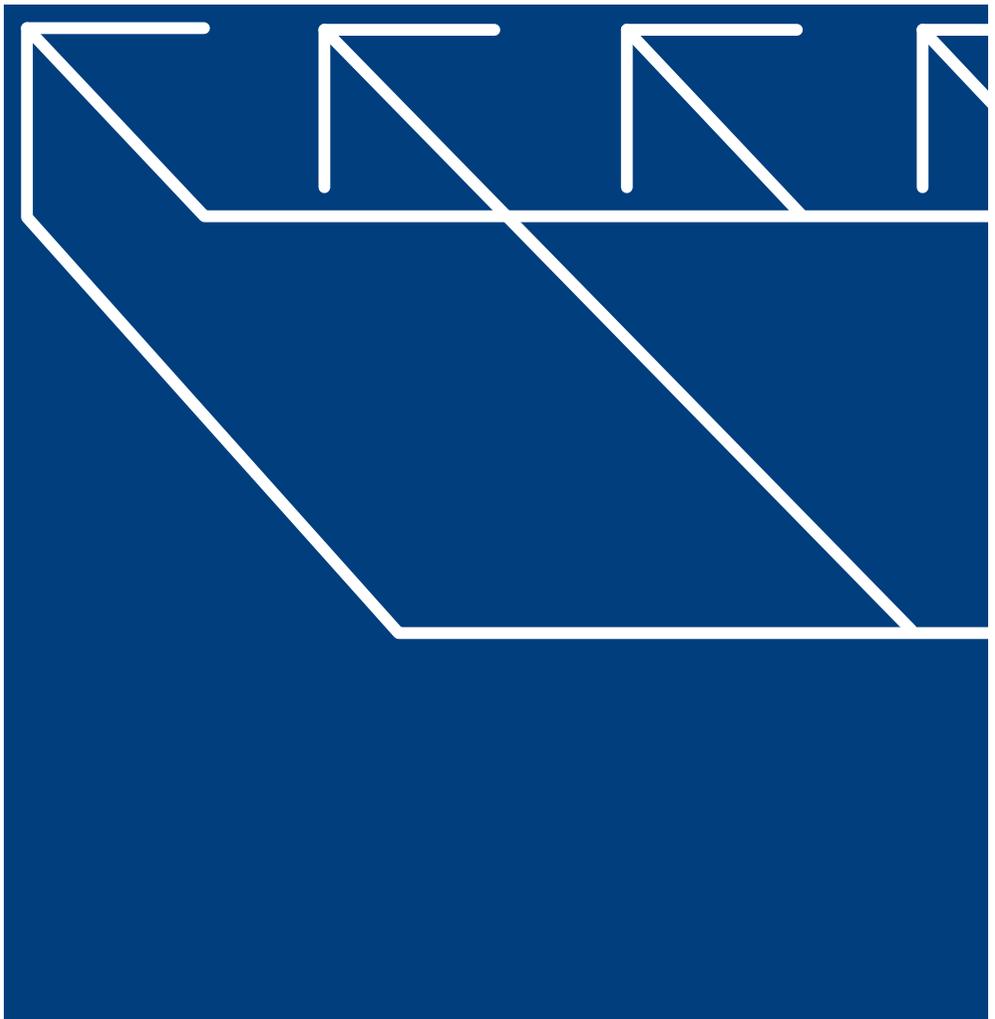




PANEL GAMES: HOW CLIENT ORGANIZATIONS PICK THEIR LEGAL ADVISORS

NOVAK DRUCE CENTRE INSIGHTS

No. 3



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‘LAW IS NOT MERELY COMPLEX... IT IS ALSO HIGHLY AMBIGUOUS AND UNPREDICTABLE. THE NECESSITY AND QUALITY OF LEGAL SERVICES ARE NOT MERELY DIFFICULT FOR NON-EXPERTS TO JUDGE; THEY ARE ALSO DIFFICULT FOR EXPERTS, EVEN THE EXPERT PROVIDING THE SERVICE, TO JUDGE.’

(G.K. Hadfield, *The Price of Law* – 2000)

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Based on the working paper, ‘Panel Games: How Do Clients Select and Retain Their Preferred Legal Advisors’ by Samantha Fairclough.

PANEL SYSTEMS

It is common for client organizations to employ a range of law firms to handle their external legal requirements, rather than remain loyal to one or two firms. Many operate a ‘panel’ system, whereby several law firms are selected and retained as exclusive suppliers of external legal services for a defined period of time. It has been claimed that in recent years buyers of professional services – especially large corporate organizations – have become increasingly demanding and discriminating in their choice of professional advisors, particularly regarding quality, price and the standard of attention they expect. So how in practice do client organizations select and retain their panels of preferred law firms? To find out, Dr. Samantha Fairclough – an Associate Fellow at the Novak Druce Centre – conducted a series of face-to-face interviews with in-house legal counsel in a range of leading UK client organizations.

MANY ORGANIZATIONS OPERATE A ‘PANEL’ SYSTEM, WHEREBY SEVERAL LAW FIRMS ARE SELECTED AS EXCLUSIVE SUPPLIERS OF LEGAL SERVICES

WHO GETS CHOSEN?

The number of law firms retained by client organizations for UK-based legal matters ranges from three to twenty-two, with the average being 9.8. A typical panel might comprise:

ONE OR MORE MAGIC CIRCLE FIRMS FOR COMPLEX, INTERNATIONAL, FINANCIAL OR HIGH RISK TRANSACTIONS

THREE OR FOUR NATIONAL OR REGIONAL UK FIRMS OR MID-TIER LONDON FIRMS FOR MORE STRAIGHTFORWARD OR 'COMMODITIZED' ISSUES SUCH AS EMPLOYMENT MATTERS OR SMALL CORPORATE TRANSACTIONS

A US FIRM WITH A UK OFFICE FOR US LEGAL WORK

TWO OR THREE FIRMS, EITHER NICHE PLAYERS WITH A SPECIAL EXPERTISE IN AN AREA RELEVANT TO THE CLIENT OR 'ON TRIAL', BEING GIVEN SMALL PIECES OF WORK WHICH MIGHT LEAD TO REGULAR INSTRUCTION IN THE FUTURE

WHO DOES THE CHOOSING?

In-house counsel – qualified lawyers employed by commercial organizations to represent them – are the primary instigators of relationships with external law firms and lawyers. All counsel that were interviewed headed teams of legally-qualified and other employees in their organizations. Some in-house legal departments were small while others up to 75 lawyers strong. The surprise finding was that, no matter how large the in-house legal department, all these client organizations still need their 'hands held' by external legal advisors. One might perhaps surmise that in-house lawyers do not value themselves as professionals to the extent that private practice lawyers do and find reassurance and legitimacy from contact with professional colleagues.

That said, in-house counsel can be considered sophisticated users and choosers of their panel law firms. Many of them had been private practice lawyers in the past and acquired excellent knowledge of the legal market. Many also work alongside their external advisors as members of a joint team, and are thus highly knowledgeable of the task at hand.

IN-HOUSE COUNSEL ARE SOPHISTICATED USERS AND CHOOSERS OF THEIR PANEL LAW FIRMS

NONE OF THE IN-HOUSE COUNSEL INTERVIEWED SAID PRICE WAS THE PRIMARY REASON FOR EMPLOYING A PARTICULAR LAW FIRM. NEVERTHELESS, IT REMAINS AN IMPORTANT FACTOR

WHY AND HOW DO THEY CHOOSE PANELS?

Client organizations cited six main considerations that guide their choice of legal advisors:

1. WORKLOAD

Most interviewees claimed that panel firms were brought in to help in-house departments when they were struggling with heavy workloads, rather than to provide legal expertise which did not exist internally. This claim should not be taken at face value, however, since all interviewees had law firms on their panels to assist with matters that were beyond their own legal or technical capabilities.

2. 'HORSES FOR COURSES'

Indeed a key reason for keeping certain firms on hand was to deal with specialist, complex, or logistically difficult legal matters. A common expression used by interviewees in this study was 'horses for courses': paying a fair market rate for straightforward, or 'commoditized' legal work while accepting that a premium rate was payable for complex, high risk, or unusual legal matters performed by legal experts. For example, a number of interviewees in this study were in-house counsel representing large financial institutions or investment banks. These explained that they were regularly involved with transactions whose scale, complexity and rate of innovation were such that only the very largest firms – firms within the 'Magic Circle' or at its boundaries – were capable of assisting them.

3. 'WILLING WORKHORSES'

As well as retaining niche firms and US firms, in-house counsel often retain a small cadre of national, regional or mid-tier London firms on their panels to deal with day-to-day legal affairs and low-to-medium risk or value litigation and transactional matters. The attentive service and cost-effectiveness of some of these firms was widely praised. Clearly, for many clients these firms act as workhorses to deal with their day-to-day problems. While thoroughbred niche

firms are only occasionally saddled up, and the champion pedigree Magic Circle firms are only brought out for the most important occasions, substantial regional or national firms represent attractive options because they offer good value for money and because of the quality of service and scale of operation they offer.

4. 'CLIENT SPECIFIC KNOWLEDGE'

Client organizations showed themselves keen to maintain long-term relationships with a limited number of lawyers and law firms who had developed a particularly close understanding of their industries, organizations, past histories, strategies and modus operandi.

5. PRICE

None of the in-house counsel interviewed said price was the primary reason for employing a particular law firm. Nevertheless, it remains an important factor. Retaining a panel of law firms was felt to encourage competition between rival firms on price, resulting in preferential terms for clients or financial discounts. Another financial consideration that guided the choice of legal advisors was taking advantage of 'freebies' – training events that panel law firms offer to in-house lawyers, or secondees that these firms position in client organizations. Both bring financial benefits: the former saves the client time and money in providing valuable training for its staff, and the latter provides a labour source which is cheaper than engaging the law firm directly.

6. HISTORY

Many in-house counsel had simply inherited long-standing relationships from their predecessors, or had become linked to a range of law firms through acquisitions and takeovers. Most reported, however, that they were satisfied with these arrangements and happy to maintain them given the benefits arising from the continuity and client-specific knowledge residing in their panel firms.

HOW IMPORTANT IS REPUTATION?

Some previous studies have suggested that the reputation of a professional service provider is one of the least important factors determining client loyalty. At the same time, a persistent theme in professional service literature has been clients' uncertainty about the quality of service they might receive, and their tendency to look to secondary cues such as reputation to establish the credibility of a professional service firm.

These contrary impulses also emerged from our findings. In-house counsel, we found, consider themselves sophisticated buyers of legal services. Client counsel were confident in their own abilities to assess the quality of legal services provided to them, believing their assessments to be superior to any advice they might obtain from the press, reputational assessments, or legal directories.

The British legal press's near obsession with ratings and rankings has encouraged a great deal of labelling and categorization of law firms – and we did find limited evidence of the influence of media assessments and rankings suggesting that positive or negative reports could chip away at the perceptions of in-house counsel over time. But in general there was widespread cynicism about the legal press and its ability to make useful discriminations between firms. Some respondents referred to the press as 'scurrilous rags', or forums for 'chit chat', with little credibility and questionable veracity. The most scathing criticism was reserved for the various award ceremonies hosted by legal magazines. Almost without exception, these were decried as illegitimate or 'rigged'.

Rather than to the media, client organizations looked to indirect sources – a tendency accentuated in a sector shrouded by client confidentiality and discretion and which exhibits what has been called 'an introverted façade'. The sources of information client organizations were most prepared to rely on were word-of-mouth recommendations from trusted contacts. Often they were reluctant even to contact a firm with whom they had had no previous link of some kind.

Despite – or perhaps because of this – the UK legal profession remains a field sharply stratified by reputation. The Magic Circle and similar labels form part of the cognitive geography of the British legal profession, forming a collective industry map in the minds of market participants. Other reputational tags and stratification devices such as 'Global Quartet', 'Silver Circle', 'National' and 'High Street' also play a key role in client organizations' decisions regarding their preferred panel firms.

Clients' need for a panel relationship with at least one of these high status Magic Circle firms overrode any desire to demonstrate financial rationale for their panel decisions. They were not dissuaded by the fact that there are a number of high quality, 'full service' law firms in the reputational tier below that of the Magic Circle, who charge at lower rates. Magic Circle firms clearly occupy a competitive niche which brings them huge advantages in terms of access to clients. They are felt to be an essential part of any panel because they are perceived to possess a monopoly on complex, high risk and difficult transactions.

CLIENT ORGANIZATIONS PREFERRED TO RELY ON WORD-OF-MOUTH RECOMMENDATIONS FROM TRUSTED CONTACTS

ALTHOUGH MAGIC CIRCLE FIRMS CURRENTLY ENJOY PRIVILEGED ACCESS TO BLUE CHIP CLIENTS WITHOUT FEAR OF RIVALS, THEY SHOULD PERHAPS LOOK TO THEIR LAURELS

These advantages mean that Magic Circle firms can charge premium prices and to an extent take liberties with their relationships with client firms. Since there are no perceived alternative providers of this kind of high-level work, Magic Circle firms enjoy a position which reinforces their already almost invincible reputations. For boundary firms located just outside of the Magic Circle, the loss of business due to their failure to be included in this category must be huge.

We identified one category of client organizations who were so wedded to their elite firms that we called them 'Magic Circle groupies'. At the same time, we also came across a disproportionate number of complaints about Magic Circle firms, describing them as 'arrogant', 'complacent', 'inattentive', 'stodgy', 'not showing enough energy' and 'patchy in terms of associates'. While clients can have little complaint about paying a fair price for a so-called 'Rolls Royce' service, the concerns raised about Magic Circles firms' client service – or rather lack of it – should be a warning sign for these firms.

Although Magic Circle firms currently enjoy privileged access to blue chip clients without fear of rivals, they should perhaps look to their laurels: the abuse of their position may already be impacting their image at a word-of-mouth level and may come back to haunt them. Reputations can be tarnished, the status quo crumble, an incumbent can fall from grace and a boundary firm can move up to the Magic Circle. At the very least, negative reviews could enable firms already within the Magic Circle to poach clients from one other.

BREAKING IN

How can an up-and-coming law firm gain access to a panel? Our research has identified strategies that may help practice managers and marketing managers in law firms initiate and develop successful relationships with clients.

Know your target. The capabilities and needs of clients are multidimensional and should be carefully assessed in advance, taking account of the history and nature of clients' current portfolio of law firm relationships.

Show up on the radar. Respondents listed a variety of ways in which law firms had come to their attention – word-of-mouth recommendation, observing an individual 'on the other side' of a transaction, meeting lawyers at conferences and reading about firms or individuals in the press. Any of these connections could lead to an invitation to participate in a 'beauty parade'.

Personal chemistry counts. While price is important, in-house counsel are primarily interested in the quality of their relationship with their external legal advisors. They value individual empathy, attention and compatibility above everything else. Respondents talked about being persuaded by a 'spark' with a particular individual. However that spark is most likely to be ignited by a lawyer perceived by the client to have intimate knowledge of their business and its legal concerns.

Be the beauty parade queen. Once in a beauty competition, what are the key attributes to emphasise? One interview spoke of the top four C's which his firm looked for: 'competitiveness, commercialism, compatibility and cost-consciousness'.

Get your foot in the door. As mentioned, some in-house counsel give small pieces of work to non-panel firms in order to test their abilities and, if successful, are prepared to hire them for more significant assignments. There is evidence that some London-based firms are being wrong-footed by their regional competitors, who pursue aggressive, client-centred strategies perceived by clients to be 'proactive' or 'dynamic', leading to an increased flow of work out of the capital to these firms. A number of respondents explained that their relationships with these mid-sized regional firms had developed because these firms had first proved their abilities on small legal matters and impressed them with their competitive pricing and exceptional service.

Invest in the relationship long-term. Recent changes in the legal market have shifted the focus of legal marketing from initiating to maintaining relationships. The key lies not only in delivering good service but also in building trust, developing client-specific expertise and continually refreshing knowledge in client-related areas.

Look to your laurels. Magic Circle firms might benefit from pursuing strategies which elicit desire rather than dependency in their clients. They would also be well advised to weigh the long-term implications of the service-oriented criticisms outlined in this report.

The Insights series aims to provide accessible summaries of recent research by members and associates of the Novak Druce Centre for Professional Service Firms at the Saïd Business School, University of Oxford. Each Insight focuses on a particular issue in the management of professional service firms and offers a fresh, up-to-date reading of this issue.

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