fairfax INSIGHTS

Know Thyself and Thy Clients

"The customer's perception is your reality." ~ Kate Zabriskie, author

Client feedback can be a valuable predictive indicator of the future intentions of a firm's current client base as well as a method to uncover emerging trends in industries on which the firm is focused. We have conducted a significant number of in-depth interviews of in-house buyers of legal services over the past three years and these conversations indicate some interesting shifts in the market for legal services. In this month's Insight, we share some themes from these interviews and the implications for law firms in today's market.

As many observers have noted, the legal market is seeing increased segmentation driven in large part by changing client demands. One factor behind these changing demands is the rising sophistication of the legal departments in most large companies, which has led them to recruit very good lawyers and shift the source of legal expertise from primarily outside the company to increasingly inside the company. Furthermore, as law departments come under more pressure than ever to cut costs, many are changing the *nature* of the work that is handled in-house and what is procured externally. In doing so, clients are viewing in-house resources as a key cost lever. Many clients we speak to are less interested in broad-based, general advice and are focusing their external legal spend into three primary areas: bet-the-company, specialist, and capacity-enhancing.

Bet-the-Company Matters

Bet-the-company matters have always been a key area of focus for large law firms and we do not see much change in the ongoing need for highly honed expertise brought in from the outside when the company's livelihood is on the line. While this type of work tends to be less price sensitive (although not immune from price pressures) and is seen to be highly attractive by law firms and individual lawyers, many firms are chasing it. At the same time, the pool of work that is truly bet-the company is quite small. Relationships may mean less for these matters as well since clients simply wants the best expert they can afford, no matter where they are, to guide them through the challenges facing them. Furthermore, clients tell us that boards and other stakeholders often take comfort in engaging firms with well-known brands for these types of issues.

Focused Specialists

In many ways, the market for focused specialists is similar to bet-the-company work in that it also tends to be less price sensitive because the supply of suitable advisors is limited. Clients recognize that specialization has both practice and geographic dimensions: for many it is not just the deep experience within a narrow area of law but also the relationships in the community with the courts, regulators and other stakeholders that can impact the outcome and ultimate success of the matter. Specialists play an important role in law departments' external counsel portfolio because they allow clients to deploy highly targeted advice to specific yet occasional issues. As one development company that requires environmental permitting work in specific jurisdictions explained, "We can't hire people in-house for this work. We don't have enough of it for a single person to do full-time. And because the work is so targeted in nature, someone else can't just pick it up. You have to be a deep specialist. That's largely what we engage outside counsel for."

Enhancing Capacity

The final area where clients engage outside firms is to increase their own capacity. Clients need additional capacity for a number of different reasons. Sometimes they have legal needs that are uneven in nature, such as an occasional acquisition or litigation. Other times, clients may be restricted in the number of lawyers they can employ in-house and rely on outside firms to supplement their in-house capacity. Other clients may have legal needs across many geographies that they cannot manage themselves or they have repeated volume-driven work that clients believe can be done more cost-effectively with an outside firm (such as, for example, certain insurance defense work or debt collection). Capacity-enhancing legal needs tend to place an importance on the relationship and clients depend on their outside counsel to have a deep understanding of the business so that they can work effectively and efficiently with the in-house team. Clients also tend to be the most price-conscious for capacity-enhancing needs because they involve a high quantity of work. Plus, the larger relationships that accompany higher volume provide more negotiating power to clients.

Implications for Law Firms

What are the implications for law firms of these three areas of need? While clients still say frequently, “We hire the lawyer, not the firm,” it is clear from our interviews that firms also matter. First, many large sophisticated buyers of legal services do care about a firm’s scope of services and breadth of coverage. While they value local relationships, the sheer quantity of legal work under their control requires tremendous management resource. They can reduce the effort required to manage large amounts of legal work by consolidating it into fewer, often large, firms. Clients tell us that not only do large firms reduce the *transaction costs* because they do not require multiple contact points, fee negotiations, etc. but they can also help get work done efficiently in far-off locations. (As one client noted, he could lean on his local relationship partner to pressure her partner in a far-flung geography to finish something quickly, whereas if he were trying to work directly with a local firm, it might be more difficult to get good service.)

Although many large clients appreciate the benefits of a relationship with very large law firms, they also recognize the challenges. The most frequently-mentioned shortcoming is a perceived unevenness in quality and sometimes a higher rate, although in fairness, sometimes clients seem to generalize across all large firms based on a negative experience with one. Such shortcomings have the potential to tip the scales in favor of smaller specialized firms, particularly those that can tightly maintain quality and consistency among their lawyers.

Some large clients have told us that while they will often turn to their large firm relationships first, they will still go outside those relationships when they require specialists. For smaller firms, it is worth considering whether they are trying to help clients with their capacity needs or if there is a potential to provide more specialist expertise that is inefficient for clients or their larger competitors to cultivate. Because staying in close touch with these clients to better anticipate their needs is critical, a focused practice can pose tricky business development issues since these needs come up less frequently than capacity-enhancing needs.

Smaller and midsize firms also not surprisingly have an advantage with smaller and midsize clients. In markets where larger firms have entered more recently, many clients view the pricing for large firms to be higher than their smaller competitors. For clients without a need for multijurisdictional matters, they see less value in engaging with very large firms and will focus their external legal spending on smaller and midsize firms instead.

Overall, our client interviews suggest that law firms need to understand fundamentally what type of need they are serving with their clients. Firms with lawyers in many jurisdictions provide value to large multinational corporates seeking capacity enhancing capabilities as well as some specialty capabilities but are sometimes less attractive to smaller companies. However, while huge clients have a large volume of work, they can also be price-conscious and demand consistency. Those who succeed in providing highly consistent, good quality service at a reasonable price point will be fierce competitors for capacity-enhancing legal needs.

On the other hand, highly specialized boutiques can serve both large and small clients effectively, so long as they are working within their niche. While their clients may be less price conscious, a narrow focus can leave the firm vulnerable to other competitors interested in the space or in extreme examples to obsolescence if the law changes in a dramatic way.

The message we receive over and over again from clients is that firms need to understand where they add value and build upon those relationships and capabilities. Firms that try to be too many things to too many clients end up diluting their energies, making it difficult for clients to distinguish them from their competitors. Firms that are listening closely to their clients and thinking carefully about the problems they solve will be in the best position to adapt and thrive going forward.

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