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The Legal Process Outsourcing Landscape in 2011

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Act Fast; The Offer Ends Soon; First Come, First Served

Headline savings from the use of Legal Process Outsourcing range from 44%[i] through to an even more breathtaking 90%[ii]. However, outsourcing deals that are driven only by a desire for savings seldom achieve their full potential; cost has to be viewed as part of a full portfolio of strategic benefits. 2011 offers a small number of progressive law firms and legal departments, a once-in-a-lifetime opportunity to access this wider portfolio of benefits, wrapped around their current operations and strategic objectives, while also shaping the future LPO delivery landscape.

The Emerging Delta

2010 saw a remarkable confluence of forces: a maturing supplier market that cemented confidence in the theory of LPO; a growing volume of LPO supply that puts downward pressure on prices but confirms the wisdom of the early movers; law firms remaining under margin pressure; in-house legal departments in the public sector and private sector facing significant cost pressure.

Anecdotally, these movements are summed up by two specific events in late 2010. First, in November, Thomson Reuters acquired one of the major LPO providers, Pangea3, buying out the same VC firm that had invested early in YouTube, Oracle, etc. While LPO has been around for many years, this was a major global corporation buying into this sector, giving it a new level of validity. No one would have been surprised if a traditional outsourcer like Accenture, IBM, or Wipro had been the buyer, but Thomson Reuters is a data and information company that sees the value of the "Knowledge" more than the "Process Outsourcing." Combined with the astonishing number of LPO suppliers (we are currently tracking 135 on our LPO Market Watch database), this demonstrated genuine supply-side maturity.

Second, around the same time, at a conference in the Scottish town of Stirling (think Braveheart and you are in the right place), a survey showed that 15% of local authorities were considering outsourcing their legal departments. Public sector cost pressures in the UK are well documented, so the attraction is obvious. The surprise is that the legal department ranks as high as fourth in the priority of functions companies consider outsourcing.

In the wider context it now appears that the Public Sector "gets" LPO, in-house legal departments "get" LPO, and our research shows that even the 83% of law firms that "would not comment" on their use of LPO are at least investigating it. If the Pangea3 deal confirmed the supply-side maturity, this fully confirms the demand-side market maturity.

Shape the Landscape – Offer Closing in 2011

Despite the increasing flow in the rivers of supply and demand, the delta where they meet has not yet been fully formed. 2011 is probably the last opportunity for a handful of law firms and legal departments to shape this landscape in a way that directly benefits their organization. If anyone has any doubt about what is available, look at the CMS Cameron McKenna deal with Integreon.

Here was a major European law firm outsourcing all back office (non-legal) functions to a third party, having the work carried out on their existing premises in the center of London, by the existing CMS workforce who have transferred to Integreon, with, one assumes, a large savings guarantee. When you look back at the major, market-breaking deals in other areas of outsourcing (e.g., HR, clinical research, and F&A), the locations which were taken over from a client as part of a deal are still the key delivery hubs 10 years later.

For any law firm or legal department that wants to preserve their workforce and benefit from LPO there are still several variations on the CMS/Integreon deal waiting to happen, but the number of opportunities is strictly limited.

Deals that involve the transfer of an existing operation (e.g., back office non-legal, centralized legal operations units, low cost on shore delivery centers, etc.), preferably in a low-cost, onshore location, will be of huge short term interest to Suppliers but will not be duplicated. To illustrate this point, we are willing to take all reasonable bets that Integreon will not be doing a second "transfer of operations" deal in London covering back office functions. Each deal is a one-of-a-kind, so the question to be asked is "Do you want to shape the market or be shaped by it?"

So Many Options – Which Island To Choose?

On our mythical LPO delta there are multiple islands forming, with varying profiles of risk and benefit, all the way from offshore outsourced to onshore insourced. Unusually, the choice of Island destination is heavily affected by externalities rather than being purely business-driven.

Clear examples of market externalities are the anti-outsourcing political climate in the US or encouragement by UK regional economic development bodies to invest outside of South East England. A TARP-funded organization like AIG or Fannie Mae will probably not expend valuable political capital by offshoring legal work to India, but will be more attracted to a low cost, onshore location. The recent UK example of Herbert Smith transferring activities from London to Northern Ireland shows that regional state "encouragement" makes the decision a little easier. (And we have also seen examples of low-cost US states offering similar "encouragement.")

On the ethical front, the directional guidance of the legal bodies has swung towards accepting the existence of LPO, though with one eye on protecting in-country legal jobs. American Bar Association (ABA) clearly reminded the profession that outsourcing of work does not abrogate responsibility for the results and the quality of work being carried out. We wish that other professions had stated that point just as loud and clear in other areas of outsourcing. However, the ABA's judgment is still at Discussion Draft status and with the UK Solicitors Regulation Authority *considering* conducting a "thematic review" of LPO in 2011, you do get a feeling that they are trying to put Tarmac on an already well-trodden path.

Regardless of which (if any) LPO island is chosen, the option selected in 2011 will still offer organizations some competitive advantage and the ability to control the landscape. By going to clients with a clear and pre-planned strategy, law firms and law departments will be talking a language that many of their clients have lived and breathed for years.

Relax – The Islands Are Joined Together

Decisions made in 2011 are not final in terms of the delivery model, location and scope of services. If you choose to offshore in 2011 then bringing it back onshore further down the line is not unheard of. More common is the initial choice of an onshore location followed, when the organization is comfortable with the offsite delivery model, by full offshoring.

Given the age of the marketplace there are perhaps only a handful of Second Generation buyers of LPO services so it is hard to determine any evolutionary pattern. Someone like Microsoft falls into this category and their decision to extend the use of LPO in India was a double-confirmation of their comfort with the outsourced, offshore model.

To help existing customers acclimatize and progress the LPO providers have to remember the importance of ongoing innovation. Most LPO deals are the "Lift and Shift" of existing operations to either a new location or a new process owner. The LPO will do what comes naturally (i.e., project management, Six Sigma, lean manufacturing, etc.) but will get to a point where they have optimized the process as far as possible. The question then turns to "what next?" and the LPOs have to have an answer to that.

Users of any outsourced service most frequently complain about the lack of innovation in their supplier. So that LPO doesn't suffer from that, both sides must act early in the relationship; account managers have to drive it to their clients; supplier managers in the clients have to embed it in the strategic governance structures.

Innovation will also come from specialization. Suppliers who can demonstrate a depth of operational excellence in specific verticals (mining, financial services, pharmaceuticals, etc.) will have a clear advantage when going head to head in competitive bids. In any transfer of assets deal, the competitive value of the sector-specific knowledge has to be factored in to the overall deal value. The legal profession will get comfortable buying non-core services from a trusted supplier who may also be supplying their competitors with the same services. Indeed, the suppliers already have the structures and disciplines in place to ensure that there are no conflicts of interest.

Are We There Yet?

There are many articles on the future of law firms and what the firm of 2020 will look like, but when it comes to outsourcing, the major pharmaceuticals offer an interesting parallel. As advanced users of KPO, pharmaceuticals can show managing partners and general counsels a model in which previously core activities such as R&D are outsourced to deep specialists, even as the organization operates and grows in the glare of quarterly reporting and the pressure of meeting analyst forecasts.

Our projections show a 34% growth in the LPO market in 2011 and even that takes it to only a fraction of 1% of the overall size of the legal services market. So, clearly, we are not "there" yet. As transfer of asset deals happen, the growth of the overall market will continue but the range of options available to the next wave of buyers will be more limited. Setting up a strategic relationship based around your current operations, people and location will not be an option 12-18 months from now. Given that these deals take a minimum of 6 months to complete then Q1 2011 should be spent having a long hard look at the options in front of you and recognizing that this is a once-in-a-lifetime opportunity that, at the very least, ought to be investigated.

Recommendations for Law Firms and In-House Legal Departments

1. **Review the market landscape in your geography and area of specialization.** Determine the gaps and your potential fit with the LPO Suppliers' existing capabilities and portfolios.
2. **Carry out an operational gap analysis between your current practices and market best practice.** This should cover the use of technology, the level of process automation, the use of service metrics, benchmark performance, use of Six Sigma/project management, etc.
3. **Establish an operational asset inventory.** Process improvement costs are typically written off as they are paid for but this masks hidden value and undermines your bargaining power in discussions with LPO suppliers.
4. **Use Steps 1-3 to build the business case to establish the value available to your organization.**
5. **Establish a clear value proposition with which to approach LPO suppliers, covering the opportunity available for both your organization and the LPO.**
6. **Don't work in isolation.** At an early stage reach out to the LPOs and start a dialogue. Regardless of the hard facts identified in any analysis, successful outsourcing comes from cultural and strategic alignment.

About HfS Research

HfS Research is the foremost advisory analyst firm and social networking community, focused on helping enterprises make complex decisions with their business process and IT outsourcing strategies.

With 43,000 subscribers, HfS Research provides the most impactful and frequently-visited global collaborative community platform in the global services industry, providing rapid and insightful commentary, analysis and debate of enterprise outsourcing dynamics. The organization is unique in the fact that it integrates personable social networking with market research and advisory services.

The HfS Research mission is to provide a unique environment for collective research, opinion, experience and knowledge across the global outsourcing industry to help enterprises explore new performance thresholds. Led by industry expert Phil Fersht, the HfS Research team is a multi-disciplinary group of analysts across North America, Europe and Asia/Pacific regions, with deep domain knowledge in Business Process Outsourcing, Information Technology Services and Cloud Business Services.

Launched in 2007, HfS Research's acclaimed blog "Horses for Sources" today has more than 120,000 monthly visitors across the global outsourcing industry, and is widely recognized as the leading destination for collective insight, research and open debate of industry issues and developments. The HfS LinkedIn community is thriving with over 12,000 industry professionals sharing views and information daily. More information about Horses for Sources can be accessed at www.hfsresearch.com. The company can be followed on Twitter at www.twitter.com/horses4sources and LinkedIn by joining The BPO and Offshoring Best Practices Forum.

For more information about HfS Research, please email research@HfSResearch.com.

[i] Source PwC

[ii] Source Pangea3