

Despite nearly two decades of predictions of imminent and fundamental change in the legal industry, the sector has proven remarkably resistant to change. In particular, the most unusual, most irrational characteristic of this industry – namely, the dominance of high price, high margin law firms appears almost impervious to market forces of rationalization and client complaints of poor value for money. According to CLOC studies, law firms still account for 62% of overall corporate legal spend¹ and rates are on the rise. Indeed, top law firm revenues and PEP are increasing, with top US firms breaking the \$5m PEP barrier for the first time in 2018².

With this backdrop, any discussion of the future of legal services must consider whether this persistent resistance will continue or if how it might begin to give way. I argue that a credible theory of change in our industry must not overlook the enduring power of law firm brands or make imaginary leaps into alternate future states in which simply because the law firm economic model is old-fashioned and irrational, it gets written out of history and replaced by technology and tech-enabled alternative services providers (like Axiom Managed Solutions). On the contrary, I would suggest that any vision for change must incorporate the powerful role of law firms and that new modes of partnership between firms and alternative providers which build on the comfort, prestige and continuity law firms can uniquely bring are more likely to result in meaningful change.

Resistant to change

Two idiosyncrasies of the Legal market help explain the profound resistance to change. First, and most broadly applicable is the industry's reverence of precedent. In the common law world, aspiring lawyers have the importance of precedent pounded into their heads from the first day of law school. Reverence for precedent -- the idea that when in doubt, one should revert to the status quo, do as has been done before -- is quite literally the antithesis of innovation, which generally requires upending the status quo in favor of a new approach. As a result, it should not surprise us that the legal profession is conservative, precedent bound and resistant to change.

Second, and more specific to the phenomenal persistence of traditional law firms even as so many commentators have predicted their decline, is the fact that almost all in-house lawyers (the primary buyers of legal services) were themselves once law firm lawyers. Not only does this create a web of strong personal relationships and loyalties between buyers and providers of law firm services but it also puts in-house lawyers in the enviable position of being able to hire their former bosses. In fact, Axiom Managed Solutions' (AMS) analysis of more than \$2 billion in law firm spend across multiple clients shows that a strong predictive factor in the web of loyalties, favors and habit that drives fragmented law firm spend patterns is the presence of law firm alumni in in-house departments directing work to their old firms³.

Allying with the establishment

If we can agree that meaningful change in this industry means addressing what I called its most unusual, most irrational characteristic, the dominance of high price, high margin law firms, then it might seem that change is at odds with the future prospects of law firms. While in general, one would expect change will eventually result in shrinkage of the law firm industry as we know it today, this doesn't mean the decline in that sector will be uniformly spread. On the contrary, there will be winners and losers. Much has been written about the fact that the highest end, pure advisory firms (of which Wachtell with its low ratio of partners to associates and pure focus on high-value work is often held up as the

prototype) are better situated to withstand the next generation of change while the AmLaw 200 face real threats⁴. It is likely true that top firms may be competitively advantaged in delivering high end advice where you would expect them to continue to be able to command high prices and enjoy high margins. Even among the AmLaw 50, however, there are probably only a small handful of Wachtells.

Apart from that small handful, most of these top 50 are firms are built on transactional legal work. In many cases these are quite complex or specialized transactions (e.g. high value M&A or esoteric financial services trades) but this is work that requires transaction-specific knowledge and familiarity with market custom more than novel analysis of profound legal issues. This work will become increasingly competitive. AMS analysis of current law firm spend shows that transactional legal work accounts for about 75% of non-litigation spend. Extrapolating across the market, this suggests a market size of close to \$200 billion in spend on such transactional legal work⁵. This spend is highly fragmented with the work spread across a large number of firms with the necessary capability.

This transactional legal work is where even the world's most respected law firms compete, typically splitting the market with a number of their peers. AMS analysis indicates that in a typical transactional category, at a particular client, the law firm with the largest share of work within that category will account for less than 25% of total spend and that 80% of spend will be split across 10 firms, with a long tail of firms accounting for the final 20%⁶. While our analysis covers only a few recent years of legal spend, anecdotal observation suggests this dynamic has been in place for some time with firms locked into a fairly narrow range within any one transactional category at any one client. One year they may have 10% of that client's spend in that category and the next they might have 12% or 8% but radical growth or change in market position is rare.

Yet we believe this work is ripe for innovation that could drive transformational growth for law firms willing to approach it in a new way. AMS analysis shows (perhaps surprisingly) that a whopping 50% of the total hours (representing 38% of total spend) billed to clients in relation to this transactional legal work is performed by lawyers with less than two years of experience. This work undertaken by junior lawyers at rates of around \$350/hour at top firms⁷ is most susceptible to tech-enabled disruption. Handled in a new tech-enabled model, this \$350/hour work could be delivered for \$150/hour or less.

While various structural impediments have made law firms slow to deliver this disruption, perhaps the most credible path to material change in the biggest, ripest category of work in this stubbornly change-resistant legal industry will be through partnerships between law firms and new-model, tech-enabled providers. For law firms willing to collaborate with new model firms, it is an opportunity for transformational growth that can bolster their market position in the face of change. For alternative providers looking to challenge the status quo, rather than overlooking law firms or minimizing the comfort and prestige they offer to the in-house lawyers who engage them, this model builds on the natural market strengths of law firms by co-opting them as a platform to bring innovation to a much larger pool of work than they would have access to on their own. For clients, this accelerates change and delivers it with a degree of continuity that reconciles their appetite for innovation with their reverence for precedent.