

Legal Services Offshoring: On the Runway?



This article discusses the emerging opportunities arising from the offshoring and outsourcing of legal services.

New Momentum

Across the world right now, a number of changes are taking place in large international businesses, which will have a profound effect on the structure of the legal services market and the potential for legal service outsourcing. This will eventually affect Singapore legal practices and create enormous opportunity for those that have the right strategy, relationships and skills.

For instance, major international companies are changing the way they buy premium professional services and this will speed up the outsourcing process. All professional disciplines are involved, including legal, accountancy, consulting, executive search, architecture and merchant banking. Despite being highly sophisticated, big budget and important purchases, many have, until recently, been bought outside the normal disciplines applied to other business purchases.

High-level executive search is probably the most dramatic example. It has been offered to the leaders of large companies by partners in private practices who have treated HR specialists with disdain and relied on direct access to chief executive officers, directors and chairmen to generate business. Accountancy and law have been a little more structured; auditors being appointed by an audit committee and leading law firms taking up places on panels of approved suppliers. Yet the involvement of purchasing specialists has frequently been minimal and, where they have been engaged, there is scope for them to offer much more. The general counsel of leading international firms, for example, have been able to brush aside periodic supplier reviews because they thought that they understood the value given by outside counsel better than their own buying function.

However, the governance changes put in place for public firms after America's Enron debacle have changed all this. Companies that are registered on the New York stock exchange (and this includes very many large international companies that are not American) are obliged to ensure that their buying processes are objective, clear and well managed. This has enabled several to initiate changes in the purchasing of professional services and their experience is being passed on to others. It will eventually be recognised as 'best practice' and affect the approach of smaller companies across the world.

One of France's leading consumer product companies, for example, initiated a review of its search suppliers, which reduced its worldwide pool from nearly 20 to just three. The process has created new worldwide rates of supply and new measures of success, and its directors are now applying that learning to the other professions, including law. The CEO is comfortable that governance requirements have been met and, if personally involved in a project, is happy to choose practitioners from suppliers available to them from a proper selection process. This means that direct approaches from the partners of other suppliers to company leaders are unlikely to be welcome.

New Structures for Law Firms

At the same time, there are new structures evolving in western legal firms that are changing the nature of legal services. For instance, the recent move by Australia's Slater & Gordon to become a limited company has caught the profession's attention worldwide. It appears to be the first floatation of its kind and has made reality of a prospect that, until now, has been merely a distant theoretical possibility for lawyers everywhere.

All eyes, from London's 'magic circle' firms, through potential new entrants and investors to leading merchant banks, are now on Australia. Finance houses are already talking to legal practices there about constructing similar deals. If the technicalities work out, these should become public in the months ahead. At the same time, the interest of established businesses has been caught by the possibility of entering an inviting market. For instance, in the United Kingdom, the draft legal services bill, which will make possible different ownership structures there, is likely to be enacted soon. It prompted one bank's in-house counsel to remark:

As I process many mortgage applications every year, I am already in the legal services market. Add to that the chance of bringing streamlined service to an industry where quality is poor and distribution inefficient; plus incumbent net margins of 25% when I have target net margins of 5%, and it becomes irresistible.

Yet we already know from other professions (like accountancy, search and consultancy) that the behaviours, culture, decision-making processes and service style of a publicly-owned practice are very different to those found within a partnership; and this leads to a fundamental change in approach. For example, partnerships are reluctant to use profits to invest (preferring to distribute them amongst partners), whereas plcs routinely set aside large funds for projects to enhance productivity. They therefore gain an edge by using their capital budgets to improve productivity through technology, process and system improvements. It makes them much more efficient and streamlined than rival partnerships.



The Effect on Western Legal Services

As this thinking is applied to legal services in Europe, the United States and Australia, both clients and partners in external firms can be heard to talk of 'commoditisation'; a worrying change for the latter. Until recently, the leading international practices have been among the most successful organisations the world has seen. Their partnership structure, comprising cells of small practices, has enabled them to thrive when others have failed. As a result, some are entering their second century of business, earning net margins that are often two or three times higher than the clients they serve. For instance, many would, to date, have been disappointed with net margins below 30 per cent whereas the target net margins of some of the world's better-known corporations are around 5 per cent.

These large international practices seem to have been immune to the stark need to improve productivity that has been experienced in, for example, manufacturing, computing and banking, and has led to outsourcing, offshoring and investment in remarkable innovation in those industries. However, these relentless changes in how firms buy professional services are forcing leading law firms to consider innovative service redesign for, perhaps, the very first time.

In America, for instance, another effect of the Enron problems has been the huge increase in the cost of governance issues and this has squeezed budgets for other legal services. It has prompted large international clients to introduce sharper methods to control risk, such as standard forms that are tightly managed and updated at regular, carefully planned intervals by their general counsel. Whereas, in London, senior representatives of a group of large clients recently informed partners of various 'magic circle' firms that, unless they took the initiative to 'create factories to handle lower value, routine work', they would set something up themselves. While, in Australia, a number of firms were outraged last year by the demands of one of the country's biggest buyers of legal services and the nature of their request

Plcs have to report to the financial markets and account to, largely anonymous, shareholders for their use of funds. This introduces into these organisations the relentless drive for process improvement, cost reduction and innovation that are natural to harsh competitive environments. Over the long term, they adopt an unarticulated drive for productivity improvement in response to pressure from shareholders, customers, competitors and public commentators.

There is usually a clear management structure with delegated authority to run functions within agreed budget and strategy parameters. Management are able to create and execute programmes to meet the firm's goals. In short, they are not running after different partners rushing into tactical, sometimes whimsical, activities, or continually adjusting to suit the views of different people. Leaders in these firms can expect specialisation, investment, and the ability

to get on with the job. That this is a feature of different governance structures is shown by the experience of Littler Mendelson PC, North America's largest labour and employment law firm. They are a 'professional corporation', under Californian law, rather than a partnership. Wendy Tice-Wallner, chairman of the board and managing director, says that this has enabled them to respond quickly to acquisition opportunities and delegate clear actions to specialists in IT, marketing or HR. Each of these now sets their own implementation plan within the agreed strategic framework, while 'lawyers serve clients'.

These fast emerging structures are seeking to build chains of efficient, streamlined practices, often using younger practitioners operating under a wider span of control. They are much more open minded to suggestions of outsourcing and their culture is more receptive to suppliers offering service based around IT investment.

to renew their retained representatives. Partners in all the leading practices had to explain their reluctance to commit to clauses guaranteeing, for instance, that they would always give their potential client their cheapest prices.

Price pressure also seems to be affecting different legal specialities in different ways. It is not just practices offering consumer services, such as mortgages and other domestic services, which are investing in IT and 'back offices' to streamline their organisation. Some corporate clients say, for instance, that patent drafting, registration and support services in various parts of the world (estimated by one source to be worth US\$50 million) is so routine that 'it's not even worth outsourcing'. Whereas, even in the ever-growing M&A markets, some clients talk about needing lawyers to just 'paper a deal' rather than add real value.

Their Response

These harsh pressures are forcing partners in some of the world's best-known private practices to take seriously the 'offshoring' and outsourcing of legal services. All leading firms, for example, have international networks with offices in most major centres. So they have, within their own organisations, client service staffs that are charged out at considerably lower rates than those in the major centres like New York, London and Sydney. Until very recently, inertia has made it very difficult for them to use, say, people in Malaysia or Singapore to remotely work on contracts presented to clients in leading western capitals. It is much easier to use associates nearby or work within their own office than to think through components of work that can be automated and given to others. So it is no surprise that practitioners only outsource when driven to.

This cultural resistance is now being challenged by informed buyers, in a quest to reap substantial price advantages. Although a partner in Paris, Melbourne or Boston might manage the interface with a client, there is no reason why an amount of the work should not, through technology, be passed to their

colleagues in other countries who are often trained in similar professional practice and speak English fluently. This inertia has been the main reason why the offshoring and outsourcing of legal services has not really taken off to date. This is despite much discussion and debate about it in the legal press, and other professions that have shown that, once it is moved, fundamental change can follow across many international practises.

It now seems that if it is not actually taking off in legal service yet, it is at least on the runway. One estimate, for instance (by Australia's PRISM legal consulting) suggests that there are 100 'legal process outsourcing firms' in the United States alone. Moreover, they report that this number has increased from 77 since May this year.

These companies offer back office support; help with research, documentation, drafting, briefings, proposal preparation and secretarial assistance. They are progressively winning work with western partners of both large and small practices, responding to the need to cut costs, streamline practice procedures and improve or preserve margins. The reason for their growth is obvious. One company that specialises in this field, Office Tiger, estimates that the potential for such outsourcing could be as much as US\$2 billion in the United States alone and that the top 200 law firms there spend US\$20 billion annually on office operations and documentation.

Interestingly, others are already going much further and including remote suppliers in client work. One leading magic circle firm appears to be making a huge investment in India, where education is good, legal structures are similar to England and the services of qualified people are cheap. There are also current examples, not yet public, where some of the massive international firms are making arrangements with high quality smaller practices in cheaper markets to pass them components of client projects. The partner in a major western centre provides the client interface, but the work is done largely by remote workers in a cheaper location.

Some estimates put the costs in these overseas locations at around 60 per cent of those in the domestic market. Like smaller hands inside a massive, elegant glove, these foreign professionals work on projects remotely, in order to preserve margins. So productivity is, at last, coming to the professions, legal services included.

So What Should Singapore Firms Do, to Cash in on This Trend?

The international outsourcing of legal services is no longer limited to India. Providers are known to be operating in Sri Lanka, Finland and New Zealand. These countries are succeeding because of a combination of competence in the English language, familiarity with the tenets of western law, favourable time zones and relatively cheap, educated talent. As Singapore has similar advantages, there is no reason why practices here could not take advantage of these opportunities to develop a new, strong source of income. Yet, to do so, leaders must consider a number of issues.

The first step to success in winning offshored business will be building friendships and partnerships with western firms. As with clients, the partners of western firms need to deal with people they know and trust. They know that their clients are unlikely to be comfortable, at first, with their cases being sent across the globe. In fact, the leaders of two firms experienced in offshoring of consumer legal services, said recently that lawyers would normally tell clients of such external involvement in their work only after they have expressed satisfaction with their service. Their view is that, if told beforehand, many would not proceed. So trust, confidentiality, security and professionalism are essential. Suppliers need to progressively earn the trust of individual partners in western firms if they are to develop a reliable income stream in this field.

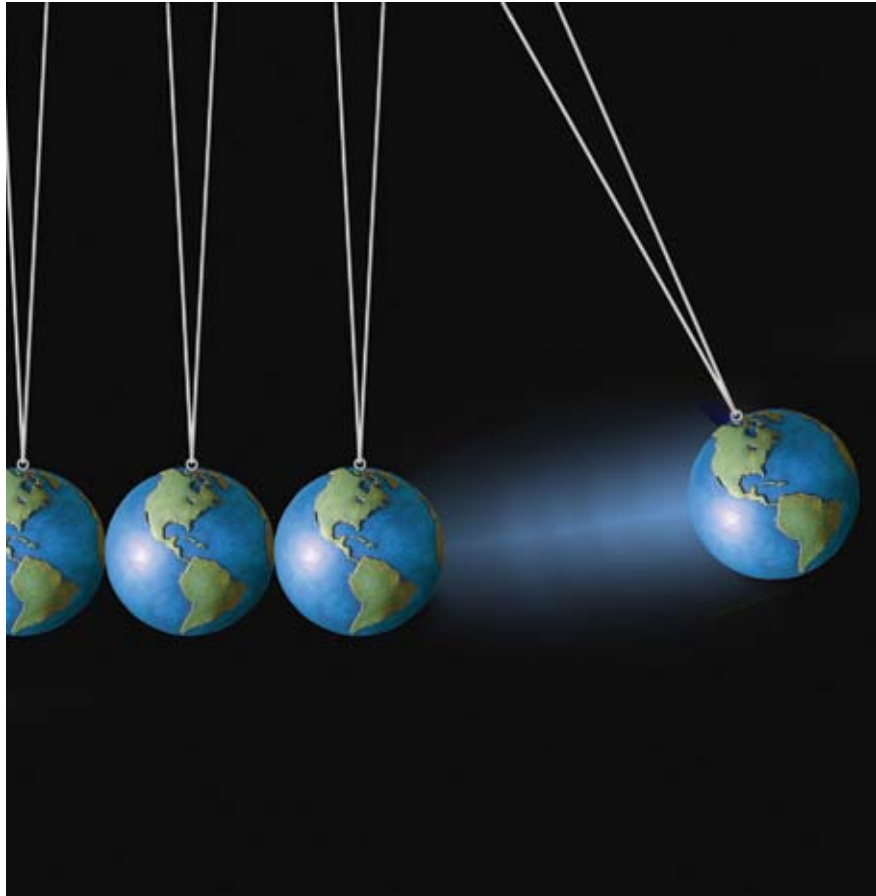
The majority of successful partners in networked firms got there by serving clients well and have been there their entire career. This experience affects their professional relationships. If a young

professional is asked for a particular skill by a client, they will call in a colleague from their network. If the colleague performs well, the client is pleased and trust is established between the two colleagues. The two professionals will work together again and share ideas as their careers progress (of course the converse is true if the colleague fails). Large firms therefore become inter-related networks of partners who trust each other, having worked under pressure together on client engagements. These inner circles may be based around a common skill, geography or industry expertise but they are the backbone of the firm. They pass on strategy, resources, knowledge, skill and gossip. To succeed in providing this very sensitive service, outsourced providers must tap into this network and ensure that they understand their pressures and clients.

To succeed with the new types of emerging firms, though, a different approach is necessary. They need to be convinced of competence, experience and real benefits. They are much more likely to respond to an approach from an experienced provider, if the proposition is appealing. Singapore firms wanting to attract their attention may need to partner with others who already have experience of international outsourcing.

Over time, any firm wanting to build an income stream in this type of work must be prepared to invest in the technology that will enable efficient international communication of work. This technology will need to be robust, not failing frequently as new technology can. It also needs to be secure and efficient. Above all, though, it will need to interface effectively with law firms in western countries, so it needs to be carefully specified and expertly handled. It is no coincidence that successful outsourcers hire some of the leading legal IT specialists. For many new practices this is a new organisational competence requiring vision, investment and careful management. It is only for the serious minded.

It would also be wise to get government support. According to the United Nations conference on trade and development,



world trade in services grew by 17 per cent in 2004 (the last year for which figures are currently available) and 14 per cent in 2003. This followed a spell of annual growth at around six per cent per annum (in every year, except one, between 1990 and 2003). This international trade is important to developing countries where several are gearing up to tackle international service opportunities. In 2004, they accounted for 22.6 per cent of the world's total export of services.

International export success in services varies according to development of the economy, government policy and education of the population. For example, in 2004 India raised its share of world service trade to 1.3 per cent, from 0.5 per cent in 1990, despite the huge growth in overall international service trade during that period. Moreover, the country then used its developing international competitiveness in IT skills to plan an incursion into the business process outsourcing market. One estimate put the number of Indian

firms providing international, IT enabled services, at over 200 in 2004. As a result, its 'computer and information services' exports made up 48.6 per cent of its total service exports in 2003, a growth of 28.5 per cent over the previous year. So, nations that are competing with Singapore for this trade are supporting their domestic businesses with public policy designed to promote growth in international service trade.

These growing international service opportunities are hard for businesses to ignore and several have been prompted to consider a move into legal services outsourcing. Practices in a number of countries are planning international market penetration, hoping to repeat in service markets the success of, say, the Japanese in consumer products during the 1980s. Singapore legal practices should be able to get their share too, if they plan their approach carefully.

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