London legal services

market overview and outlook

Novum Partners

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In the pages that follow, we seek to provide some insight into the combination of forces that are reshaping the London legal services market and to contribute to the understanding of ‘disruption’ across the wider legal services market in a meaningful way.

Mid-market overview

In the mid-market, the nature and intensity of competition is increasing as clients continue to push for value and force competitors to deliver more efficient and cost-effective services.

At the same time, a growing number of clients are turning their attention to handling more matters in-house as well as *disaggregating* more parts or phases of matters between different firms (and non-traditional service providers) to achieve increased efficiency.

In large measure, this changing client behaviour reflects mounting internal pressure on in-house legal departments to improve their commercial focus and become more influential drivers of corporate success. This, in turn, is putting GCs under sustained pressure to drive measurable improvements in the efficiency and effectiveness of their overall legal spend. And as pressure on GCs to do more with less continues, it is becoming increasingly apparent to many of them that the old way of doing business with external legal advisors is unsustainable in the long term.

For mid-market law firms, this changing client behaviour is further exacerbated by the confrontational go-to-market strategy of several focused non-traditional service providers: these providers are steadily improving their offerings while using aggressive messaging tactics to differentiate themselves; gain share; and position themselves as a cost-effective alternative (for work of ever-increasing complexity) going forward.

Three of the 'Big Four' accountancy firms (PwC, EY and KPMG) are also investing in their UK legal capabilities, as well as integrating them with their existing industry-focused service lines to provide a higher-value combined offering for clients. These firms are beginning to show quantifiable progress and are worth noting because of their potential to develop clearly differentiated and compelling value propositions in the years ahead.

And, not surprisingly, in response to escalating competition (and changing client behaviour), mid-market law firms are becoming leaner, nimbler and fundamentally more competitive as they continue to invest in technology-enabled services and strip out anything that increases costs, but not value, for clients.

Another prominent theme has been the near-constant political and economic turbulence following last year's EU referendum outcome, and market participants expect political and economic uncertainty to be the 'new normal' as the UK negotiates its exit from the European Union.

Simply stated, change is the only constant in the mid-market. And the increasingly challenging environment is testing the adaptive capabilities and resilience of most mid-market firms, as well as redefining what it takes to be a successful law firm in this tier of the market.

Mid-market outlook

In the short to medium term, the clear implication of an ever more challenging mid-market is that driving profitable growth will become increasingly difficult for firms with few obvious or sustainable competitive advantages.

What's more, if competition intensifies over the long term as expected then incumbent firms in a position of competitive disadvantage will cede their competitive position, and struggle, in an unforgiving environment where clients have higher sophistication; more options; better information; and greater power in the buyer-provider relationship than ever before.

In our view, the changing competitive dynamics in the mid-market signals the end of easy growth, and it is unlikely that firms will be able to co-exist as peacefully as they have in the past for much longer.

The underlying market forces are beginning to recast the industry's winners and losers, and, moving forward, driving sustainable and profitable growth will require firms to take market share from competitors rather than relying largely on the base retention of clients and aggressively managing their cost bases.

In addition, the profit-depleting market forces at play are likely to translate into further strategic cost-cutting and consolidation among firms, and as the competition for market share intensifies over the long term, the market will become increasingly segmented as firms narrow their focus on parts of the market they can serve better than others.

This increasing segmentation will accelerate the trend of clients buying from a wider range of specialist service providers on the basis of efficiency and cost-effectiveness (quality being assumed).

And as clients disaggregate more parts or phases of matters between multiple providers (to achieve increased efficiency) cross-selling will become increasingly difficult for undifferentiated full-service firms.

Of course, it's not all doom and gloom, and the difficulties facing mid-market firms are neither insurmountable nor universal. The market will become much more intensively competitive, but more robust and resilient firms (with clearly differentiated and compelling value propositions) are already well positioned to grow and face future competitive pressures.

These fundamental shifts are likely to result in a re-ordering of the mid-market, but there is still time for many firms with eroding competitive advantages to make bold strategic choices and better compete in an ever more challenging environment.

Going forward, as price-based competition continues, mid-market law firms (and non-traditional service providers) will become fundamentally more competitive. Those that prevail will, at some point, drive upmarket in pursuit of higher profitability.

Top-tier overview

The forces reshaping the mid-market are increasingly at play in the top-tier of the market, which is also going through a period of tightening margins and intensifying competition.

However, a different kind of competitive fight is nearing full swing at the very top of the London legal services market, as the industry enters the next phase of globalisation and US law firms exploit a rare opportunity to take significant share away from key competitors in a mature, highly contested market.

In recent months, the pace of change in the top-tier has started to accelerate and at least two critical trends acting together suggest the market is entering a period of fundamental change.

First, the current market environment has prompted previously unmoveable partners (in a significant number of top-tier firms) to consider relocating their practices to firms that are better positioned to compete and maintain long-term differentiation.

This emerging trend is in part driven by deep-seated organisational problems at several higher-leverage top-tier firms (with eroding competitive advantages), and as a result many of these talented individuals have concerns that money alone can't address.

The majority of higher-leverage firms have done well to improve profitability in the last year despite challenging market conditions, but a closer examination of the organisational health of several of these firms brings a much different picture into focus. The organisational challenges vary from firm to firm, but there is a growing consensus among partners in many of these firms that the days of being all things to all people are over, and that the underlying assumptions supporting their firms' existing business models need to change in line with the external environment.

This attitudinal shift is further exacerbated by another emerging trend: the increasing separation of advice from execution. A growing number of clients are combining the advisory services of partner-led teams (with much less gearing) from top-tier firms with the execution services of providers at a variety of points along the value chain to achieve increased efficiency. Unsurprisingly, this changing client behaviour is also fuelling concern among high-performers in several higher-leverage firms (with eroding competitive advantages).

The second and perhaps most obvious trend is that a number of prominent US firms have made significant investments in growing out or launching English law offerings in recent years. With several of these firms now reaping disproportionate rewards (while continuing to invest in high quality lateral additions), many others are taking notice and adapting their playbooks accordingly.

Additionally, by continuing to build strength and depth in many of their core international practices, these more efficient US firms (with lower-leverage models and high-performance cultures) are becoming increasingly attractive propositions for both lawyers and their clients.

Top-tier outlook

As top-tier law firms continue to adapt to an increasingly fluid and challenging competitive environment, it is undeniable that some are faring much better than others.

The current market environment clearly represents a sizeable opportunity for several prominent US firms, and with growing morale problems in their partner and associate ranks, these are challenging times for a number of the top-tier's higher-leverage firms.

Looking to the future, we expect to see US firms continue to gain prominence in the top tier. Several are likely to build more comprehensive UK law offerings in their traditional areas of strength, mainly through lateral acquisitions. And others with already comprehensive UK law offerings are likely to continue building strength and depth both organically and through lateral acquisition.

Meanwhile, many of the top-tier's higher-leverage firms will have to drive sustainable top-line and bottom-line growth to retain key individuals who are critical to their long-term differentiation and success.

In the short term, above-market growth is imperative for many of these firms, as average growth (or thereabouts) will do little to address the growing sense of discontentment among associates, nor will it slow the growing compensation gap (and distance) between their equity and now swollen non-equity partner ranks.

However, driving sustainable and profitable growth will prove difficult for many of these higher-leverage firms in the current market environment.

In the short term, realigning their cost-bases will improve profitability. But, these firms cannot cut their way to sustainable and profitable growth (as cost reduction and performance improvement will eventually run out).

Sustainable bottom-line growth requires sustained top-line growth. And this means these firms will have to do more than rely largely on the base retention of clients and aggressively managing their cost bases. They will need to take market share from competitors. This has always been challenging. But, in the current market environment these higher-leverage firms (with eroding competitive advantages) will have to find a way to grow their market share and minimise high-performer turnover at a time of steadily increasing competition and record levels of lateral recruitment at international firms.

Going forward, with the exception of a core of highly complex or important matters, clients will continue to combine the services of providers at a variety of points along the value chain, in order to achieve increased efficiency. Over time, this will make it increasingly difficult for a number of higher-leverage firms to drive sustainable and profitable in a way that *reinforces* their existing business models.

As things stand, the scenario where pivotal people start to leave several higher-leverage firms is the most likely to prevail, and, in the medium to long term, if US firms continue to capture market share from key competitors (and grow both organically and through lateral acquisition), then we are likely to see more of them move ahead of some of the UK's largest law firms by UK revenue.

A perspective on Disruption

Few management theories have attracted as much attention in the business world as Harvard Business School professor Clayton M. Christensen's theory of disruptive innovation, which explains how and why the pursuit of profitability leaves industry-leading companies susceptible to failure.

Christensen's ground-breaking theory has been tested and validated through studies of a broad range of industries, including financial services, retail, management consulting, communications, computers, cars and cameras. And it has passed tests on its predictive accuracy with flying colours.[1]

However, despite its popularity and utility, the core concepts of Christensen's theory remain widely misunderstood. So, before discussing 'disruption' in the legal services market, we should specify what is meant by the term disruption, as well as summarise some of the key concepts that Christensen and his colleagues have introduced.

What is Disruptive Innovation?

In a December 2015 Harvard Business Review article titled 'What is Disruptive Innovation?' Clayton Christensen and his co-authors Michael E. Raynor and Rory MacDonald address the frequent misapplication of the terms disruption and disruptive innovation.

They remind us that disruption describes the process by which innovating companies develop simpler and more affordable offerings that eventually displace (or 'disrupt') the products or services of established incumbent businesses.

The authors point out that disruptive innovations are often confused with 'sustaining innovations', which are improvements to existing products or services that generate high margins and match or exceed the level of performance that the incumbents' main customers require.

The authors clarify that, when compared to sustaining innovations, disruptive innovations '… are initially considered inferior by most of an incumbent's customers'. They also make clear that while early-stage disruptive innovations make products or services more accessible and affordable, most of the incumbents' main customers are 'not willing to switch to the new offering' until it meets their performance requirements.

However, once the new offering delivers the performance that incumbents' main customers require, the authors explain that '… they adopt the new product and happily accept its lower price', adding, 'this is how disruption drives prices down in a market'.

The authors also assert that because the new offerings initially do not meet the performance requirements of most customers, disruptive challengers are usually able to avoid head-on competition with incumbents. This allows disruptive challengers to gain a foothold by delivering a 'good enough' offering to 'low-end or unserved customers' in two markets that incumbents often overlook: 'low-end or new-market footholds'.

They explain that '*low-end footholds* exist because [in the pursuit of profitability] incumbents typically try to provide their most profitable and demanding customers with ever-improving products and services, and they pay less attention to less-demanding customers… This opens the door to a disrupter focused (at first) on providing those low-end customers with a "good enough" product'. They also add that, '*in the case of new-market footholds*, disrupters create a market where none existed. Put simply, they find a way to turn nonconsumers into consumers'.

Christensen and his co-authors then go on to describe how their understanding of what causes disruptive challengers to move upmarket has developed through their continuing work, writing:

'What we've realized is that, very often, low-end and new-market footholds are populated not by a lone would-be disrupter, but by several comparable entrant firms whose products are simpler, more convenient, or less costly than those sold by incumbents. The incumbents provide a de facto price umbrella, allowing many of the entrants to enjoy profitable growth within the foothold market. But that lasts only for a time: As incumbents (rationally, but mistakenly) cede the foothold market, they effectively remove the price umbrella, and price-based competition among the entrants reigns. Some entrants will founder, but the smart ones—the true disrupters—will improve their products and drive upmarket, where, once again, they can compete at the margin against higher-cost established competitors. The disruptive effect drives every competitor—incumbent and entrant—upmarket.'

They also address 'four important points [about disruption theory] that get overlooked or misunderstood' throughout the article:

First, that 'disruption is a process'. The authors make clear that: 'the term "disruptive innovation" is misleading when it is used to refer to a product or service at one fixed point, rather than to the evolution of that product or service over time'.

They also caution that 'because disruption can take time, incumbents frequently overlook disrupters', and they highlight that when disruptive challengers succeed '… their movement from the fringe (the low end of the market or a new market) to the mainstream erodes first the incumbents' market share and then their profitability'.

Second, that 'disrupters often build business models that are very different from those of incumbents'. The authors emphasise that 'disrupters tend to focus on getting the business model, rather than merely the product, just right', highlighting that finding the right business model can allow disruptive challengers to '…move upmarket without emulating the incumbents' high costs—that is, to follow a disruptive path'.

Third, that 'some disruptive innovations succeed; some don't'. The authors explain that it is a mistake to assume that '…a company is disruptive by virtue of its success'. They make clear that it is important for managers to understand the different types of innovation because '… different types of innovation require different strategic approaches', and they point out that if managers fail to correctly identify the type of competitive challenge they face, then they '… may end up using the wrong tools for their context' or reduce their chances of 'succeeding as a disruptive innovator (or defending against a disruptive challenger)'.

Fourth, that 'the mantra "disrupt or be disrupted" can misguide us'. The authors stress that 'incumbent companies do need to respond to disruption if it's occurring, but they should not overreact by dismantling a still-profitable business'. Instead, they advise that incumbent companies '… should continue to strengthen relationships with core customers by investing in sustaining innovations', and create a stand-alone business 'focused solely on the growth opportunities that arise from the disruption'.

The authors then distil 'what a disruptive innovation lens can reveal':

'The theory of disruption predicts that when an entrant tackles incumbent competitors head-on, offering better products or services, the incumbents will accelerate their innovations to defend their business. Either they will beat back the entrant by offering even better services or products at comparable prices, or one of them will acquire the entrant. The data supports the theory's prediction that entrants pursuing a sustaining strategy for a stand-alone business will face steep odds.'

They continue by clarifying that 'it is a mistake to assume that the strategies adopted by some high-profile entrants constitute a special kind of disruption', demonstrating how to apply the theory by looking at Tesla Motors (a high-profile entrant that is almost always described as disruptive) through the lens of disruption theory. They state:

'One might be tempted to say the company is disruptive. But its foothold is in the high end of the auto market (with customers willing to spend $70,000 or more on a car), and this segment is not uninteresting to incumbents. Tesla's entry, not surprisingly, has elicited significant attention and investment from established competitors [several incumbent companies including BMW, Mercedes-Benz, Porsche and Aston Martin are investing billions in high-end emission-free models]. If disruption theory is correct, Tesla's future holds either acquisition by a much larger incumbent or a years-long and hard-fought battle for market significance.'

The article concludes with the authors stating that they 'are eager to keep expanding and refining the theory of disruptive innovation', something that Christensen is clearly committed to doing through his continuing work and ongoing dialogue with professionals in both the academic and business worlds through disruptiveinnovation.org.

Key Concepts

On disruptiveinnovation.org, Clayton Christensen and David Sundahl define and explain several key concepts that are 'central to the theory of Disruptive Innovation', two of which are particularly relevant to any discussion of disruption in the legal services market:

First, 'the Innovator's Dilemma'. 'The Innovator's Dilemma is a situation in which successful companies and competent managers are encouraged to make decisions that maximize profitability and simultaneously result in the company's long-term downfall. By prioritizing investments with higher profits, managers are often unwilling or unable to satisfy customers in low-end or new markets. These customers become "overserved" by the current product or service, meaning they are either unwilling to pay for the high-end performance or they never had access to that product in the first place. This allows new innovators to gain a foothold from which they can disrupt the incumbent company's core business. This dichotomy is inherent in the Innovator's Dilemma; decisions that maximize market dominance also reinforce the conditions under which disruption occurs.'

Second, 'the Capitalist's Dilemma'. 'The Capitalist's Dilemma is that by overemphasizing short-term improvements in profitability, investors inadvertently undermine long-term investments that would generate more attractive profits over time. Companies improve profitability in the short-term via two types of innovation, called sustaining innovation and efficiency innovation. Sustaining innovations improve a product or service for existing customers. Efficiency innovations lower

the cost to produce a product or service for existing customers. Both types of innovation help a company improve profitability in a way that reinforces its existing business model. Companies improve long-term profitability by investing in market creating innovations. Market-creating innovations provide a product or service to new customers that was previously unavailable to them. Established companies struggle to invest in new market innovations because they require a new business model and do not improve profitability in the short term.'

Surviving Disruption

In a December 2012 Harvard Business Review article titled 'Surviving Disruption' Maxwell Wessel and Clayton Christensen also shared several relevant (and valuable) insights. For instance, the article introduced the concept of the 'extendable core' – the aspect of its business model that enables the disruptive challenger to maintain significantly lower prices as it drives upmarket to compete against higher cost established incumbent businesses.

When discussing 'what makes an innovation disruptive?' the authors explain that 'all disruptive innovations stem from technological or business model advantages that can scale as disruptive businesses move upmarket in search of more-demanding customers. These advantages are what enable the extendable core; they differentiate disruption from mere price competition'.

The authors then clearly 'delineate the barriers' a disruptive challenger would have to overcome to undermine established incumbent businesses. They do this by answering a question that is often asked by incumbents, 'what would have to change for my current advantages to evaporate?', writing:

'To approach this question, we propose a systematic assessment of five kinds of barriers to disruption, arranged here from easiest to overcome to hardest.

1) The momentum barrier (customers are used to the status quo)

2) The tech-implementation barrier (which could be overcome using existing technology)

3) The ecosystem barrier (which would require a change in the business environment to overcome)

4) The new-technologies barrier (the technology needed to change the competitive landscape does not yet exist)

5) The business model barrier (the disrupter would have to adopt your cost structure)'

The authors assert that 'the more difficult the barrier, or the more barriers a disrupter faces, the more likely it is that customers will remain with incumbents'. They continue by stating 'this approach may seem intuitive, but decades of training have taught executives to focus not on the value they provide for their customers but on proxies for it—high-level profit and revenue data. If an innovator is causing a company losses, it's deemed threatening. If not, it's often dismissed'.

The authors also emphasise that 'overestimating a threat can be as costly as ignoring it', and they argue that 'accepting the existence of a new competitive paradigm is never easy. It often forces us to acknowledge an inevitable loss of business. It may require us to develop disruptions that cannibalize our existing businesses', adding, 'failing to come to terms with these realities does us no service'.

The article then concludes with the authors advising that 'before leaders engage in reckless price competition or squander resources and effort in the futile defense of lost causes, they owe it to their shareholders, employees, and customers to take stock of the entire situation and respond comprehensively—to meet disrupters with disruption of their own, but also to guide their legacy businesses toward as healthy a future as possible'.

Disruption in the London legal services market

Turning to the London legal services market, we will start by broadly assessing the five barriers a disruptive challenger would have to overcome to undermine established incumbent law firms:

1) 'The momentum barrier (customers are used to the status quo)'. It is difficult to argue that clients are tethered to the status quo when, with the exception of a core of highly complex or important matters, clients continue to insist that incumbent firms need to deliver more efficient and cost-effective services.

Also, clients are not merely frustrated with the status quo, a growing number of them are turning their attention to handling more matters in-house as well as disaggregating more parts or phases of matters between different firms (and non-traditional service providers) to achieve increased efficiency.

2) 'The tech-implementation barrier (which could be overcome using existing technology)'. Technology that would enable legal services providers to deliver more efficient and cost-effective services is already in existence. However practical implementation at scale remains extremely challenging and expensive.

The potential of existing AI and advanced automation systems is clear. But a vast amount of time, effort and human expertise is required to train and test the algorithms, and the implementation (and maintenance) of these systems at scale is highly complex and requires a significant investment of time and resources.

3) 'The ecosystem barrier (which would require a change in the business environment to overcome)'**.** There are no significant ecosystem barriers for a disruptive challenger to overcome within the London legal services market. Market liberalisation and deregulation have removed regulatory barriers, allowing investors and new businesses (with alternative business structures) to enter the market.

4) 'The new-technologies barrier (the technology needed to change the competitive landscape does not yet exist)'. Technology with the potential to change the competitive landscape already exists, but (as noted above) practical implementation at scale remains extremely challenging and expensive. That said, however, there has been significant investment in legal technology start-ups in recent years, and over time these 'lawtech' firms are likely to dramatically improve their offerings as well as make them easier and less expensive to implement at scale.

Of course, game-changing technological advances also remain a distinct possibility at some point in the future. However, as things stand at present legal technology is more likely to augment, rather than supplant, the capabilities of lawyers.

5) 'The business model barrier (the disrupter would have to adopt your cost structure)'. There is no need for a disruptive challenger to adopt the incumbent firms' cost structure to gain a foothold in low-end or new market footholds from which they can eventually drive upmarket and deliver the

performance that the incumbent firms' main customers require.

However, for a core of highly complex or important matters, competitive advantage continues to be determined and driven by human capital. A disruptive challenger would therefore have to find a way to attract (and retain) exceptional lawyers in order to displace incumbents. This would effectively force a disruptive challenger to move upmarket by adopting a similar cost structure to incumbents, thereby making it extremely difficult for them to maintain significantly lower prices.

In other words, in order to overcome this barrier, a disruptive challenger would have to find a way to attract (and retain) exceptional lateral talent and profitably deliver the performance that the incumbents' main customers require, without adopting the incumbents' high costs.

Put simply, lower-leverage top-tier firms have the most defensible business models in the London legal services market, as disruptive challengers will struggle to create the structure and incentives necessary to attract (and retain) exceptional lateral talent for the foreseeable future.

Can disruptive challengers overcome the barriers to disruption in the Legal services market?

When evaluating the likelihood of a disruptive challenger being able to overcome one or more of these barriers it is important to remember that innovations can only be disruptive relative to the business models of established incumbent businesses.

If incumbent law firms choose to respond comprehensively and accelerate their innovation efforts to defend their business, then (as noted previously) a disruptive challenger 'will face steep odds'.

However, responding effectively would require incumbent firms to drive downmarket and compete with disruptive challengers (in a way that would not improve their profitability in the short term) by offering products or services that are *incompatible* with their existing business models.

If, on the other hand, incumbent firms choose to ignore or retreat from disruptive challengers, and focus instead on performance-improving or efficiency innovations (in a way that *reinforces* their existing business models), then they are likely to improve profitability in the short term.

However, the disadvantage to this strategic response is that it would enable disruptive challengers to avoid head-on competition with incumbent firms; moreover, the challengers would also gain a foothold from which they could eventually drive upmarket and deliver the performance that the incumbent firms' main customers require.

This situation is what Clayton Christensen refers to as the 'Innovator's Dilemma', in which 'decisions that maximize market dominance also reinforce the conditions under which disruption occurs'.

To many incumbent firms, the barriers that a disruptive challenger would have to overcome in order to undermine them may seem insurmountable from today's vantage point. But this type of assumption has been commonplace among incumbents facing disruption; moreover, time and time again incumbent businesses have struggled or failed precisely because, with disruption on the horizon, they have continued to focus on short-term results at the expense of longer-term competitive advantage.

It is therefore critically important for incumbent firms to remember that disruption is a process and is dynamic, not static. As noted previously, incumbents very often 'rationally, but mistakenly' avoid head-on competition with low-cost disruptive challengers.

This allows disruptive challengers to gain a foothold and gives them the opportunity to develop technological or business model innovations (that are disruptive relative to the business models of established incumbent businesses); moreover, as the performance of the disruptive challengers' offerings improve, the 'disruptive effect drives every competitor—incumbent and entrant—upmarket' in the pursuit of profitability.[2] This process 'erodes first the incumbents' market share and then their profitability'.[3] And the longer that established incumbent businesses wait before responding comprehensively to proven technological or business model innovations, the more vulnerable they become to competition from those that adopt these innovations.

As a hypothetical illustration of this process, let's assume that a higher-leverage top-tier firm (with eroding competitive advantages) continues to focus excessively on improving profitability in a way that reinforces its existing business model. The firm would be likely to succeed in improving profitability in the short term. However, by choosing this course, the firm would also become increasingly vulnerable to low-cost competitive challenges from legal services providers who have developed innovations that are disruptive relative to its existing business model.

The disruptive challengers in this hypothetical illustration are today's innovating mid-market firms and non-traditional service providers (with early-stage disruptive innovations): both types of firm are steadily improving their offerings, and are beginning to drive upmarket in order to 'compete at the margin against higher-cost established competitors'.[4]

Over time, if left unchallenged, the mid-market firms which are gradually reshaping their identities would (with the right business model and the adroit use of technology) be able to deliver the performance that the higher-leverage top-tier firm's main customers require in most areas, at a significantly lower cost. The non-traditional service providers would also probably be able to offer an acceptable level of performance in many areas, at an even lower cost. In this scenario, the higher-leverage top-tier firm would find it exceptionally difficult to defend its business and continue to achieve profitable growth in a way that reinforces its *existing* business model.

This scenario may seem exaggerated, but going forward, many higher-leverage firms will find it difficult to defend the low-end of their business in a way that reinforces their existing business models. Furthermore, price competition will inevitably drive a greater number of innovating mid-market firms and non-traditional providers upmarket in the pursuit of higher profitability.

Once they migrate upmarket many of these providers are likely to be able to achieve profitable growth by providing the performance that the higher-leverage top-tier firms' main customers require in many areas, but at a significantly lower cost than incumbent firms are able or willing to provide. Over time, this process will erode the market share and profitability of many higher-leverage top-tier firms. To put it another way (undifferentiated) higher-leverage top-tier firms have the least defensible business models in the London legal services market.

Moreover, as noted previously, for a core of highly complex or important matters, competitive

advantage continues to be determined and driven by human capital. Therefore, in order to displace (or 'disrupt') the products and services of established incumbent firms in these segments of the market, a disruptive challenger would have to find a way to attract (and retain) exceptional lateral talent and profitably deliver the performance that the incumbents' main customers require, without adopting the incumbents' high costs.

For many higher-leverage top-tier firms this barrier will seem insurmountable from today's vantage point (and with good reason). Nevertheless, as things stand, those that struggle to drive sustainable and profitable growth (in a way that reinforces their existing business models) are much more likely to lose key performers to firms that are better positioned to grow and face future competitive pressures than they are to take market share away from their more robust and resilient competitors.

And if disruptive challengers are allowed to continue developing technological or business model innovations (that are disruptive relative to the business models of higher-leverage top-tier firms) unchallenged, then the outlook for many of these firms will become increasingly uncertain going forward.

Simply stated, the longer higher-leverage top-tier firms (with eroding competitive advantages) ignore or retreat from disruptive challengers the more susceptible they will become to failure.

How will disruption unfold in the legal services market?

It is not possible to precisely forecast how disruption will progress in the legal services market. Nevertheless, it is possible to state with confidence that once disruption is under way, it is certain to catalyse fundamental change. And when there is fundamental change in an industry, there are winners and losers.

Moreover, however disruption unfolds (and whatever its pace), the changes wrought are likely to be foundational, regardless of whether the disruptive challengers that emerge during the process agree to be acquired, pivot towards cooperation, grow into rivals, or fail.

Perhaps the most important lesson to be learnt from disruption in other industries is that even undisputed market leaders can decline or enter a death spiral if they do not refocus and invest in technological and business model innovations, in order to deliver step-change improvements in customer experience and value.

However, step-change improvements (as well as long-term simplicity) are usually only achieved through intense periods of complexity and making longer-term investments, without regard for the effects on the short-term profitability of an existing core business.

Businesses that struggle or fail during disruption are usually tethered to traditional business models and are excessively focused on achieving short-term improvements in profitability. This short-termism causes them to undermine 'long-term investments that would generate more attractive profits over time',[5] most often because longer-term investments would have affected the short-term profitability of an existing core business.

For many incumbent firms, the opportunity cost of making longer-term investments may appear to be too high; but the cost of undermining long-term investments could be even higher. Incumbent firms face a dilemma (or two) going forward.

Conclusion

Against a backdrop of heightened political and economic uncertainty, the performance of many mid-market and top-tier firms has been resilient, to say the least.

But as firms continue to adapt to a world of growing uncertainty, complexity and opportunity, it is undeniable that some are faring much better than others. There is increasing separation between firms that are well positioned for growth and those with eroding competitive advantages. And this stratification is significant because it translates into a growing gap in resilience.

The firms that are better positioned to compete and maintain long-term differentiation will (like all organisations that compete on talent) continue to pursue the best lateral talent available. And, in the current market environment, a significant number of firms will struggle to retain key individuals who are critical to their long-term differentiation and success.

Disruption is still at a relatively early stage in the legal services market, but the 'disruptive effect'[6] is beginning to drive innovating mid-market firms and non-traditional service providers upmarket in the pursuit of higher profitability. And, at the same time, a growing number of clients are turning their attention to handling more matters in-house as well as combining the services of providers at a variety of points along the value chain to achieve increased efficiency. These and other fundamental changes are catalysing the shift to a more 'modular' industry.

The market will become much more intensely competitive over the medium to long term. This is likely to result in a gradual reordering of the London legal services market, as firms with eroding competitive advantages will struggle to minimise high-performer turnover and drive sustainable and profitable growth (in a way that reinforces their existing business models).

There is still time for many of these firms to make bold strategic choices and better compete in an ever more challenging competitive environment; however, such firms must take control of revenue-driven profitable growth, and they must also be willing to carry the cost of implementing real change, in order to ensure their ongoing success.

Over the long term, the consequences of short-termism could be catastrophic for a significant number of firms. But there is good reason for optimism. Several firms that have invested in alternative delivery models in recent years are beginning to show quantifiable progress[7]. And if such firms continue to make meaningful and measurable progress, others will undoubtedly follow.

Contact information

Paul Duffy
Partner
pd@novumpartners.co.uk
+44 (0)207 873 2308

Endnotes

[1] C. Christensen (http://disruptiveinnovation.org/theorybuilding/story-of-disruption) When writing about 'developing the Theory of Disruption' Clayton Christensen points out that the theory of disruption has been 'tested for its accuracy and predictability, and has passed these tests with flying colors', adding, 'For instance, Thomas Thurston, formerly of Intel and currently CEO of Growth Science, has been studying disruption's real-world accuracy. He has found from his sample of 3,400 predictions that the theories of disruption were right about firm successes nearly two out of three times—more than twice as good as the average prediction—and that predictions of failures were 88% right (both at $p \leq 0.01$ values). Thurston drives this point home thus: "Put into perspective, the [disruptive innovation] models have now made more predictions than all U.S. venture capital deals over the past five years combined, with a predictive accuracy more than 2.5X greater than the venture capital industry as a whole." (http://techcrunch.com/2014/06/30/christensen-vs-lepore-a-matter-of-fact/)'

[2] C. Christensen, M. Raynor, and R. MacDonald, 'What is Disruptive Innovation?' 2015 https://hbr.org/2015/12/what-is-disruptive-innovation

[3] C. Christensen, M. Raynor, and R. MacDonald, 'What is Disruptive Innovation?' 2015 https://hbr.org/2015/12/what-is-disruptive-innovation

[4] C. Christensen, M. Raynor, and R. MacDonald, 'What is Disruptive Innovation?' 2015 https://hbr.org/2015/12/what-is-disruptive-innovation

[5] C. Christensen, D. Sundahl, 'Capitalist's Dilema' http://disruptiveinnovation.org/concept/capitalist's-dilemma

[6] C. Christensen, M. Raynor, and R. MacDonald, 'What is Disruptive Innovation?' 2015 https://hbr.org/2015/12/what-is-disruptive-innovation

[7] To take but one example, Allen & Overy recently announced 'record figures for the year ended 30 April 2017'. In a news release the firm makes clear that ongoing investment in a 'range of alternative client delivery initiatives' in recent years, has 'added significantly to [their] bottom line in this set of results': (http://www.allenovery.com/news/en-gb/articles/Pages/Allen-Overy-sees-long-term-international-investment-deliver-record-results-against-a-challenging-backdrop.aspx)

Contact us

Novum Partners
15 Old Bailey
London, EC4M 7EF

+44 (0)207 873 2291
info@novumpartners.co.uk
https://novumpartners.co.uk