

What lawyers can learn from Poundworld

By Jaap Bosman, strategy consultant and author of 'Death of a law firm'.

Recently I came across an episode of 'Pound Shop Wars' originally broadcasted by the BBC between 2012 and 2015. The series focuses on Poundworld and its rivalry with other pound shops. Poundworld, founded by Chris Edwards, has over 350 UK stores selling 99% of its merchandise at £1.

What struck me was the way in which the company was managed. Everything was focused on return on investment. No costs were made unless profit would come out of it. Poundworld is a business. Its owner is a businessman and entrepreneur and literally everything revolves around making a good profit. Buying goods and selling them at a profit is the most elementary form of business.

Law firms have been for decades one of the most profitable business models in existence. Few other businesses invest so little capital with such high returns. Many partners of law firms make more money than elected heads of state or CEO's of sizable companies. Over the last 50 years profits consistently have gone up. The business of law certainly must be doing something right.

In sharp contrast with Mr. Edwards, partners at law firms are not entrepreneurs. Even if in name and title they are the shareholders of the firm, in practice they behave as highly paid employees.

Herein lies a problem. One could argue that partners at law firms have been spoiled by decades of rising profits. Making money without the need to be entrepreneurial created the false illusion that nothing could ever go wrong and that both work and money would keep coming in as by magic.

The eroding effect of commoditisation

The clients of law firms have become more and more sophisticated and professional. In-house legal departments have excellent legal skills and have a good oversight of what's out there in the legal market. For most matters clients have a choice between several law firms and/or partners to handle their case. If everything else is equal, the client will make a choice based on the price. We have already seen this during panel formation, but it equally happens for individual assignments. This is what is called commoditisation. When multiple law firms or lawyers can handle the same assignment equally well, the legal expertise in question has become commoditised.

Using this definition, it becomes clear that in a particular market a certain legal expertise is commoditised or it is not. The clients either



have a choice, without compromising on quality, or they have not. There is no grey area. It is either black or white. Letting this definition sink in for a moment, I should also make clear that commoditised work does not necessarily equal 'simple work' or 'bulk work'. It all depends on the competition in the legal market. In most mature legal markets, it will be possible at any point in time to find multiple law firms willing and capable to handle a matter. Even if it requires specialist experience and expertise. For example, the London legal market for Project Finance has become totally commoditised by now, even though it requires considerable expertise, making it harder for law firms to make a profit. That is the eroding effect of commoditisation.

Surprisingly when asked, most partners at law firms seem to suffer from 'commoditisation blindness'. They admit that such a thing as commoditisation exists, but are convinced that it will not affect their practice as what they do is invariably highly bespoke. If Poundworld had the same blindness to what was happening in their market they might have been out of business by now.

Understanding your business model

Unlike said retailer, the business model of law firms is quite simple. There is no buying and selling of goods; there is no stock to track and there is far less volatility in the workforce. Whereas the retail business is not rocket science, the business model of law firms is as simple as it can get: revenue minus costs equals profit. The only thing one should understand is that in the short term the costs are fixed. Comprising predominantly of wages, rent and IT infrastructure, costs do not vary according to revenue. This means that fluctuations in revenue will have a direct and leveraged effect on profit. Since profit is divided between the partners in full, any fluctuation will directly affect their income. As a market average,

business law firms will have a cost percentage of about 66%, so a profit margin of 34%. This means that a 10% decrease in revenue will result in a 30% decrease in profit. This is why law firms should be worried about commoditisation. Except that they are not...

Immediately after the financial crisis, law firms started to cut costs in a response to the drop in revenues. At that point in time, it was quite easy to reduce costs. Secretaries were dismissed, support staff numbers reduced, offices relocated to cheaper locations outside London or even the UK, office space reduced and the less profitable partners were made to leave the firm. By reducing costs over time, some law firms even managed to increase profits. Today, 10 years after the financial crisis, the lemon has been squeezed and a new remedy is called for. In order to survive, law firms will have to fundamentally change their business model. Innovation in the business of law should be solely focused on maintaining a healthy profitability in an increasingly commoditised legal world. Innovation should be strongly purpose driven.

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By monitoring their business performance daily, retail chains like Poundworld incrementally adapt their business all the time. They permanently monitor sales, stock and turnover - and the speed with which these fluctuate - and they closely follow their competition.

Being true entrepreneurs, the owners of Poundworld remain agile and focus on maximizing profits in the long term. Law firms on the other hand, remain in their bubble as if nothing will ever change. Nothing fails like success.

Turning things upside down

Innovation has been the buzz word in the legal sector for a number of years. A few weeks ago, I was in Paris and a friend told me that there was a seminar or conference on innovation in the legal sector every week. Typically, these seminars repeat the same mantras: "disruption is coming to the legal sector and Artificial Intelligence is taking over from lawyers". It is a strange mix of gospel for the believers and fear and doom for those who don't.

Fuelled by these repeated messages many law firms start building apps, giving models away for free or embark on using software for such tasks as due diligence. The problem with this is that they start with working on a solution without defining the problem first. Innovation needs to be profit driven. I can't repeat and stress that enough. Maintaining a healthy profitability level in an increasingly commoditised world needs to be the starting point.

Innovation should be aimed at lowering the cost of production while increasing the profit margin. Automation can do that, but only if the costs of humans is decreased at the same time. Spending money on an automated due diligence and still maintaining the same level of junior lawyers in the corporate department is not going to work.

Poundworld would never automate its warehouse and still keep the same number of people working there. Law firms need to change the business model that now relies solely on leveraged hours.

Law is a business like any other business

The business of law has been very fortunate over the last few decades. Without any 'skin in the game' and with little entrepreneurial skills, they prospered. I would argue that most lawyers do not consider themselves business people or entrepreneurs but professionals instead. Much like doctors, except that doctors operate in a fully regulated market and do not need to be entrepreneurs.

Now, due to commoditisation, the time has come for law firms to innovate and adapt their business model. This will require courage, sense of business and entrepreneurial skills. I would recommend lawyers take inspiration from Poundworld where business is still practiced in its most elementary form.

The business of law where partners charge hundreds of pounds per hour or more, could learn from Poundworld where every item costs just one Pound.

Jaap Bosman is a leading strategy consultant, investor and one of the founding partners of TGO Consulting, a boutique consultancy focusing on the legal sector operating from New York, The Hague and Hong Kong. In 2015 he published the global bestseller 'Death of a Law Firm', recently translated into Chinese. Jaap is a regular speaker on the future of the legal sector.