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Reports of Biglaw's death are magnified

JOEL BAROLSKY THE AUSTRALIAN DECEMBER 20, 2013 12:00AM

MANY legal industry commentators are proclaiming the end of the BigLaw business model. In my view, these commentators underestimate the strength and resilience of BigLaw and overstate the competitiveness of NewLaw.

This view is based on the following factors.

Law firms are not like manufacturing, retail, airline or mining businesses that have huge fixed costs. Labour costs typically are about 60 per cent of costs and occupancy 20 per cent.

The evidence points to firms being able to scale their workforce up and down with more flexibility than one would traditionally think.

For example, last week's Partnership Survey published in The Australian revealed significant shifts, up and down, in partner numbers. While there is some pain, it appears many well-run firms, when needed, are very happy to let redundant people go, de-equitise partners, stop recruiting graduates and radically reduce support staff.

There is little to stop BigLaw adopting "accordion" human capital models, and there's growing evidence that many are.

The latest figures show profits per partner at about $1 million plus for the top 10 Australian law firms. With relatively flat revenue, this must have come primarily from cost reduction.

It also needs to be kept in mind that deal-driven profits are cyclical, not structural.

The number of global mergers and acquisitions worth more than $10 billion in 2010, 2011 and 2012 combined was less than 2007 alone.

This segment of the market drives super-normal profits of the larger BigLaw law firms. I think it would be prudent to wait to see the impact an increased M&A deal flow on the legal market before calling the end of BigLaw.

Frankly I cannot see many clients trusting these NewLaw start-ups with their cross-border deals worth more than $10bn. I think many NewLaw commentators are drawing structural conclusions from a cyclical change.

Apart from the firms formerly known as Deacons and Phillips Fox, I would assert that the net impact of all globalisation activity on Australian law firms has been net neutral.

While they may have access to more cross-border deals, global clients and better support people, the costs of being part of an international firm are significantly higher than running a purely domestic operation.

Many newly global firms operate on discrete profit-sharing models and by and large have the same people, processes and clients. All benefits accruing have been neutralised by competitors matching

their strategy.

Much has also been made of the cost differential between Australian and Indian law firms, and the growth of the offshore legal process outsourcing market.

Mumbai rents are now twice as high as those in central Sydney or Perth. Top talent in India is getting scarcer and more expensive.

All evidence points to a cost differential gap that is narrowing rapidly. It also appears that the biggest clients of offshore LPOs are actually incumbent law firms looking to lower their costs.

Many industry commentators also make the assumption that fixed pricing and value-based pricing are the privy of NewLaw firms. Fixed-fee pricing has been part of BigLaw for many years. It's just one of many pricing structures they offer their clients. Coupled with this, there's a growing trend of BigLaw firms investing in legal project management and process re-engineering.

There is very little evidence to assume alternative fee arrangements will bring down BigLaw, especially when they can play equally in this space, and, in fact, offer clients more choice.

It seems to me that notwithstanding their ownership structures, the evidence points to some BigLaw firms being willing to invest, to innovate, to sow as well as to reap.

If partnerships only cared about short-term cash profits then no firm would have invested in things yielding a long-term return such as IT infrastructure, brands, new services, capability building or opening new offices. This is clearly not the case.

Many claim that the partnership ownership structure is an anachronism. While there are some downsides to this model, there are massive benefits that are seldom acknowledged.

The most significant in my view is that most middle and senior managers in a law firm partnership are major producers as well as managers.

In a corporate model, middle and senior management are overhead costs that are paid for by the rest of the productive workforce.

Partners and senior associates in law firm partnerships are profit centres. The partnership model essentially facilitates extraordinarily productive self-managed teams with relatively little management overhead.

Harvard's Clay Christensen introduced the idea that certain technologies have the potential to completely disrupt a market and replace incumbents with new entrants. Online stock trading is a good example of a technology that disrupted the Australian stockbroking industry.

Over the years there have been many candidates for potential legal market disruptive technologies such as online providers, deal rooms, e-document management systems, expert systems for discovery and due diligence and contractor workforces.

All the evidence points to these technologies being enabling rather than disruptive. That is, they appear to help the incumbents become more productive and ultimately entrench their position.

Ten years of Beaton Research & Consulting data points to Australian clients rating their BigLaw legal providers at 8 out of 10 on overall performance and 7.5 out of 10 on value for money.

By and large, the data suggests BigLaw firms ares doing a great job in serving their clients' needs and providing good value.

While there's always room to improve, new entrants better beware: the market is being well served by some pretty accomplished providers.

While the legal market is clearly going through significant change and firms will have to adapt their ways, these points suggest that BigLaw firms are unlikely to roll over and die just yet. In the words of Mark Twain, "reports of (BigLaw's) death are greatly exaggerated".

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