

Why Law Firms Should Restructure Immediately

Just what is going on here? Consider these headlines:

"Europe's largest law firm merger with US financial power"

"Regional powerhouse law firm closes its doors"

"Litigation superstar bolts city's largest firm to start boutique practice, 20 lawyers follow"

"Major IP firm merges with technology power"

"Law firm terminates 20 partners, de-equitizes 15 others"

"Brand name firm poaches practice group from midsize firm, midsize firm seeking suitor"

"Big accounting firm considers next step in legal industry strategy"

These headlines are all fictitious--some effort must be made to protect the guilty--but every one of them represents at least one, and generally a number of real life situations that have played out over the past 12 months. How can an industry, any industry, experience so much turmoil?

To understand these and other events, we must start from the proposition that the legal industry, to a greater extent than almost any other industry today, is undergoing a radical restructuring. In 10 years the present structure of the industry may be entirely unrecognizable. All of these events are part of a process that will ultimately take the legal profession from where we are today, to where we are going. But what does this mean? What is the nature of the restructuring and where are we heading?

The Legal Industry--Yesterday and Today

Much has been written about change in the practice of law, but relatively little has focused on the structure of the legal industry. Historically, and continuing today, the **legal industry** has operated on a model approaching pure competition. For purposes of this discussion, this means that:

There are a large number of individual businesses (law firms) competing for all or most legal work.

Each geographic and most specialty niche markets have multiple competitors, none of which can dominate the practice.

Individual law firms have difficulty controlling pricing, given the large number of competitors.

Although the market is not purely competitive in all areas as specific specialties have limited numbers of firms (e.g. top tier securities and transactions work dominated by a limited number of New York and London firms), even those limited areas have a number of competitive players.

Other practices, such as lower level insurance defense work, are populated by such large numbers of players as to leave virtually no pricing power in the hands of the firms.

Under these conditions, traditional approaches to strategy have often been disappointing because it is difficult to make decisions that significantly change the marketplace. Individual firms are left to compete as best as they can. Some firms have grown and evolved, and become stronger and more dominant. Others have grown without becoming any stronger. Others still have stagnated, shrunk or died, with relatively little warning.

This process of gradual evolution has come to an end, and a period of rapid revolution has begun.

Law firms can be thought of as existing on three or four geographic levels and practicing in three generic practice modes. Geographically, the firms may be characterized as local, regional, national, international and global.

The practices of most firms are structured as broad, general practices, area boutiques or industry specialists. Of course few firms are "pure" players in any of these niches. For example, many regional firms have one or two practices that operate on a national or even international level. It is frequently the case that the individual lawyers whose practices don't fit well with the firms are pushing hard for--or conversely resisting--significant change.

Jockeying for Position

There are also various strategic moves available to law firms in various **market positions**. The options for the midsize firms were outlined in "What's Wrong with the Mid-sized Firms" (Worldlaw Business, November 1999). These firms can choose one of three options with increasing degrees of difficulty. They can choose to maintain their position and consolidate as local or regional players. They can attempt to move up in size or geographic reach, either through acquiring or merging with other small to mid-sized firms or by being acquired by a national player. They can attempt to be acquired by a firm already operating on an international scale. Each of these approaches has risks. Choosing to maintain and build a local position risks losing those lawyers capable of operating on a national or international basis. But moving up the ladder necessarily requires leaving some partners behind. Not all lawyers are capable of practicing on a higher level, nor are all clients suited for all law firms. As we move away from a highly competitive legal market to a collection of oligopolistic sub-markets, there will be a necessary "sorting out" of the lawyers and clients.

Pursuing these options becomes a high-risk strategy, with potentially high rewards for successful firms. Other options are simply not possible in most circumstances. For example, it is normally impossible for a general practice firm to become either a practice area boutique or an industry specialist (although a few smaller firms have accomplished the latter.) Generally the firm cannot survive the transition.

Conversely, some area boutiques and industry specialists have more options open to them.

In addition to moving up in size or expanding geographic scope, many of these firms have the option of combining with general business law firms, sometimes at a fairly high level. The primary current example of this opportunity is the intellectual property (IP) firms. IP firms, **particularly those with significant high stakes litigation practices**, are in strong demand by the general service firms as they gear up to deal with the expanding technology economy.

Recent mergers have suggested that strong general practice firms are prepared to restructure their practices to bring in valuable niche practices. The best of these firms have opportunities to join strong national, international and even global practices.

The Plight of the Insurance Defense Specialists

Other specialists, with lower market values, have fewer options. The most notable examples today are the insurance defense firms, particularly those whose practices focus on the lower end of the market. These firms do not have the option of merging with general practice firms--in fact, most larger general firms have dropped these practices due to economic and cultural incompatibility. Where does this leave such firms? Most are pursuing one of two courses:

Do nothing, and continue to suffer and endure what are often very difficult economic conditions. Eventually, the firm is likely to die.

Attempt to diversify, with the hope of eventually becoming a general practice firm. Many firms have attempted this approach. A few firms have succeeded with this strategy; most have failed.

A key challenge for the profession is that a large portion of the legal work available falls within the general category of insurance defense, including an even greater portion of the litigation. Furthermore, this share of

work is growing rapidly, as more areas of practice fall under insurance coverage.

Diversifying out of insurance work is extremely difficult for the same reasons that general practice firms have gotten out of insurance work.

Diversification of Insurance Defense Firms

In effect, many of these firms are attempting to recreate what most commercial firms have worked very hard to undo--a commercial practice co-existing with an insurance defense practice. It generally has not worked.

Few commercial lawyers are willing to bring their practices to the defense firms. [Most of the firms achieving a level of success with this strategy have done so through modest movement to practice areas relatively similar to the defense practice](#), such as product liability.

Interestingly, few (if any) firms have yet tried the strategy most likely to be successful long term, assuming the willingness to invest in the practice--restructuring the practice itself to be more economically rational in a highly competitive environment. Such restructuring would require significant capital, technology and training investments, substantially better leverage, a new management model, and restructured relationships with the clients. It would force the significant dislocation of many lawyers, particularly many service partners who could no longer function as partners in the new model firm. However, the potential payoff would be significant.

A few forward looking firms, prepared to make the necessary commitments, could quickly take on the role of "category killers" with a result every bit as significant in the legal profession as the changes companies such as Wal-Mart and Home Depot have brought to retailing.

External Forces Driving Change

So far, we have focused primarily on what the law firms are--or should be--doing. However, many of the forces driving change in the legal industry are coming from outside the traditional boundaries of the profession.

Long established in the European market, the Big-5 have also had increasing success in the US and Canadian markets and around the world. In spite of recent restructuring in the accounting profession, there is no reason to believe that these new competitors won't continue to aggressively change the industry. They have significant advantages not enjoyed by many law firms: substantial capital, strong management and practice management, tremendous technology resources, global reach and advanced knowledge management capabilities.

These advantages will give them a tremendous ability to compete particularly with the mid-sized and corporate regional firms. Those firms will need to rethink their value-creation model and, in many cases, change radically to compete in a new environment.

Other companies are now entering parts of the traditional legal business. Some are exploiting experience learned in defending mass-tort matters, such as asbestos, or other experience to bring to market legal-related (sometimes very related) services. These include services such as document management, deposition management, research and claim settlement approaches. Such companies are attempting to commercialize aspects of the legal business that were once the province of law firms. Still other companies are beginning to exploit the internet in a variety of ways likely to radically change the profession, including workproduct, pricing and more.

Clients themselves are changing the rules of the industry as more sophisticated in-house counsel demand more from their outside providers. Once clearly ahead of the in-house departments, many law firms are now scrambling to keep up, particularly in the use of technology for communications and management. But clients are also changing the relationships between in-house and outside counsel, and often among outside counsel. For example, sophisticated clients have begun building virtual teams of outside counsel to service specific needs. By ignoring law firm boundaries, these clients are forcing firms to work together in ways unheard of only a few years ago. More will come.

Overlaying all of this is a radical change in how business is done generally. This is partially a function of the internet and other technology, but is also driven by general changes in society. The world functions on a global basis, and required reaction times are almost instantaneous. Particularly for basic services, providers have got to be prepared to deliver them now, at a high level of quality and service. If they do not, someone else, somewhere else, will. For many legal services, the firms next door are no longer the only (or even primary) competitors. We are moving in the direction of an integrated, seamless global market for legal services.

What Does All This Mean?

Change is happening. Quickly. But, can we say anything about where we will be in a few years and what it means for law firms today? While we cannot be sure exactly where we will end up, we can take a few guesses. As the legal profession remakes itself, there will be some big winners and a large number of losers. Individual lawyers and law firms will be forced to move and compete in new ways. Those that cannot will exit the industry--sometimes spectacularly.

This is particularly true in light of the emergence of Multidisciplinary practices (MDPs) both inside and outside of the traditional legal field. Multidisciplinary practice (MDP) refers to a professional entity in which a lawyer (or lawyers) partners with non-lawyers to provide legal and nonlegal services. Within the last two decades, controversy has arisen over MDPs due to how they can be controlled by the lawyers or the non-lawyers, though in either situation lawyers are required to share fees for legal services with the non-lawyers.

To this end, over the next decade we will continue to see:

A record number of mergers of law firms as the industry consolidates around a new, more stable structure.

A large number of firm dissolutions and breakups.

Continued entrance and penetration of the legal profession by MDPs and corporate entrants to the industry.

Continued client pressure for change in how services are delivered.

Within a decade or two, these forces will result in a radically transformed legal profession, which will include both a limited number of elite global law firms serving clients at the highest level and a larger but still relatively small number of truly international law firms.

At this level of legal work, there will be a more oligopolistic structure to the market. But, those firms participating will need to be constantly on guard against new (or replacement) entrants and influences from outside the profession. There will also be a limited number of elite boutiques handling a limited range of the most valuable **legal services** required by clients, similarly to the role performed by a few high-end Wall Street firms today.

Most of the rest of the corporate legal work will be handled far differently than it is today. There will be a few "category killer" firms--those that roll up much of the work now thought of as local or regional corporate work under a few far more efficient roofs. A few law firms are already starting to build to this model and we can expect the MDPs to be particularly well positioned here as well. This work will be dominated by firms capable of replicating standardized work over and over, while adapting to the specific needs of individual clients.

More commoditized areas of the practice are particularly subject to roll-ups of the practice. The defense bar is most subject to restructuring along these lines--it would only take a few visionary clients or industry leaders to force a change far more radical than any that has occurred to date.

Finally, there will be a large number of smaller, primarily local (or regional depending on the market) firms serving the needs of small-to mid-size businesses, but not competing for much of the work of larger companies. Mid-sized firms as we know them today will be anachronistic at best and rare. Those mid-sized firms wanting to survive will need much better focus than many of them have today. Those unprepared to focus their practices should decide over the next few years where in [the hierarchy of the legal industry](#) they want to be and, if possible, merge while the opportunity remains.

The turmoil we see in the legal industry today is not arbitrary or random. Nor is it permanent. It is the mechanism by which the industry is transforming itself, abandoning older outdated structures in favor of newer approaches to service delivery. As this transformation continues, it will become harder and harder for firms to radically improve their position as the structure of the profession becomes more fixed. Now is the time to take advantage of the opportunities presented by a fluid market to position firms to best compete in the radical New World of legal services.

Interested in Learning More About Legal Hiring? Read the Definitive Guide:

[*How to Hire a Legal Recruiter for Your Law Firm: How Law Firms Recruit Attorneys Using Legal Recruiters*](#)