

# SCG LEGAL: 2014 INTERNATIONAL MEETING

## 15<sup>TH</sup> MAY 2014

Global Trends in the Legal Market and Asia's Influence:  
Critical Factors for Success

# THE INTERNATIONAL LEGAL MARKET CONSISTS OF TWO BROAD GROUPS OF FIRMS

Each group following a somewhat different strategy

- The 'Global Elite' (GEs) made up of the UK's Magic Circle and the very top Wall St firms – a group of 12 to 14 firms
- The International Business Law firms (IBLs) consisting of 25 to 30 mainly US and UK firms with more than 25% of lawyers abroad
  - This group includes Latham, White & Case, Mayer Brown, Herbert Smith Freehills, Ashurst, Baker & McKenzie, DLA Piper, Jones day, K&L Gates for example
  - Some are focused more upmarket and some more focused down
- There is also some blurring between the groups
- The GEs are transaction focused, with the major capital markets as their primary locations; the Global 500 corporates (and similar) as their core client base
  - Target the largest transactions and financial deals plus Litigation
- The IBLs offer a wider practice focus and seek to locate in major legal markets in the world – the client focus being the Global 500 to 1000
  - Need strong domestic practices in order to win market share in local markets and then generate international work out of their clients
  - Hence many more offices and they develop competitive domestic practices in all locations – present a serious threat to independent local firms

THERE HAS BEEN A MAJOR EXPANSION AMONG THE LEADING INTERNATIONAL FIRMS – BOTH BY OFFICE AND BY JURISDICTION  
 And particularly by the International Business Law firms

		Offices			Jurisdictions		
		2010	2013	Change	2010	2013	Change
UK	Global Elite	125	141	13%	88	98	11%
	IBL	284	344	21%	176	217	16%
	<i>Total</i>	<i>409</i>	<i>485</i>	<i>19%</i>	<i>264</i>	<i>303</i>	<i>15%</i>
US	Global Elite	86	92	7%	59	64	8%
	IBL	410	463	13%	200	225	13%
	<i>Total</i>	<i>496</i>	<i>555</i>	<i>12%</i>	<i>259</i>	<i>289</i>	<i>12%</i>

# CLIENTS CONTINUE TO PUSH FOR A MORE COMPETITIVE APPROACH FROM THEIR LEGAL SERVICE PROVIDERS

## Maintaining pressure on firms if they wish to be selected – a buyer's market

- **The demand side of the market is driving change within the supply side**
  - Clients choose firms based on their perception of a firm's strengths
  - Seeking greater certainty in the price of work – and greater efficiencies in the work processes
  - Reducing the number of firms who are their main suppliers: fewer firms are sharing the work
  - Building an in-house capability where they can be more competitive than external suppliers
  - Increasing their use of Legal Process Outsourcing, contract lawyers etc
  - Demanding better industry knowledge, company knowledge and client service from suppliers
  - Seeking deeper and wider relationships with their main suppliers – requiring firms to invest more time in these activities
- **Internal resistance and systems inhibit response to these pressures**
  - Requires a significant change in how many firms have operated until now
    - Partner resistance to change is strong in too many cases
    - Performance metrics need to change to reflect the required changes in partner behaviour
- **Many firms will not adapt easily to what clients are demanding – leading to a reduction in the number of highly competitive firms**

# MAJOR COMPETITIVE TRENDS IN THE GLOBAL LEGAL MARKET CONTINUE UNABATED (1/2)

## With competitive pressures requiring a change in business models

- **A few firms are responding by improving their service delivery and client relationship management processes**
  - Seeking increased consistency in service levels – especially between offices
  - Managing through practice groups across offices in an effort to 'enforce' standard processes
  - Investing heavily in training, technology, knowledge management and standardising work
  - But partner resistance to change is strong
- **A number of US firms are following their UK peer firms by broadening partner performance metrics – recognising that performance is more than generating hours**
  - Revenue/profit managed by a partner is replacing Personal Billable Hours as a major metric
  - Including metrics on client relationship management and business development activity (not just origination)
- **A growing realisation that the underlying issue is achieving behaviour change within a partnership**
  - Many of the required changes require a fundamental shift away from the traditional practice of law
- **But the majority of firms are still working along the traditional model**

# MAJOR COMPETITIVE TRENDS IN THE GLOBAL LEGAL MARKET CONTINUE UNABATED (2/2)

With competitive pressures requiring a change in business models

- **Four major trends are reshaping global markets**
  - Market segmentation
  - Pricing and work process efficiency
  - Demand vs Supply focus in the business model
  - Globalization
    - With consolidation and scale advantages being across all of these
- **These trends will impact firms at all levels and in all legal markets**
  - The difference between firms and markets is one of timing
  - These trends are more obvious in mature markets and at the upper end – but are spreading outwards and down
- **While the impact of some of these will be felt more in the long term, firms need to be planning for them now**
  - It will be too late once they are 'on your doorstep'

# MARKET SEGMENTATION IS CHANGING THE LAW FIRM BUSINESS MODEL

## Requiring greater strategic clarity – and a more competitive approach

- **Market segmentation breaks a large, mainly undifferentiated market down into segments that differ in their competitive requirements**
  - Closely related segments allow a firm to pursue them within the same strategy
  - Others will have widely different bases of competition, making it difficult for a firm to compete across a wide range of segments
    - Means a firm fails to compete effectively in any segment
    - Or if it succeeds in one, it will be difficult to do so in the other
    - E.g. competing in both high-value and low-value market segments is no longer possible
- **Need to identify the client types and work types that represent the core business in the market position on which the firm is focusing**
  - Where they compete effectively – other work types play a support role or are being abandoned
  - Equally, firms are moving away from clients who do not fit the core
- **The move away from a 'full service' to a more focused strategic approach is well under way in the upper end UK firms**
  - And US firms are beginning to follow this as well

## PRICING IS ON THE AGENDA OF MOST FIRMS – ALTHOUGH FEW ARE DEALING WITH THE ISSUE EFFECTIVELY

**Tackling this requires a fundamental change in behaviour/working practices**

- **Clients are open to a variety of pricing methods but the trend towards more certainty in the end price is clear**
  - Unquestioned hourly rate pricing has all but disappeared – except at the very high value level
  - Most hourly rate pricing is subject to significant discounting – partly requested by clients but also offered by competitive firms
  - Fixed or estimated pricing is slowly creeping in
- **Partners in many firms are struggling to move away from hourly rate pricing – easier to just discount rates rather than make the behavioural change required**
  - Discounting with no change in work processes simply erodes profitability
- **Fundamental changes are required to work processes if firms are to meet the price constraints and maintain/ improve profit margins**
  - Need to understand the actual/ likely end price before commencing the work
  - Manage the work to meet the price set by the client and the profit margin required by the firm
  - A complete re-orientation as to how law firms have worked
- **Partner resistance to this is very high across the legal profession**



# THE DEMAND VS SUPPLY APPROACH TO THE BUSINESS MODEL IS A KEY ISSUE TO ADDRESS STRATEGICALLY

## Then matching the supply elements to the demand issues

- **95% of law firms operate with a supply side model, while the market changes require a shift to a demand focused model**
  - Marketing materials and selling approaches are supply focused
  - Lawyers focus on their technical expertise rather than their client expertise
- **With a demand-side focus, client needs are understood and work types and processes are developed to suit these**
  - A supply-side focus means that the work types are developed from the law firm perspective and then an attempt is made to accommodate client requirements
- **The result is that law firms present themselves as a 'department store' for legal services**
  - Everything laid out waiting for clients to match their needs to the law firm offering
  - Whereas a demand focus does the matching for the client
- **Finding a balance between the supply side and demand side is crucial**
  - Increasingly firms are realising the need to approach their business with a strong client approach
  - Focusing on the issues as the client sees them then adapting their 'product' to these
- **A demand focus will change the role of the partner – including reducing the billable hours per partner**

# THE LONG-TERM MARKET STRUCTURE WILL BE FUNDAMENTALLY DIFFERENT FROM THAT TODAY (1/3)

## A different structure is taking shape over the next decade

- **More than 50 law firms are competing either as Global Elite or International Business Law firms – or aspiring to do so**
  - The market cannot support such a number given the size they will need to be to compete effectively across the globe
- **By 2020 there will be a leading group of 10 or so firms with the capabilities to compete effectively in all major regions in higher value work**
  - It will be a mixture of present Global Elite and IBLs
  - There will be a second tier of firms who compete in a lower value position than the first group
- **There will be more transatlantic mergers, and mergers between these firms and local firms in many jurisdictions**
- **There will undoubtedly be more large law firm failures**
  - The competitive demands plus the financing problems faced by partnerships are creating a very fragile environment
  - Some others will decline in market position and survive only by a significant restructuring – with many being forced into different ownership structures

## THE LONG-TERM MARKET STRUCTURE WILL BE FUNDAMENTALLY DIFFERENT FROM THAT TODAY (2/3)

A different structure is taking shape over the next decade (cont'd)

- **The middle ground in the mature markets will disappear**
  - The high value end dominated by the successful international firms and smaller (often local) specialists
- **Purely domestic firms seeking to compete at the higher value end will need a different focus to the international firms – a narrower focused strategy**
  - A re-orientation of how a law firm works will be essential – moving to a demand focus rather than supply – and a new business model
  - a strong focus on client service, relationships, industry knowledge and local business/regulatory contacts
  - A strong international capability of some type for those at the upper end of a market
  - Focus on work in which the firm has a real edge
  - And work where their depth satisfies clients against the international firms
  - Focus on a small number of related industries
  - Adopt new pricing policies and cost efficient processes
  - Strong organization capabilities - implement efficient and effective management structures

# THE LONG-TERM MARKET STRUCTURE WILL BE FUNDAMENTALLY DIFFERENT FROM THAT TODAY (3/3)

A different structure is taking shape over the next decade (cont'd)

- There will be significant change at the lower value end as well
- Firms who seek to compete successfully here will face a range of new competitors
  - LPO suppliers; Contract Lawyers; low cost law firms with high leverage; artificial intelligence systems
  - Will need a new business model to succeed
    - Fixed price
    - No frills
    - Standardised processes backed by technology
      - Standardised cost structures
    - Partners who sell and supervise
    - Tightly managed – not a partnership governance model
    - Demand not supply focused
- Will require a different way of thinking – abandoning the traditional business model of law firms

# THE CORPORATE MARKET SHOWS A SIGNIFICANT SHIFT TO EMERGING MARKETS – PARTICULARLY ASIA PACIFIC

Globalising of business leads to the globalising of law

Fortune Global 500 Companies (by Revenue)

Region	Year			Change, 2005 to 2012	
	2005	2008	2012	Number	%
North America	189	167	143	-46	-24
Europe	178	190	161	-17	-10
Asia Pacific	127	132	181	+54	+43
Latin America	5	10	13	+8	+160
Middle East	1	1	2	+1	+100
<b>Total</b>	<b>500</b>	<b>500</b>	<b>500</b>	<b>0</b>	

Note: There were 16 Chinese companies in the Global 500 in 2005 and 89 in 2012.

## GROWTH RATES FOR THE LEGAL MARKET DEMONSTRATE THE GEOGRAPHIC SHIFT

Geographic diversity in growth rates will lead to a restructuring of the global legal market

Forecast revenue growth (US\$Bn)	2013	% of market	2017	% of market	CAGR
North America	390	48	504	44	5
West Europe (ex UK)	134	16	151	13	2
UK	40	5	46	4	3
Russia/CIS/CEE	11	1	17	1	8
Asia Pacific	109	13	215	19	14
Latin America	105	13	167	15	10
Africa	24	3	34	3	7
Middle East	7	1	9	1	5
<b>TOTAL</b>	<b>820</b>	<b>100</b>	<b>1143</b>	<b>100</b>	<b>7</b>

Based on world economic growth forecasts and demand for legal services we forecast an average growth rate in the global legal market of 7% for next 4 years – with some slowdown to around 5% after that

# THE ASIAN LEGAL MARKET WILL PLAY AN IMPORTANT ROLE IN SHAPING THE GLOBAL LEGAL MARKET

- **The size and growth of the corporate and institutional business in the region will lead to a rapid growth in the market for legal services**
- **A leading position in the Asian market will be an essential component of global leadership**
  - Some of the present leaders are likely to lose out due to a lack of competitiveness in Asia
- **A key decision will be to decide on the core markets in Asia – leaders will not need to be everywhere**
  - PRC, Hong Kong, Japan, Singapore, India, Indonesia are likely to be core
  - South Korea, Malaysia, Thailand, Vietnam, Cambodia, Taiwan and the Philippines likely to be secondary
  - But will need to monitor economic and industry developments
- **A presence in Asia will be critical in winning work going out of the region**
  - It is less about servicing work into Asia – although important
  - The nature of the market is that you need to be here to capture the work going out

# FDI FLOWS HELP TO IDENTIFY THE MORE 'OPEN' ECONOMIES

Where international legal work is more likely

- The major countries in terms of FDI over 2007 to 2012 are:

	FDI In (US\$ Bn)	FDI Out (US\$ Bn)	2012 GDP (US\$ Bn)	2012 GDP/capita (US\$ K)
China	1236	486	8227	6
Hong Kong	437	460	263	37
Japan	72	582	5961	47
Singapore	250	143	277	52
South Korea	18	125	1130	23
Indonesia	74	29	878	4



## ASIA HAS BEEN A RECENT EXPANSION MARKET FOR IBLs – NEW PLAYERS AND EXISTING FIRMS EXPANDING

### Newer players and Asian Offices and Lawyers (2006 – 2014)

Firm	Offices		Lawyers	
	2006	2014	2006	2014
Kirkland & Ellis	0	3	0	55
Weil, Gotshal & Manges	2	3	15	34
Latham & Watkins	4	5	54	107
Orrick, Herrington & Sutcliffe	1	5	28	77
DLA Piper	6	7	147	303
Baker & McKenzie	14	14	887	1,032
Mayer Brown	0	7	0	254
Reed Smith	0	2	0	131
<b>Total</b>	<b>27</b>	<b>46</b>	<b>1,131</b>	<b>1,993</b>

## INTERNATIONAL FIRMS ARE BUILDING POSITIONS IN ASIA WITHIN A VERY FRAGMENTED LOCAL MARKET

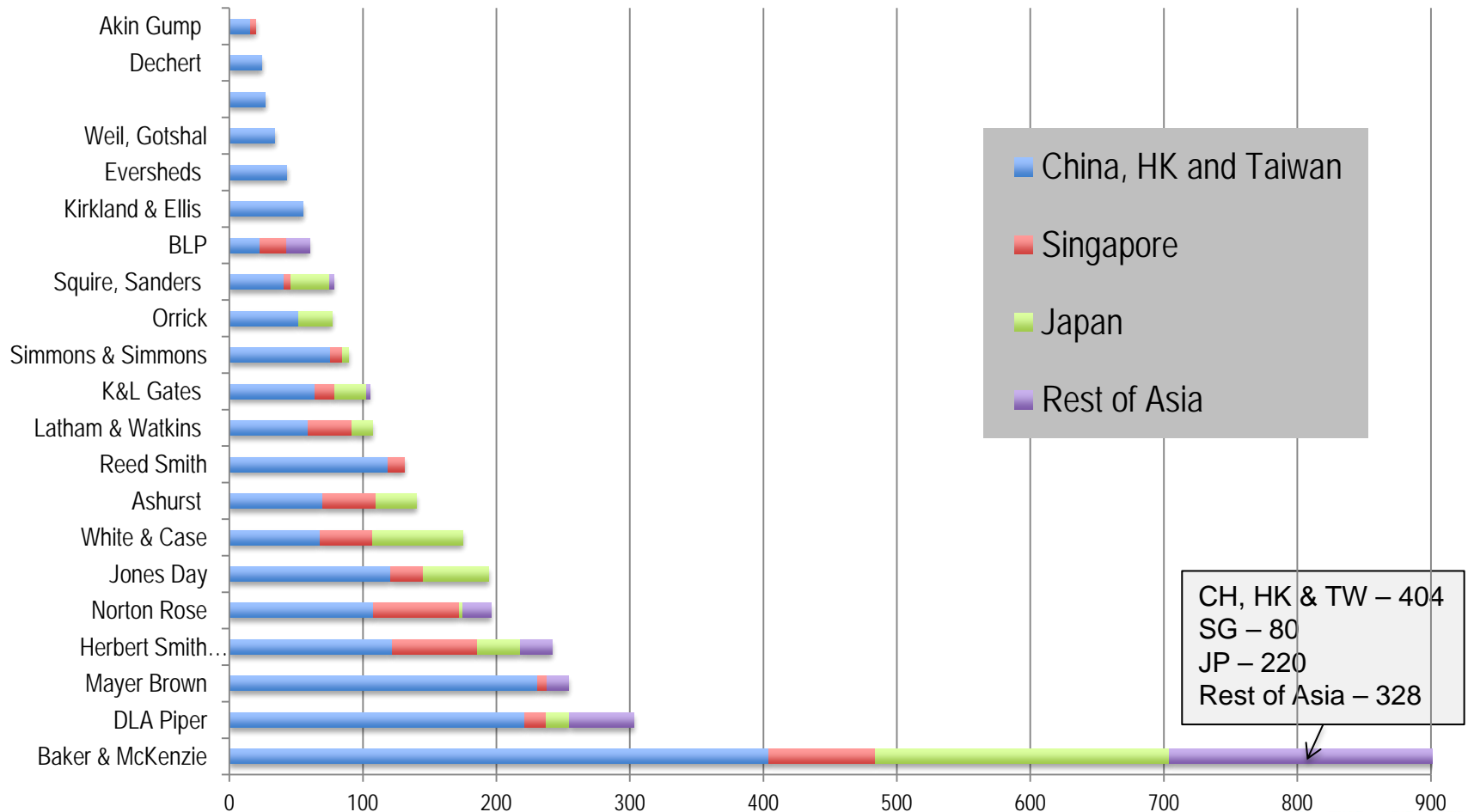
- The top 50 firms in Asia have over 27,000 lawyers including 3,000 in firms based from outside the region, the US and UK
- The largest international firms are Baker & McKenzie (1032 lawyers); Clifford Chance (345); DLA Piper (303); Linklaters (299); Mayer Brown (254); Hogan Lovells (247); Herbert Smith Freehills (242); and Freshfields (235)
  - And 7 others with between 100 and 200 lawyers
  - There are over 150 foreign firms operating in the region (70 in Hong Kong alone)
- There are 25 UK and US firms each with over 20 lawyers in the region
  - This group has 3,500 lawyers and 120 offices in total
- There are some very large 'local' firms – 12 over 500 lawyers (includes KWM)
  - Although many are not organized into a coherent structure and operate more as a 'loose group of individuals' with little consistency
- The local market is very fragmented
  - e.g. of the 800 Hong Kong firms, 90% have 5 partners or less
  - This could change once LLP legislation is implemented – mergers will be likely

## THE TOP 50 ASIAN LAW FIRMS IS DOMINATED BY CHINESE FIRMS

	Firms (no.)	Lawyers (no.)	Lawyers per Firm (avg.)
China	20	16212	811
South Korea	6	2866	478
India	5	1690	338
Japan	5	1936	387
Singapore	4	1233	308
Hong Kong	1	279	279
Taiwan	1	413	413
<b>Asian Firms</b>	<b>42</b>	<b>24630</b>	<b>586</b>
<b>UK/ US Firms</b>	<b>8</b>	<b>2968</b>	<b>371</b>
<b>Total</b>	<b>50</b>	<b>27598</b>	<b>552</b>

# BESIDE A FEW MAJOR PLAYERS, MOST IBLs HAVE YET TO DEVELOP ROBUST PRESENCES IN ASIA

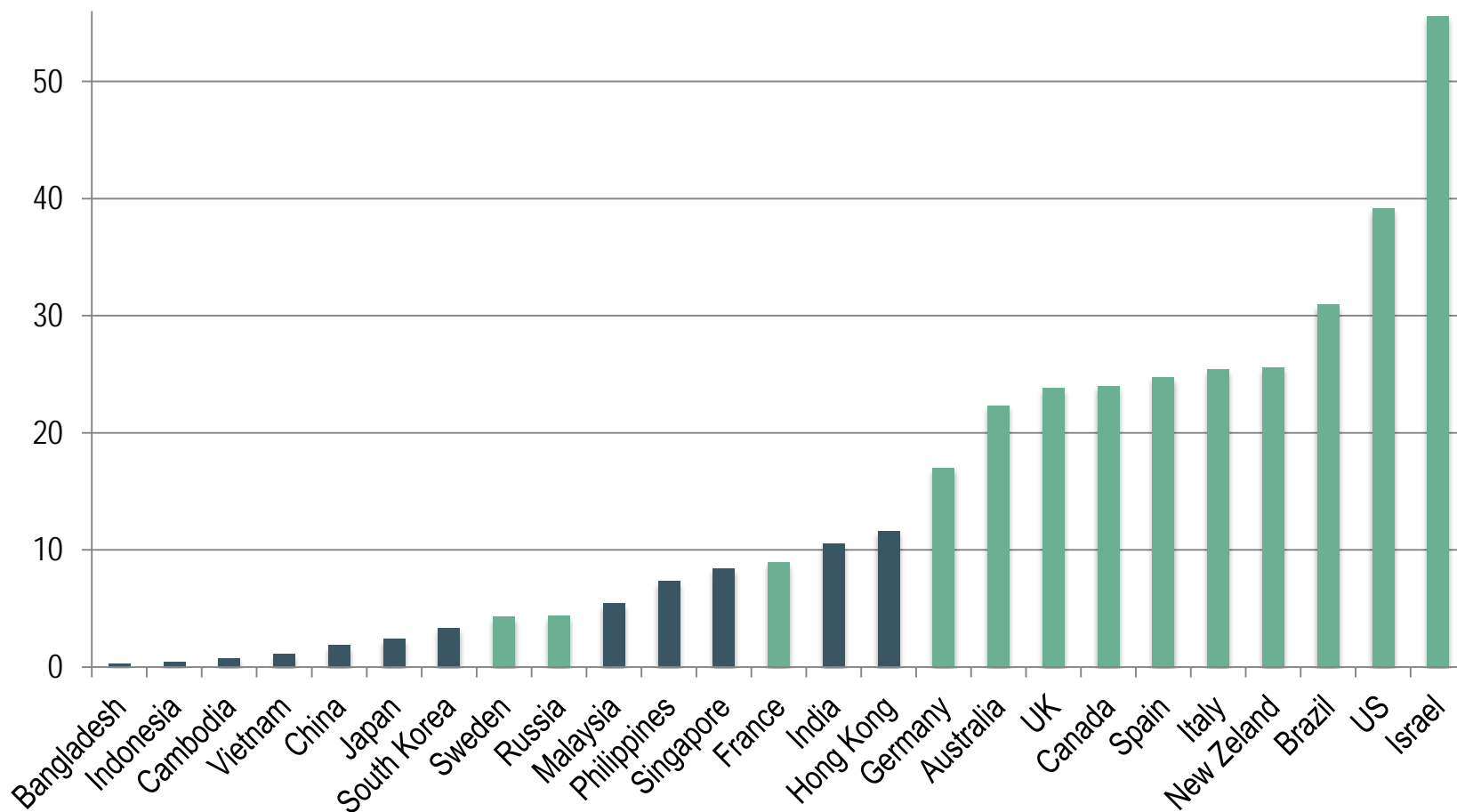
## IBL Lawyers by Firm and Region (2014)



Source: Firm Websites

# THE ASIAN LEGAL MARKET IS LOWER IN CONCENTRATION THAN MANY MATURE MARKETS – ALTHOUGH HONG KONG IS GETTING CLOSE

Number of lawyers per 10k citizens



## THE ASIAN MARKET CONTAINS A SIGNIFICANT NUMBER OF CHALLENGES – FOR FOREIGN FIRMS (1/2)

- There are some important issues that international firms will need to address if they are to succeed in Asia
  - Different cultural influences – between Asia and elsewhere and within Asia
    - A major influence on buying patterns
  - Pricing – local buyers are generally not prepared to pay the prices international firms charge
  - Relationships – requires a considerable amount of non billable time over a long period - usually with little revenue and profit
  - Need to bring on local lawyers at all levels
  - Training and lawyer development requires a different approach
  - Regulatory issues
  - Recruitment and secondments
  - Expatriate remuneration packages

## THE ASIAN MARKET CONTAINS A SIGNIFICANT NUMBER OF CHALLENGES – AND FOR LOCAL FIRMS AS WELL (2/2)

- **There are some important issues that Asian firms will need to address if they are to succeed as independent of international firms**
  - A clear strategic focus that positions the firm 'to the side' of the major international firms
    - A core practice and core client focus – not a full service approach
  - Recognise the strength of the international firms is much greater than their numbers in Asia
  - Developing clear role for partners – where they spend their time
  - Building client relationships with key decision makers - ensuring they know what you are best at
  - Developing an effective organisation that supports the lawyers achieve their goals
    - Business development
    - Technology
    - Human resources
    - Finance
  - Clear decision making processes that are effective in a competitive environment

## MANAGING REFERRALS IS A KEY ISSUE FOR INDEPENDENT ASIAN FIRMS

- **A fast growing emerging market will always create a strong flow of referral work from foreign to local firms**
  - This work can be an attractive revenue source and profitable – helps maintain utilisation and can be good quality work
- **Essential to monitor referrals in and not become too reliant on them**
  - Firms referring in a volume of work are likely to set up here eventually
  - Partners can use this to avoid their own business development
  - Some referral work will be outside the strategic focus and create 'busy fools'
  - A tendency for lower profit referral work to increase
- **Firms find their strategic options are limited by the amount and source of referrals**
  - Difficult to explore options if it affects referral flow
  - A minority of partners benefit more than others and block strategic moves
  - Referral work flows can be short to medium term and should not create barriers to longer term strategic thinking
- **Referral work needs to be treated as a flow of work from specific clients and assessed for strategic importance, profitability and risk of ending suddenly**



# ENTRY INTO ASIA REQUIRES EXTREME CLARITY OF STRATEGIC VISION

## It is not for the faint hearted

- It requires a significant investment planned over the long term
  - Establish long term goals for the business (5-year) and annual milestones in terms of development
  - Ensure the Asian strategy is a subset of the firm's overall business strategy
  - Enter with one or two core practices, for which the firm has a strong reputation in its home market
    - ...and are core at home
    - Focus on 'home market core clients' where the firm's name is known
    - Build a competitive depth in these practices
      - Outsource other work – beware of 'strategic creep'
    - Develop the client base beyond 'home' clients
    - Only add another core practice once the initial practices are profitable
      - Repeat the process
    - Invest significant partner time in relationship building and business development
    - Structure the economics to suit the local market and the different role of the partner

# THERE ARE SEVEN AREAS ON WHICH ALL LAW FIRMS NEED TO FOCUS FOR SUCCESS IN ANY MARKET POSITION

Many have given these some attention, but within a traditional view of the market

1. Ensure there is clarity of strategic positioning and the related strategy – and its acceptance within the firm – along with a supporting business model
2. Achieve competitive levels of performance – financial but also across a range of activities
3. Implement processes to ensure work is done cost effectively – while meeting profit targets
4. Develop very effective, structured and disciplined business development and client relationship programs – appropriate to the strategy
5. Develop an economic structure for each practice group – given its role in the firm's strategy
6. Articulate and manage a set of acceptable behavioural standards
7. Implement lean and effective management structures, along with strong organizational processes that support the strategy



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