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My Milkshake Is Better Than Yours: Part 1

Disruption and the Mid-Size Law Firm

By **Jill Dessalines**

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Law360, New York (May 24, 2017, 6:18 PM EDT) -- A while ago, I watched a Ben Stiller comedy[1] about two competing gyms, one run by Ben Stiller's character, a mean guy with a sculpted body and a serious food compulsion that he constantly tries to suppress; and one run by a less ripped but really nice guy (played by Vince Vaughn). After the nice guy wins, Stiller's character gives in to his food compulsion and gains a couple hundred pounds. The last scene shows Stiller in a fat suit singing, "My Milkshake is Better than Yours."

Now, when I first heard the song[2], I thought it had been made up for the movie because it was just that ridiculous. Imagine my surprise when I learned that not only was it a real song, but it had been a chart-topper. Anyway, as I was sitting there, incredulous, listening to this song, it reminded me of Harvard Business School professor Clayton Christensen's most recent work on disruptive innovation. How's that for a segue?

Disruptive Innovation 2.0

Christensen coined the phrase "disruptive innovation" in the '90s to describe the effect of commoditization of previously elite products and what happens to market players when products and services previously reserved for the wealthy were produced at lower cost for a larger market. The phrase has been bandied about since then and usually used to describe what happens to markets when new technology permits competition to enter the field. And that is part of Christensen's larger body of work that looks at why it is so difficult for market leaders to maintain their position.

When I first heard the phrase "disruptive innovation" I thought to myself, "That doesn't sound like a good thing." I mean, disruption sounds like a brutal, violent change that leaves bodies in its wake. And, without realizing it, I guess I wasn't far from the mark. Twenty years later, Christensen has refined his concept and continues to study the market impact of disruptive innovation. I call it "Disruptive Innovation 2.0."

The market changes we've seen over the last 20 years in every industry have proven Christensen's theory. New entrants to a market provide a product or service to a wider market than previously available. Status quo market leaders try to attract an even more exclusive clientele. The new entrants to the market migrate from the low end and eventually gain acceptance by the middle market. And those businesses in the middle either transform, are acquired or die. Years ago, we saw the effects of disruptive innovation in the steel industry with the major mills being nearly shuttered by smaller, more agile mines.

Since then, we've seen disruptive innovation across a variety of industries. Computers that

took up entire buildings have been displaced by smartphones that are smarter than we are. Airline carriers like Southwest have moved from the province of the budget-conscious vacation traveler to every Fortune 500 company's travel roster. CDs were disrupted by downloadable files, and we've seen the bevy of major music publishers whittled down to a few, all rendered nearly obsolete by file-sharing and subscription services. Cruise lines that once catered only to the uber-wealthy now offer Disney cruises for the whole family. The major publishing houses have merged into a handful, and those handful are getting their lunches eaten by Amazon. Most recently it's been Airbnb disrupting hotels and Uber disrupting taxis; and we've seen this disruption in just about any other product you can name.

Look at the history of mergers in this country. Consider the media industry: in 1983, 90 percent of American media was owned by 50 companies; and in 2011, 90 percent was owned by six companies. Look at the 147 companies that control 99 percent of the world's wealth; or the 10 companies that control virtually all of American consumer products — market consolidation is marching along to its inevitable conclusion.

And now it's the legal industry's turn. This should come as no surprise, and I'm sure it doesn't to most of you.

Law firm mergers are telling the same tale. In order to do battle in a market where demand is flat and competition is intense, law firms are merging in record numbers. In 2015, there were a record 91 law firm mergers, which broke the record of 88 mergers set in 2013. In 2016, there were 85 mergers, 11 of them international, which set a record for cross-border collaborations.

With market demand flattening, the prevailing wisdom is that the best way to win new business is through acquisition — a market concept that has already swept across the world in most other market sectors, resulting in markets with two or sometimes three major players and everyone else scrambling for niche markets. Left unaltered, this trend means that law firm mergers will continue until the top 200 becomes the top 100, becomes the top 50, becomes the top 10; and those top 10 will try to get 90 percent of all high-dollar, big corporate business.

All you have to do is look around at other markets to see how this tale will play out. With big firms going high and seeking ever higher dollar work and small firms and new entrants going low and seeking to commoditize high-volume, low-dollar work, mid-sized firms must decide how to maintain their client bases before the clients' acceptability of the small firms and new entrants for middle market work is a fait accompli.

And aside from the mergers, consider the number of firms that were household names (at least in the households of lawyers) that are no more: Brobeck, Thelen, Heller, Howry, Donovan, Dewey, Coudert Brothers, Choate ... and these are only some of the large firms. There have been scores of mid-size failures nearly too numerous to list.

So how can you position your firm for success within that reality?

With large firms continuing the trend of going up-market, seeking higher dollar work and higher per partner profits, they present mid-sized firms with an opportunity. These large firms can end up leaving the mid-market clients and mid-market work behind simply by pricing themselves out of that market. As Michael Corleone said in Godfather III, "Your enemies always get strong on what you leave behind."

Big Ticket Litigation is in Reach — But Don't Sacrifice Mid-Ticket Litigation

Litigation is the perennial budget hog for most large corporations, so I'll use that as an example of how this trend of going up-market is likely to play out. Mid-sized firms can still

pursue high-dollar, up-market matters by presenting price differentials and by carving out specialized areas of expertise to get a piece of the action.

However, don't pursue sporadic high-dollar work at the expense of a steady diet of mid-dollar work from large and middle market clients. I believe the commonly accepted statistic is that 70 percent of new business comes from existing clients. And it costs six to seven times more money and effort to win business from new clients than it does to grow your business from existing clients.

According to a CounselLink study of mid-sized firms (from 201 to 500 lawyers), those firms' share of big-ticket litigation ($1 million in annual billings) went from 22 percent to 41 percent from 2010 to 2013. During this same three-year period, firms with more than 750 lawyers saw their billings drop from 26 percent to 20 percent.

From 2013 to 2016, mid-sized firms' market share of big cases has flattened, but the overall trend is apt to continue as corporate clients continue to search for more cost-effective legal services. An AdvanceLaw study of general counsel revealed that 74 percent of them would be willing to use firms outside the Am Law 20 if the cost differential was greater than 30 percent. And 57 percent of those GCs said that Am Law 20 firms were less responsive than other firms.

So while mid-sized firms always have to battle the corporate client's impulse to make the "safe" choice by going with large firms for high-stakes litigation, competing on price, going deep within your areas of specialization and using your superior responsiveness can convert some of those engagements.

Don't Wait to be Squeezed out of the Middle Market

Right now, new entrants and alternative providers like the former accounting firms that are now multidisciplinary practices, or project-based services, contract lawyer agencies or web providers, may have an advantage on price. But they do not yet have the credibility to consistently attract corporate clients.

You can distinguish your firm by leveraging your pedigree and the depth of your expertise to maintain mid-market clients. You can grow adjacent areas of your practice for selected client groups so that your brand is centered around a small group of capacities within a limited area of expertise. For example, you can focus on a few select industries and offer a wider range of services to specific client groups. Those services could include things like risk assessment, compliance process creation, audit compliance, and other services that are adjacent to litigation.

You can automate some of your lower dollar services and staff them with contractors to deliver adjunct services, with a default option to deal with a firm lawyer. And you can close the technology gap between the newer, more modern and more technologically driven competitors and your current state. Use your historical data for budget creation, to establish and track best practices and to capture metrics on adherence and the impact of those metrics on costs.

You can drive litigation process improvement using process maps, legal practice management protocols and project management techniques. You can engage in enhanced and open collaboration on how to deliver services to your clients; because collaboration has become the new business model that your clients have been pursuing for years now.

You can take a page out of the book of NewLaw and start offering greater flexibility to lawyers and the agility to scale engagements at project rates to clients. Because NewLaw is here to stay and will probably siphon off a significant part of the legal workforce of millennials from mainstream law in coming years.

You will ultimately need to change your operational model, your economic model and your compensation model. You will need to go from pricing your services on the basis of cost to pricing them on the basis of value.

Change Hurts

Change is never easy. And change is exactly what is required. The question isn't whether change will come. It will. The change that law firms must undergo will either take place now or later.

Firms will either get ahead of it or be left behind. The only way to address changed circumstances is with changed behavior.

The research clearly shows that most law firm managing partners in firms with 50 or more lawyers know that they must change their basic operational models. Yet this same research also shows what all of you probably know — knowing that change is required and actually instituting change are two very different things.

In Altman Weil's 2013 Law Firms in Transition Survey report, 238 managing partners of law firms with 50 or more lawyers were asked a series of questions about whether their firms were willing to change basic operating models. Consensus was nearly unanimous that permanent changes in the legal market had occurred and would continue, with 95.6 percent agreeing that there would be more price competition, 95.6 percent agreeing that there would be heightened focus on improved practice efficiency, 89.7 percent agreeing that there would be more commoditized legal work, 79.5 percent that there would be more non-hourly billing, 78.6 percent that more competition from nontraditional service providers would be forthcoming; and 66.7 percent believed that the pace of change in the law firm market would continue to increase.

But only 44.6 percent had taken any steps to improve the efficiency of their firms' delivery model, and those who did mostly altered their staffing models to include part-time, outsourced and contract lawyers. Forty-five percent reported that their firms had restricted admission to equity partnership and heightening retention standards. Twenty-nine percent reported that their firms had changed their approach to pricing.

While most responders believed their firms could keep pace with the new reality of the legal market, the majority of responders had a low level of confidence in their partners' willingness to change.

These findings were refined and reaffirmed in Altman's 2016 Flash survey: 59 percent of surveyed partners do not change because clients don't ask for it; 56 percent don't change because they aren't in enough economic pain; and 64 percent don't change because of partners' resistance to change.

Of course, the willingness to transform the law firm structure is only the first step in the foundational shift that must occur in order for most law firms to survive the coming reality.

Tune in tomorrow for Part 2 of "My Milkshake is Better Than Yours: Disruption and the Mid-Size Law Firm."

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[1] "DodgeBall: A True Underdog Story" (20th Century Fox)↩

[2] "Milkshake" by Kelis, written and produced by The Neptunes, on the album "Tasty" (Star Trak, Arista Records)↩

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