to address complex issues facing his clients. One example of such an innovation is the introduction of the “poison pill,” allowing companies targeted for hostile takeovers to fend off unwanted advances from corporate suitors simply by amending their articles of incorporation. Such innovations have given Wachtell Lipton opportunities to enjoy “first mover” status, and raised the firm to higher levels in the minds of their clients.

TAKE FIVE

These questions can guide your firm’s discussions around pricing and profit model.

1. How do we currently generate profit?
2. Based on the practice we are trying to develop, is there another profit model that might work better?
3. How would our clients expect us to price it and bill for it?
4. Are we doing something innovative for which we can charge a premium?
5. Could we provide additional value-added services, such as discounts on related work, or complimentary updates on compliance and practice area developments?

CHAPTER 3

Scope of Activities: Figuring Out What You Do, and What You Don't

Re-envisioning the law firm model also involves evaluating the scope of activities offered to clients, which includes both the processes necessary to directly serve clients' needs as well as those required to operate a business.

In a litigation practice, for example, the first category of processes would include things like client consultation, pre-trial motions, discovery, depositions, and court appearances. The second includes general functions like finance, human resources and back-end operations. A firm's choice of activities in both categories shapes its strategic approach to winning business.

Increasingly, law firms can pick and choose the specific services they wish to provide to meet client needs. However, this has been made possible not through the actions of the law firms themselves, but instead because of new entrants to the legal services industry that are "picking apart" the sequence of steps involved in serving legal needs.

For example, as discussed in Chapter 2, Pricing and Profit Model, the rise in non-traditional legal services providers has allowed some clients to bypass attorneys for basic transactional needs. As new entrants to the legal space, such as legal process outsourcers, re-shape the market, law firms must adapt by examining their scope of activities to ensure that clients' needs stay front and center.

Law firms tend to frame discussions of their activities around their practice areas. But this approach limits the range of choices law firms have to consider, and emphasizes the firm's priorities over those of clients.

As discussed in Chapter 1, Client Selection: Finding Your Niche, client needs should be at the forefront, rather than an afterthought. By emphasizing clients' needs – rather than the firm's assets and core competencies – a firm can develop practice areas and competencies around the demands of the market.

LEGAL PROCESS OUTSOURCING: Pangea3® is a legal process outsourcer with a well-defined scope of activities. Outside the mold of a standard law firm, Pangea3 delivers services that are peripheral, but still important, for corporate law departments. The company provides services that do not necessarily require a fully licensed, U.S.-based attorney, and therefore, relative to a law firm, it can deliver services at a far lower cost. For example, its corporate services offerings include contract management and abstraction, which are labor- and technology-intensive processes that are not well suited for most lawyers and their firms. And while originally a direct competitor to law firms, LPOs such as Pangea3 are increasingly being seen as a means for law firms to outsource potentially unprofitable activities. This enables firms to continue to offer a broader range of services, but place primary focus on those activities that are the most profitable. (Disclosure: Pangea3 became part of Thomson Reuters in 2010.)

ON-DEMAND LEGAL PROFESSIONALS: Eversheds, a London-based Magic Circle firm, makes the most of its scope of activities with its subsidiary, Eversheds Agile. The subsidiary leverages the firm's ability to attract, select and place qualified attorneys and staff on projects, including those that are not being overseen by Eversheds itself. Eversheds Agile touts itself as meeting "a demand by clients for temporary, high-quality legal professionals that provide peace of mind and a link to an international law firm. It sells vetted legal resources – who may or may not be part of the core Eversheds firm – by the week or by the project. In market vernacular, this practice has come to be known as a secondment, and it can be a highly lucrative way to leverage a firm's experience amongst potential new clients, while also learning the client's business literally from the inside out. Eversheds itself gets the benefit of offering a whole new range of services to clients it may not otherwise be serving, while keeping the primary focus of the firm as a whole on its key profit drivers.

TAKE FIVE

These questions can steer your firm's discussion around your scope of activities.

1. What new activities are we already prepared to handle, and which ones could we gear up for?
2. Which activities are beyond our expertise? Can we learn those?
3. Are there activities that would be more profitable for us to outsource?
4. Are there activities we can absorb as insourced work?
5. What activities are we currently handling that we need to stop doing?

CHAPTER 4

Winning and Keeping the Business: Differentiating Your Firm

All of the thought around client selection, pricing and profit model, and scope of activities does not matter if your firm cannot capitalize on new business development opportunities and win the business. To do this, a law firm must set itself apart from its competition. Traditional businesses may differentiate themselves in a number of ways, ranging from a slight price advantage (like a gas station) to being a business that really owns the standard in a given industry (like Microsoft®). While a business that “owns the standard” is in a very strong position to protect its profit stream, it is highly unlikely that any law firm can truly own the standard in a given practice area, at least for long. Too often, law firms try to win business based on much less dynamic differentiators.

Many law firms rely on their brand when thinking about differentiation. But a firm’s brand may not be as strong as the firm believes it is. After all, it is the market’s perception of the brand that matters, not the firm’s.

For example, a regional law firm may be very well established in its key markets, but may be an unknown outside its geographic area. What if the firm expands beyond its home territory? Such a firm may be in a very weak position if it is trying to win business based on its perceived brand strength. The firm may find itself in a much weaker position, being seen as a commoditized resource, where the difference would come down to cost.

Firms that differentiate themselves solely on cost struggle to protect their profits. If a firm can sustain a cost advantage but can’t otherwise differentiate itself, it could get into the lawfirm equivalent of an airline fare war.

Simply giving clients a discount on hourly rates won’t lead to sustained profitability, unless those discounts are supported by a structural edge in fixed and variable costs. This is where process improvements and project management come in to play for firms looking to differentiate based on cost advantages. But with so many other ways to differentiate a firm, ideally cost would only be part of the answer.

Many successful firms are finding the answer lies in shifting from name recognition to ownership of client relationships. The emerging focus on client and industry teams is a strong indicator of this trend. BTI Consulting Group’s “Client Service 30” report highlights the advantages of providing exceptional client service, including 30 percent higher profits and 35 percent higher client retention.²

With results like these, it’s easy to see why firms focus on owning the client relationship. What’s tougher for many firms is making the transition.

Shifting to owning the client relationship means considering questions such as, “Who really owns this relationship? Is it the firm, or the relationship partner? If it is the partner, what can the firm do to gain more control over that relationship in a way that won’t cause friction with the partner?”

Particularly the last question may be very difficult to answer, but a firm’s answers to these questions could involve major changes in a firm’s business design. As the Client Service 30 report results demonstrate, these can be tough questions, but they can be well worth asking. Differentiation is key to defining the unique relationships that set it above the rest in the market.

BRAND STRENGTH VS. OWNING THE CLIENT RELATIONSHIP:

The saying, “No one was ever fired for buying from IBM,” reflects IBM’s strong reputation for competence and reliability. An equivalent statement might be made for Kirkland & Ellis, given its reputation for representing companies in complex, high-stakes issues. The general counsel who selects this firm will not be faulted, even if the final outcome is adverse.

Kirkland has maintained its reputation by being consistently among the best over a period of several decades. Its internal processes – from recruitment, training, evaluation and promotion – focus intently on ensuring that only those attorneys who repeatedly deliver positive results thrive at the firm.

Kirkland’s ability to rely on brand strength is different than Littler Mendelson’s approach to differentiation. Littler is a firm with full-service capabilities and a particular focus on labor and employment. One way Littler protects its stream of profits is through its case management tool, CaseSmart, which combines Littler’s proprietary technology platform with quality assurance measures.

CaseSmart stores the firm’s clients’ labor and employment contracts in a single central repository, so that Littler attorneys and clients can consult documents whenever a contract-related question comes up. Were the client to want to transfer their documents to a competitor firm’s system – provided one even exists – it would be expensive and time-consuming. By offering a powerful solution integrating its systems within its clients’ operations, Littler owns the client relationship, an incredibly strong point of differentiation and an effective way to keep the business.

TAKE FIVE

These questions can help your firm determine how to best win and keep the business.

1. How do we differentiate ourselves?
2. Among the clients we’re targeting, where do we win their business, and once we have it, how do we keep it?
3. What are we doing to innovate?
4. What do we do better than our competitors? What do our competitors do better than us?
5. Does our firm own the relationship with our clients, or do we rely on one or two partners to do that?

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²<http://www.btibuzz.com/buzz/2015/1/7/7-lessons-from-the-client-service-a-team.html>.

CONCLUSION

The business design framework – client selection, pricing and profit model, scope of activities, and winning and keeping the business – can guide attorneys and law firms toward developing sustainable, profitable business models. By assessing the drivers and trends shaping the legal market, and taking a strategic approach to everything from how the firm finds clients, to creating and capturing value for those clients, the firm can create and maintain profit streams. Winning business in the face of changing market forces is a challenge; the business design framework can help law firms make the most of business development opportunities and drive business growth for decades to come.



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