Globalization and the Future of International Law Firms – The Perspective of a Management Consultant

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A. Introduction

The legal profession world-wide has been transformed over the last decade and the shift towards globalization is an outcome of that transformation. The critical force driving this transformation has been the impact of competition and this has been generated on both the client (buyer) side and the law firm (supplier) side. While still not complete we have witnessed a remarkable progression, from a traditional profession with tight restrictions on competitive practices to an increasingly highly competitive professional business sector.

This transformation has occurred at a different pace around the world and different regions are at differing stages of development in this process. One sign of this is the current status within the ruling professional bodies (i.e., Law Societies and Bar Associations). In most cases these have been followers rather than drivers of the process and the degree of relaxation of rules governing competition within a particular country or region is a sign of the competitive pressure on firms in that jurisdiction. In general, the greater the pressure, the greater the demand for professional bodies to adapt their regulations to the new environment, and this is what has happened.

The primary regions in the world where the competitive transformation has occurred have been the USA and UK (with Europe now changing rapidly) but it has also been intense in countries such as Australia, Canada and South Africa. Within Europe the UK has been the leader in the transformation and the changes in mainland Europe are a reflection of what has happened in the UK already. Furthermore, these changes in the legal profession also reflect some major social, economic and political changes that are occurring throughout Europe as well.

In this article the focus is mainly on Europe. There are two reasons for this and the first is that the pattern of events in Europe over the last decade provide an

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excellent case study of an 'industry' in transition, from low to high levels of competition, and the implications that this has for everyone in that industry. In particular it demonstrates how change that occurs initially in one market segment flows over and across other segments of the same industry, such that no one is immune from the impact. This is a main theme in this article.

The second reason for focusing on Europe is that it demonstrates the growing internationalization of the legal profession within one region. The issues here are common across the world albeit at a different stage of development (as noted before). In seeking to build a 'European' market position as distinct from a position in each local jurisdiction, the critical issues raised by globalization (i.e., cross border) are illustrated and, therefore, serve the needs of this article. We stress, however, that the key principles and issues apply in all other regions of the world.

A critical issue explored in this article is the workings of competition in a profession, in this case the legal profession but with wider applicability. This is an area in which many lawyers are still struggling to understand the meaning of competition, how it applies to a law firm, what it requires to be competitive and how to put it into practice. This lack of understanding is not surprising, given how quickly competition has swept across the profession. Furthermore, a lack of in-depth understanding has not been to the detriment of many, simply recognising it as a fact of life and at least starting to implement some of the changes that can make a firm more competitive has allowed many to prosper during a period of turbulence and growth.

The danger is, however, that many who have implemented change over recent years become complacent and see themselves as now being 'competitive'. In reality what has happened over the last decade, to a large extent, is that one group of firms recognized the need for change while another group did not. The latter group has all but disappeared in the UK (either through merger, split or decline) and this process is now underway in mainland Europe. We see this as Phase I of competition, those who recognize the need strive to do 'things' better and tend to succeed relative to those who fail to adapt. This is not the same thing as becoming competitive as we will argue below.

In reality, many of those who are in the Phase I successful group have not addressed competitive issues in a fundamental way. They have moved from being firms in a low competitive environment to firms that are managing themselves much better than before in a higher stage of a competitive environment; and there has indeed been quite fundamental change in many firms to make them better. In most cases however, the benchmark is better than before not more competitive vis-à-vis competitors. The two exceptions to this are the UK 'Magic Circle' firms (Allen & Overy, Clifford Chance, Freshfields, Linklaters and Slaughter and May) who made leap away from a number of other firms who were around the same market position in the late 1980s, and another small group of firms who are just beginning to stand out from their direct competitors. Both of these groups have done many of the things that we explain in the next section that take 'becoming better than before' to a higher stage, which is 'becoming competitive'. What is becoming clear to many is that

simply being better than before is not good enough if direct competitors are even better again, firms can become better but decline against competitors. The critical issue in competition is to be better than the competition in such a way that a firm's chosen market sees additional value generated over and above what competitors generate; it is about outperforming the competition, not mirroring what they do and hoping to do it a little better.

This is not meant to denigrate the many other firms who have made far reaching changes in their business in recent years and who are indeed very good firms, but when asked what makes them stand out, what differentiates them from the competition in a way that really creates added value in the market there is very little that is truly differentiated in a competitive sense. They do similar things in a similar way with similar people to a wide range of similar firms. One firm might be better at some things than another but so are many more firms. They have similar systems and processes and are grappling with similar problems. They have a fear of trying something revolutionary because if no one has done it can it be any good? but are also sceptical of doing something others have done (even if it needs to be done) because of the copycat effect.

In effect we are at Phase II in the development of a competitive industry. In Phase I there is a separation of those who accept change and those who do not. In Phase II the separation occurs within those who accepted change, some continue on with the change process and turn it into a fundamental competitive change, while others keep on making things better, but better than before, not necessarily more competitive. Put another way, the incremental changes that tend to occur in Phase I are not the way to address the required changes of Phase II. In Phase II there is a need for some radical thinking about the whole legal process and the ways in which it can add significant bundles of value to clients that competitors cannot match easily or quickly; and to then structure an organization so that it continues to generate layers of competitive advantage ahead of competitors. Bold and radical thinking will be required along with a willingness to take risks and this is a package that many lawyers have been unable to embrace so far.

The fascinating issue in mainland Europe is that firms are entering Phase I of this process just as the UK market is going into Phase II. Also the separation in Europe is likely to be faster and quicker than the UK because of the influence of the more competitive UK firms in mainland Europe. Some of the major drivers of change across Europe are the UK firms who are addressing change as a real competitive differentiation (the firms in the two groups noted above) and the firms joining with them will be swept into Phase II very quickly. Other firms in mainland Europe will move more into Phase I (being better than before) either independently or with UK and US firms who are still in that position. The gap between these firms and those who are really grappling with the fundamental issues of competition is likely to become huge and in a short space of time. Firms who fail to understand this difference between being truly competitive and simply better than before are likely to be left well behind in the race for quality clients, quality work and quality people, and the gap between them and those who succeed is unlikely to ever be bridged.

In the next section we address what it means to be truly competitive and the difference between this and simply 'being better than before' (but not necessarily more competitive). We then use this to demonstrate that globalization and the rise of international law firms has a perfectly coherent competitive logic to it. The fact that not every consumer wants to buy from such a firm does not invalidate the concept provided there are enough buyers who see value in it. We then apply this to the current status of the legal profession in Europe and present some hypotheses about the future of international law firms based on this.

B. Competition and Law Firms

Across the UK legal profession the most common pattern has been a management revolution rather than a strategic or competitive revolution. Driven by increasing demands of buyers to improve performance, firms have adopted a wide-range of management processes that have caused fundamental changes in them as organizations. Very little of this has been strategic at a fundamental level although there is no doubt about its necessity. Without these changes many of these firms would not exist today. By becoming better organizations than before they have been able to 'stay in the game' and maintain a level of success. Furthermore, without these changes they would not be in a position to drive through the next round of change which will be to build a truly competitive business for the long-term. While many in these firms will recoil at this suggestion, and feel that they have positioned their firm in a competitive position already, our argument in this section is that they have positioned their firm to now be capable of moving into a competitive position and the next few years in the UK will start to separate those who can move to the next stage and those who can not. Studies of other professions who have gone through a similar process demonstrate the same pattern. The accountancy profession in the late 1970s/early 1980s went through its Phase I which is always more of an organization/management revolution than a strategic one. For many firms, however, it is a necessary 'rite of passage' before they can grapple with the fundamental strategic issues of competition. The accountancy profession also showed that, as in the legal profession, there will be a small number of firms who are able to move quickly through Phase I and into Phase II and make huge competitive gains on everyone else.

As we noted in the introduction, the same process is underway in many mainland European firms although the pattern is a little more diverse than it ever was in the UK. There are firms who are refusing to face reality and are prepared to undertake very little change (to be fair, not all of the partners in these firms are of this view. which is why partners are starting to move between firms). Others are well into Phase I, seeking to improve the management and operation of their firm in a classic Phase I 'better than before' approach. A third group are already moving into Phase II (in

some cases having barely entered Phase I) because of their links with the UK firms who are in Phase II. This makes the first group of mainland European firms particularly vulnerable, their clients, partners and staff who see the need for change have a number of other choices in today's market and many are making that choice. As happened with the early movers in the accountancy profession the experience of those firms who have linked with Phase II UK firms is being used by many of those resisting change to argue that it is all doomed to failure, that the pain and problems that are being encountered 'prove' the folly of the changes proposed. All this proves is that any firm who moves quickly from a low to a highly competitive environment will find it painful (and some people in those firms will reject the pain and leave). But those who come through this will have the potential to leapfrog their competitors. The decision to jump quickly to a Phase II position is a part of the bold and radical thinking that is necessary to transform a firm into a highly competitive organization. Provided the changes deliver the value that clients are seeking, and deliver more than competitors, there is a prize to be gained for the pain. This is one of the biggest lessons of competition that many lawyers have yet to learn and many will learn the hard way as many already have. As the old sporting cliché has it, 'There is no gain without pain'.

In considering what makes a law firm highly competitive or, put another way, what the elements of a competitive business model are for a law firm, it should be noted that the period we describe as Phase I in the competitive process is an essential part of this business model; i.e., the changes undertaken by firms in Phase I are an important transition towards a competitive position. A major concern we have is that too many firms think that by addressing the Phase I issues they have achieved a competitive position whereas our argument is that there is still a second phase; and those that have survived into Phase I will suffer in the next few years if they fail to address these issues and move on quickly to Phase II.

Our argument in the preceding paragraphs is more that some firms have been able to move rapidly through the Phase I changes because they realized that they were transitionary steps, not that these changes were unimportant.

In our Phase I, the early transitional years of competition, firms addressed a wide range of issues and, in many ways, have transformed themselves into much more effective business organizations than a decade ago. People who criticize law firms for their organization and management miss the point that there has been enormous change in this area. In many ways it has been an organizational revolution but a necessary one if firms are to become more competitive. They have developed 'strategic' or business plans (but see below), implemented management and decision making structures (and moved to some delegation of decision making by the partners to a management team), developed practice groups as profit centres and management units, installed better management information systems, implemented marketing processes and programmes, implemented performance management systems, developed new ways of compensating partners, and undertaken management training along with a wide range of other management processes and disciplines. There is little doubt that the average UK firm is now a

much better managed organization than a decade ago (even though it might not be perfect, but then, who is?); and it is this model that many mainland European firms are seeking to emulate.

Despite all of these changes the vast majority of UK firms (and mainland European firms) do not have a firm grasp of a competitive strategy for their business, and the changes required to achieve this will make the past changes pale into insignificance. The strategic planning they have undertaken has, in many cases, given them a clearer focus on their business, they have become much more aware of what clients want in service delivery and they have sought to adapt to these needs and wants, and they have recognized that commodity (or low value added) services need to be structured and delivered differently to higher value added services. Many have gone further and implemented relatively sophisticated technology-based documentation systems which achieve consistency throughout a firm and reduce costs. What has yet to happen in many of these firms, to varying degrees, is to link up all of the strategic and business issues into a coherent approach to developing a competitive business in the future, one that is not only better than before but which is differentiated from competitors in such a way that it provides sustainable growth and profitability above the average. This requires a level of competitor and market understanding that is still absent at the required depth in many firms, and it requires the ability to translate this into both a set of organizational processes that can deliver the required value to clients and which contain an adaptability to constant external change. Becoming truly competitive requires a firm to take the resources and skills it has, which are similar to those of its competitors, and then configuring and managing these in a way that generates a value to clients far superior to that which those competitors generate. Only when it does this can it move to a position where it can start to differentiate itself by attracting better quality resources and clients which then drives another layer of competitive advantage between it and the competition. Put another way, in Phase I of the competitive revolution firms transform their organizations and develop pieces that can form a competitive strategy; in Phase II the winners will be those who assemble the pieces together and manage these into a coherent competitive strategy. We set out below what this means.

A coherent competitive strategy for a law firm should contain:

- a clear strategic positioning and the key strategic components for achieving it;
- the strategic capabilities and competencies required by such a strategy;
- the organizational processes to deliver this;
- in-depth client/market knowledge and understanding.

Under the rubric of 'strategic positioning' will be the type of firm it is seeking to be, the position in the market it wishes to occupy, the client/practice area focus that is consistent with this and the core strategies for moving forward. It will also address the position in terms of whether it is seeking to be a high value provider or not. The relationship between those parts of the business that are in the focus and those that are not will also be explained. Within the core strategies will be those areas where the firm intends to differentiate itself from the competition.

The strategic capabilities and competencies will spell out clearly what exactly the firm has to build and develop in order to meet the requirements of the strategic positioning statement. This will include technical skills as well as service delivery skills, documentation systems and other processes tied into the creation and delivery of the legal process. In here will be something that will demonstrate how this firm will outperform the competition, either in terms of the capabilities and competencies it has or in how it will turn these inputs into a superior output (or both).

The organizational processes will cover the priority areas within the organization as to what has to be done and managed effectively in order to deliver the services in the manner required in the preceding parts of the strategy. It will also establish the economics of the business given the required price/cost ratio of the core business and the margin will be reflected in most of the structures and processes. (A low margin business will be configured entirely differently to a high margin business in almost everything it does and this means much more than just the partner, staff ratio that obsesses many today).

Finally, but of equal importance, there will be a deep understanding of the market for legal (and competing) services, the trends and patterns in that market, in-depth insights into specific focus areas in the market and the benefits they perceive from legal services, and an understanding of what changes might create latent needs and wants thereby stimulating new benefits. The way in which competitors generate value will also be known in-depth. There will be large investment made in truly understanding how value can be created for clients in different ways and what constitutes a competitive way for this firm as distinct from others.

In our view these four areas, when integrated, define an effective competitive strategy for a law firm. Having such a strategy does not mean a firm will be successful because it still has to be delivered. It might be coherent but fundamentally unachievable given the firm's positioning today. But without such a strategy firms will be increasingly at risk as others develop such an approach to their business (as some have done already).

We noted earlier that the majority of UK firms have addressed many of the organizational issues required to make them better managed and more effective organizations. They have also developed many of the pieces that form a competitive strategy but have not pulled them together into a coherent whole, at least one that provides a real competitive differentiation in the sense described above.

Within the strategic area many firms have developed a clearer focus to their business in terms of the clients they serve best and the practice areas where they have greatest strength. In far too many, however, they are not clear as to where the non-focus areas fit and there is a distinct lack of discipline across the partnership as to whether people really do spend their time on the focus areas or not. Furthermore, they have many partners who might have agreed with a particular strategic positioning but actually wish it to be something else and are always 'pushing beyond the strategic boundaries', resulting in a lack of clarity in the market. Many have identified the practice areas that are their strongest, but not realized that they are no more competitive than many other firms in these areas. Finally, far too many are

unclear about their value focus (are they high value added or commodity); and are attempting to deliver services in a way that matches a value level far away from where they actually are. While there is a general understanding now of high and low services, firms with quite different mixes between high and low are operating in very similar ways.

There is also a lack of understanding about the key strategic components for delivering a strategy. The focus in many firms is still on technical skills rather than the package of skills required to deliver services in a competitive way. To some extent this is because they are unclear as to how competitors deliver services and how differentiation might be achieved. A key reason for this is that many partners still cling to a cherished belief about the role of a partner in delivering legal services to a client and find it difficult to envisage anything radically different. The role of technology in actually delivering services is still rejected by many as is the notion that a significant volume of legal services do not require a lawyer to deliver them let alone prepare them for delivery. There is a long way to go here for many firms.

As a consequence while most now have better managed organizations with defined processes and systems in place, these are not structured in a way that will ensure the firm achieves a competitive differentiation in what it does. They tend to ensure that a similar output emerges across the firm and that it is reasonably efficient, rather than directed at the key areas of competitive advantage and configured so as to highlight these.

Finally, while most firms now carry out client interviews and questionnaires etc, a large number are focused on the detail of service delivery rather than on developing insight and depth into the buying patterns and trends in particular sectors. Furthermore, there is very little thinking about breakthrough strategies, i.e., finding ways of delivering services that produce benefits clients have not even thought about but see the value immediately it is done. Asking the market what it wants and whether it is satisfied with what it is getting is important and valuable, but breakthrough thinking tends to come from people who look at the market data and ask the 'what if' questions. The buyers of services are rarely the people to answer the breakthrough question but insightful thinkers who understand the patterns of a market can do so.

In essence we see that the next major challenge in Phase II for law firms is to pull the pieces together within each of the four components and to then integrate them so that each component is interdependent with the others. As we will demonstrate in the next section a small group of firms are already well down this path and this group includes the firms who are making the running on building an international law firm. This small group have a very clear focus in terms of both clients and practice areas, they know the value position they want and have structured their organizational processes, economics and delivery systems to achieve it, they understand the primary strategic capabilities and competencies that they must have and are developing these, and their market knowledge is high. In addition these firms demonstrated 'breakthrough' thinking by moving into cross-border legal services when the market, generally, said there was no demand. They recognized that with the right approach

demand could be created and this is largely what has happened. The challenge for all other firms is to now create their own business model, one that differentiates them in terms of the value they add to clients over what competitors can do, and to be able to focus on building the capabilities, competencies and organizations that can sustain their differentiation. Not all successful business models need to have an international element but, if it does, then there are some critical capabilities, competencies and organizational processes that will need to be in place to be successful.

The single biggest barrier to firms moving into a strong competitive position is the character and nature of the partners and the quality of leadership in a firm. In any population a large majority of people will be conservative, resistant to changing the well-ingrained ways of 'this is how it is done'. This is particularly true in the professions where practices and traditions in ways of working demonstrate, over many years, that they bring success to those who follow them. The training of a lawyer even today is about instilling in people a sense of tradition in the legal process, in the way a lawyer works to get the best result for a client. But it is this very way of working that is being challenged by the competitive environment. The means by which benefits have been generated for clients in the past is being turned upside down as clients now reinterpret what they see as a benefit. Simply re-jigging the role of a lawyer, boosting the role with the use of some technology and imposing economic constraints on the time taken to produce the work, do not address the fundamental issue, which is, in a world where the demand for and benefits of a service have changed fundamentally, there is enormous scope to completely reconfigure the creation and delivery of that service in such a way that the traditional process cannot match and yet which sacrifices nothing in terms of professionalism and exceeds the expectations of the market. While one can sympathize with partners who see their years of training being abandoned and a completely new role emerging, it is the revolutionary that will make the real breakthroughs in the next decade and the practice of law will not be the same again.

The changes will not come about through those that want to throw everything out and 'become businessmen or women'; that cliché still abounds but it entirely misses the point. Nor will it come about through the 'let's shake them up school', who see the problem disappearing if everyone runs around the market telling all and sundry how good they really are. Nor through many of the similar ad hoc and ill-disciplined approaches that are advocated and which lack any in-depth understanding of both the nature of change in a partnership and the fundamental strategic issues facing the legal profession. Moving a firm through our Phase II and into a strong competitive position will come through a group of people in a firm who accept our framework for a business model, work through it collecting evidence and information (and encouraging others to do likewise), who use this to lead the thinking in a firm, who ask more questions than they give answers, who do not rely on one-off examples or emotion to cloud their judgement but look at patterns and trends, and who are resolute in seeking a solution no matter how much it challenges the orthodoxy, but who never forget their professional ethics and that they are lawyers through and through. These people are able to integrate the need for a fundamental change in the

way legal services are to be developed and delivered in their firm in the future with both their professional ethics and their role as a lawyer. They do not presume that the former need contradict nor challenge the latter and they look for solutions that address the competitive challenges their firms face within the framework of the latter. These are the true leaders in the legal profession of the future and those firms that have already started to develop a real competitive strategy have done so more through these 'thinking revolutionaries' than the charismatic 'let's turn everything upside down' approach.

Achieving a competitive strategy in the way described here will not be easy nor will it be painless. There are people in the legal profession today who will not survive, who will not be able to cope with the demands that this new approach will place upon them. The oft-repeated cry of 'I didn't come into the law to ...' will be heard in every law firm in Europe at some point. The answer is to not back away from the revolution but to try and find ways to help people adapt to the change, to learn new skills and to find new levels of understanding about their clients, competitors and themselves. Even then, some people will go to firms that are in the more traditional mould and some of these people will be very good lawyers, assets to their firm. Nevertheless, the process of change cannot be stalled, those who seek to escape it will find that it either catches them up or they end up in a declining position in the market. Changes of the magnitude that are sweeping the legal profession are not selective in their choice of target and no one who wants to be successful (in any market-focused way that one wishes to define success) can avoid the fundamental forces of competition.

C. International Strategies for Law Firms

An international strategy for a law firm must be a part of its overall business model, it must be an integrated part of the chosen business strategy and address all of the competitiveness, capabilities and organizational processes that are required to support it. Given the client/practice area focus within a firm's business strategy an international strategy must simply be a geographical extension of this. Any international strategy that is not aligned with the overall business strategy in this way is likely to be seriously flawed and carry a high risk of failure.

Hence an international strategy must represent a means of strengthening a firm's competitive position in some way and do so in all geographic markets in which it operates. There must be some mutually supportive aspect to the strategy. For example, it might secure the same core clients across a number of geographic areas and reduce the risk of losing them in any one region; it might generate synergies within a practice area by operating in a number of jurisdictions rather than one (e.g., helping clients find the best tax location for a new operation); or it might widen the market for a firm that has a very narrow focus in its client/practice area mix, thereby

reducing risk. In the event that an international strategy does not offer the potential to strengthen a firm significantly (relative to competition) in an overall sense, then it is questionable whether it should be undertaken at all; and this strengthening should be based on hard market data and analysis, not the fanciful conjectures of a few people in a firm. Many firms who are at present considering international expansion would be much wiser to focus on developing their existing business strategy into a more effective domestic competitive positioning and only then decide whether it should invest resources abroad in international markets.

The driving force behind the globalization of legal markets to date has been the shift in the large transactions market (i.e., M&A, Capital Markets, complex Financing and Projects). The cross-border nature of these transactions, the concentration of these within the multinational group of companies and the growing dominance of UK and US law in these transactions, has led to the need for an international capability if a firm is to be a serious competitor in this part of the market in the longer term. The ability of a firm to provide both UK and US advice regarding the structuring of a transaction, and to then manage the completion of a large transaction across a number of different jurisdictions, is now a real competitive necessity for a firm that wishes to compete at the upper end of the 'transactions' market anywhere in the world. (Note that it is a necessity not an advantage, when viewed relative to other firms in this market position.) In addition, the ability to achieve a seamlessness in the quality of advice and service across all offices (a 'one-firm' approach) is seen as an essential requirement if a client is to see added value in using one firm in all relevant locations rather than the best local firm in each jurisdiction.

Many firms have sought to follow the upper end of the transactions market by expanding abroad without realising that they are not in the same business as the major transactions players. They do not compete regularly in this market and the business rationale for their expansion is not particularly clear. There are reasons why firms outside of a top transactions position might generate a competitive advantage by expanding abroad, but the success of that strategy will depend on the firm being clear about what the driving force is in their particular market, and this is highly likely to be different to that driving the transactions market. Simply copying the moves of firms who are competing in another market position, or expanding abroad because it seems a good thing in general to do, is very high risk in today's competitive world.

The underlying driver for an international strategy is the extent to which a firm, with offices in a number of jurisdictions, offers a value to clients over and above that generated by leading local competitors in each jurisdiction. Initially, it might not matter whether clients recognize that such additional value is potentially available, a firm who decides that such a value could be generated might be capable of developing a market for that value (i.e., develop a breakthrough strategy).

The breakthrough approach to strategy mentioned earlier applies in the case of the international expansion of law firms and is demonstrated by the UK Magic Circle firms. They were expanding abroad ahead of the market demand for a global

law firm and this expansion was an extension of their domestic core client/practice area strength. When clients saw the potential benefits that could flow from a global law firm some became converts to the idea. It was, and still is, very clear that there were certain conditions a law firm would have to meet in order to generate that additional value, opening offices in different parts of the world without attending to a range of other matters was not the way to convince the market that the perceived value could be delivered. While there are people in large global businesses who still resist the idea of a global law firm, the evidence is increasingly clear that the activities of the UK firms have helped create a market for a cross-border firm, but they could do so only because the potential for additional value was latent in the market for large transactions. These firms are now investing heavily to demonstrate to the market that they have, or are building, organizations that can deliver the value promised. (In other words, they are addressing the four parts of the business model framework set out earlier.) This is not true of the many other firms who have started down the international path. Our discussion of this issue with many who express opposition to the idea of a global law firm reveals that most agree with it as a concept but argue that no firm is yet in a position to deliver the potential value on a consistent basis. Given that some firms are increasingly aware of this, and continue to build their capabilities to deliver, it can be expected that the market for such a firm will continue to expand.

Hence before contemplating an international strategy a firm must look closely at its domestic core strategy, particularly at its existing and planned core client types and core practice areas. If this indicates few clients with international operations and/or there is little evidence that additional value can be generated from having an international capability in its core practice areas (existing or future), then it would be wise to reconsider whether or not to proceed in attempting to build an international capability. In addition, if it is not already in a strong position domestically in terms of its client/practice area focus, this is also a warning sign that expanding abroad, before the domestic base is strengthened, is potentially high risk.

On the other hand, if there are competitive issues in a firm's core areas of practice that could be enhanced by an international capability then the firm should investigate this in some depth. As difficult and expensive as it might be to build an international capability, the failure to do so might threaten the long-term future of the firm in its current position. This latter likelihood is increased if the core clients for these services already have international needs in these areas or are developing businesses that will generate these needs, they are likely to start to work with a firm that can meet their international needs and this firm might subsequently seek to capture the home market work also.

As we noted before, at the heart of any effective international strategy is the ability of a firm to demonstrate, in real terms, the additional value to clients from this additional capability over them using local firms in each jurisdiction. If this cannot be articulated clearly then it is highly likely that there is no justification for an international strategy. Once the underlying drivers of the market have been examined and a firm is convinced that, in at least certain parts of the market, there is

a case for an international strategy, then it is still important to determine why a firm should pursue this option over others. A case might exist but there might be more valuable strategic options in the domestic market that are not threatened by the lack of international capability.

There are several reasons why a firm might consider expanding outside of its domestic market and these are:

1. to widen the market for a particular client type and/or practice area focus, especially where the domestic market imposes some limit on growth;
2. to defend existing domestic clients where competitors are offering an international capability and the clients have needs that can be enhanced by such a capability;
3. to achieve a strategic aim that is not achievable within an existing strategy and a domestically focused market.

The expansion of the UK 'Magic Circle' firms is an example of the first reason. These firms were building a strong UK business in transactions work, particularly in large transactions during the 1980s. This was to a large extent driven by the political, economic and social changes that occurred in the UK in the 1980s as the business sector moved more towards the US deal-driven approach. This is now being mirrored across mainland Europe although with some differences. It became clear that although the UK market was growing, the economy lacked sufficient size and depth in the longer term to generate the volume of large deals required to allow the top firms to maintain their critical mass in their core areas of practice and sustain profitability; hence a move into mainland Europe was a natural next step. The wider geographic market opened up a larger client base and gave access to a much bigger volume of larger transactions than purely UK based firms could achieve.

This same approach can work in other areas of law. A firm might have a specialist practice area (e.g., Labour Law) in which it has developed some highly competitive methods in the way it packages and delivers the service. The firm's competitiveness could be in the service delivery and the packaging more than in the technical skill of Labour Law; or, put another way, others might have or be able to acquire comparable expertise in the technical area but find it difficult to match the value added through this firm's delivery system. In this case, a firm might take what is an essentially domestic business, based on the law of the home jurisdiction, and seek to penetrate markets in other jurisdictions by hiring people with the technical skill and building the delivery system around them. In this case the bulk of the clients could be domestic in each jurisdiction, (although the development of the business would be helped if there were multinational clients in the home territory who were prepared to buy the service elsewhere), because the international driver would be a delivery system that added value over what local providers could offer. It is more the delivery system rather than any technical expertise that is being exported in this example because this is what is adding the value over local suppliers. The same would apply to firm that built up a real depth of knowledge in a particular industry, it could

export this knowledge into other markets, provided it was not easily copied by others, and build an international business in this industry. The technical knowledge delivered might not differ too much from what others are offering but the real competitive element is in the industry knowledge and the translation of this into value added in the legal services, and it might take someone else a long time to build such knowledge. Examples such as these abound in other professions and will occur increasingly in law. The key issue in each case is that the international driver, and the extent to which this offers additional value over that provided by local firms on a sustainable basis, might not be the legal skill as such nor will it necessarily be domestic clients with international needs. As a general rule, the narrower the domestic focus on clients and practice areas, the more likely that some geographic expansion will be required in order to support high growth over time.

The second reason above for expansion (to defend the client base) is the most commonly given reason, particularly where a part of the market has an international capability and others do not. We shall comment further on this below but there is a very strong downside risk in this approach. Under this justification we include situations where clients suggest a firm expand, and situations where the firm takes the initiative to expand, abroad. As we note below, unless the firm has something which is a real competitive advantage in these other markets, there is no particular reason why clients in the home market should buy a firm in another market simply because of the relationship in the former. In the event that the relationship offers a specific value (e.g., in-depth knowledge of the client's business) and this can be replicated in the new markets then there might be a case, but it will depend on the firm being competitive on a number of other dimensions in the new markets which it enters. This is an area where firms often would be better off by studying how they improve their domestic competitiveness rather than believing that opening foreign offices is the route to salvation.

The final reason (developing new strategic objectives) is also risky in that it usually requires a significant shift in an existing business strategy. Seizing on international expansion as a way of shifting a firm's strategic objectives could be in terms of core clients, core practice areas or both. An example here is the number of firms who have been focused primarily on Intellectual Property work in the past but who now want to be seen as a leading 'new media', 'new technology' or 'e-commerce' specialist firm. Given the international nature of these market sectors, market leadership in a major country is almost certainly going to reside with firms whose international profile matches that of their client base. Hence the shift from IP to something much bigger is possible only by expanding internationally. The question here that should be asked is whether the firm can maintain a healthy and competitive business in its original form, albeit a somewhat traditional and 'low on excitement' business or whether the competitive nature of its market is making the existing business redundant. If the former is the case then the firm has a choice as to staying with the existing business or making the leap into an entirely new business; if it is the latter then there has to be change, so the choice is about the best option and then considerations about domestic versus international options can be explored.

The critical issue under each of these 'drivers' is the firm's competitiveness in both its existing and in a new market. There is little point setting up, or merging with a local firm, in a new market if the firm will not achieve a competitive level of performance in that market in a reasonably short period of time; and if the firm has little to export from its existing market to support that competitiveness, then serious doubts about its ability to build it in a new market must arise. This is the single most important factor in any international strategy and one which a high proportion of firms seeking to expand abroad overlook. There is often a blindness to the fact that there is no necessary correlation between being perceived to compete reasonably well in the domestic market (but with no outstanding characteristics) and doing so in another, geographically distinct, market. This is why firms who are not leaders in any particular area (client type, practice area or both) in their home market need to think very carefully before deciding to expand abroad, even when encouraged to do so by existing clients.

This issue requires further elaboration because it is a common (and expensive) error among all professional firms. Many firms see opportunities in other geographical markets and decide they want to seize these, and yet they do not occupy a strong position at home in the comparable client types, practice areas represented in these opportunities. If a firm finds it difficult to compete at the top of the market in a particular area in its home market it is hard to see what it is leveraging as a competitive advantage in a foreign market, particularly where the foreign market is reasonably developed and mature. Put a different way, a firm should be extremely wary of basing an international strategy on a client type/practice area focus in which it is not already in a 'leading group' in its home market and in which there is little internationalization of that position.

Both of these last points can be illustrated by recent events. The UK Magic Circle firms were transactions leaders amongst FTSE 500/Fortune 500 companies in the UK prior to their recent drive abroad, so their international expansion has been based on a client type/practice area in which they had domestic leadership; their reputation in the UK (a mature market) gave them credibility with the buyers of these services when they moved into mainland Europe. In addition, their home market position gave them access to many of the investment banks and multinationals who used them in the domestic market (and to some who knew them but did not use them domestically). They are now seeking to build a high quality service that is consistent across all offices, build critical mass in core practice areas in each location and deliver services in a way that is perceived to add more value in each location relative to local competitors. It is these three points that have contributed to much of their success in Europe to date. Put another way, and relating it back to the previous section, their expansion abroad was simply a geographical widening of their existing business model in the UK.

Contrast this with many of the US firms who have entered the London market over recent years. Some of these firms have no clear client type/practice area focus and come in as 'all things to all people' just as the mature UK market is moving to favour focused firms (of which the Magic Circle are amongst the most focused).

Others come in with the intention of focusing on an area (often M&A, Capital Markets or Project Finance), but lack any leading competitive position in the US and bring no competitive credibility to the UK market, they are head to head with dozens of local firms focused on the same areas. Furthermore, they are generally oblivious to the competitive nature of the UK market believing that, e.g., laterally hiring a few corporate lawyers will make them competitive in the UK M&A market. They do not address the service quality issue nor do they understand how critical mass operates as a competitive weapon in the UK market. A large number of US firms in London have a mixed bag of skills with a few lawyers in each of Corporate, Finance, Litigation and so on, not even ranking in the second tier level of competitiveness. In addition, many lawyers hired in the UK, while good, are no better than the average, they have no particular client-pulling skills and have no particular attributes in delivering value to clients. This same pattern of expansion is now occurring in mainland Europe as UK and US firms, responding to moves by others, are scrambling for a position but with no obvious competitive strengths and no strategic rationale for doing so.

The principles set out here hold even if a firm is being pushed by its clients to open in a new geographic area. Certainly, firms should think more than twice about opening in a territory where they do not have existing clients or work but even then the issue of competitiveness arises. A client might promise to use a firm in a particular location if it opens an office (and this might be a defensive move against that client going to a competitor who is already in the new area). Once the client is established in the new location and gets to know the local legal market they might discover that their law firm, who followed them out from the home territory, is far from being one of the best in the new territory, so the client moves the work to those who are. The key point is that following clients out to new market is one thing, if they use the firm initially then it provides a cash flow for a period of time. Nevertheless, the firm must still build a level of competitiveness in the new market if it wants to retain those clients over time, let alone build a cross-border business; a failure to do so means that it is likely to lose those clients it came out to serve, once those clients find out that there are firms in the market who are more competitive. Hence the office remains a branch office of the firm, reliant on referrals from home and facing an insecure future.

This is even more true where a good domestic client is already established in a given geographical area. The client will already have local lawyers and the client's home country lawyers will need to convince the client to move the work from its established suppliers. If the home country relationship is very strong then it will have a good chance of at least being given some work, but if the new office delivers a service that is below both the quality of the service at home and that of the better local suppliers, then the work will move back to the original suppliers. There is also a risk of a client not being prepared to even try the new office if they have no feeling that the service quality is at least as good as that to which they have become accustomed in the home country. They might accept a small negative difference in local competitiveness if the service quality matches the home country office, but they

will not accept a significant deviation below local quality. (Hiring a small batch of local lawyers, well below the critical mass of local firms, is not the way to generate confidence in a firm's competitive capabilities.)

The final issue embedded in an effective international strategy, is that of organizational integration. No matter how the firm is structured, it is essential that there be a considerable amount of cross-office interaction between people. This is certainly much easier where there is a core client type/practice area focus within the strategy but even then we have seen firms with little involvement between offices. This is hardly surprising in many cases because there are many firms who cannot achieve a high level of integration, even around clients, in their home office, so the task is much, much harder when you put space between the offices and have them in foreign jurisdictions. Nevertheless, it is worrying that a number of firms who acknowledge such deficiencies at home still believe that they can achieve it within an international environment.

Maintaining divisions between offices almost always leads to the development of work processes and service standards that are stronger office by office rather than firmwide; and a difference in culture can also develop over time. These threaten the ability of the firm to present a common style and way of doing things, thereby discouraging (or at least not encouraging) clients to use the firm across different locations.

As a result, the international strategy must contain a high amount of activities that integrate people across offices, this can be around client, practice area, marketing, training and developmental activities. Wherever possible, implementation initiatives should be staffed by cross-office teams. Hence people will be involved in activities focused on client teams, marketing groups, practice area teams/groups and skill development groups all of which will be assembled on a cross-office basis. There will also be specific office activities but these will tend to be less than one-third of all activities. A critical organizational issue here is the degree to which a firm needs to develop a matrix structure where it manages itself globally by core practice area and by geographic location.

Summarizing the key issues that can make an international strategy effective, they are:

1. the strategy is an integrated part of the firm's overall business strategy and is entirely consistent with the client type/practice area focus built in to that strategy. It is a geographic extension of the domestic strategy and aligned with it;
2. there must be at least one of three 'drivers' underpinning the strategy, namely develop a core strength in a new market, defend existing clients by following them to new markets or an upgrading of the strategic positioning of the firm;
3. a firm should only enter a new market on the back of a home strength with specific clients or by leveraging its home reputation into similar client types in the new market and/or by leveraging home strengths in a specific practice area or areas;

4. the strategy is accompanied by a clear understanding of what is required to compete in the chosen client type/practice area focus in the new market, and rigorous action is being taken (or will be taken) to build these capabilities. The firm must also be prepared for the cost of this programme;
5. there is considerable interaction between the various offices around core clients and core practice areas with value being added to the client type/practice area focus from all offices.

There are two issues that require further discussion before turning to Europe; both are attempts by firms to develop internationally but which run counter to the principles outlined above. Both approaches have an intuitive appeal that is seductive and a number of US and UK firms are pursuing one or both of these issues. While we are not suggesting that firms should follow the principles set out here rigidly we do believe strongly that principles should be broken only when a firm knows why it is doing so, in many instances we see firms who are breaking the principles but are completely unaware that they are doing so.

The first issue is what we call the 'emerging markets' syndrome. Firms who fail the test of being a leader in their domestic market in a particular practice area (e.g., Projects) see geographical markets elsewhere in the world which are not yet mature, where the major players are not present, but where some work exists and where there is an expectation that these markets will grow. The argument supporting entry into these markets is that competition is low and a foreign firm that is competent can build market share quickly, this is seen to provide a 'first mover' advantage that puts the firm in a leading position as the market grows and, over time, enhances the firm's position in other markets.

This is an argument used by many firms in a variety of professions but reality rarely fits the theory. It is exceptionable to find a firm achieve a stronger position internationally by leveraging its position in smaller markets, international leadership requires a firm to be a leader in major markets not secondary or even lower. Second, it is an expensive way to develop because the offices in these markets rarely make profits (at least at the level required to cover partner drawings). There is usually a good reason why the leading firms are not in this market and this is because the flow of work is not adequate to support a profitable business. The 'first mover' argument is also flawed because if these markets do open up, the major financiers and multinationals enter; the quality of work improves and becomes more profitable but these clients want their existing legal advisors (usually the major players). Hence 'first movers' who are not already leaders tend to never become leaders but remain as secondary firms or worse and at a huge cost. Firms who are considering an 'emerging markets' strategy need to look closely at their existing business and consider whether there are better uses of those resources in terms of strengthening their existing domestic competitive position rather than expanding abroad.

The second issue to be covered here is the 'opportunistic vs. strategy' argument. This argument takes the approach that if a particular opportunity can generate a profit does it matter how strategic it is. As a consequence, firms enter markets more

or less indiscriminately, putting a few people on the ground in one location and a few on the ground in another. In a reasonably buoyant market reasonably competent lawyers can often pull in a reasonable volume of work to cover their costs and even make a small to modest profit. The first question is whether this is the best use of a firm's resources. It might have been more profitable long-term to devote those resources somewhere else in the firm where the longer term development impact on the business would have been much greater. Second, come a downturn in the market and it is largely the unfocused offices that get hit by falling profits, they tend to live off the market rather than having any particular competitive advantages in that market. Hence they can be profitable in an upturn but very unprofitable in a downturn.

Finally, the key strategic issue is that having a number of unfocused outposts of business is hardly a good way to run a business, what is each office doing for each other and where do they take the overall firm in the longer term? A number of US firms (and a growing number of UK firms) operating in Europe are in this position; they opened without a clear strategic reason but have recruited a few people with practices that are profitable or merged/aligned with local firms. There is, however, little business driving the home and foreign offices together, there is little flow of referral work and they could well be two (or more) separate firms. No part of the firm builds a competitive advantage for another part. This takes us back to our opening point, an international strategy that does not add competitive strength to the business is unlikely to be valid and sustainable. Ad hoc offices without a clear client type/practice area focus are unlikely to build any international position for the firm and run a serious risk of bringing the firm down when the market falls.

The key point we would make at this juncture is that simply because legal markets are globalising is not a sufficient reason for every firm to follow suit. The first issue is to decide whether the firm's core client type/practice area focus requires an international capability in order to be competitive, either now or in the mid to longer term. Alternatively, is there evidence to suggest that an international capability will add a competitive value to a firm's service offering even though the market is not yet demanding it, and will the market see the value once it is offered.

For many firms the best option will be to focus on building a much more competitive business at home, defining a core client type/practice area focus in which it can compete effectively as a leader in the domestic market for a considerable period of time; and where there is little international pressure. This might require a reshaping of the business and elimination of some activities that have no strategic sense, a painful exercise and not one for which it is easy to win support in the firm. By doing this, however, it will be able to protect its core business with core clients even if they use an international competitor in another jurisdiction, a client is unlikely to move work away from a domestic leader in a domestic practice area provided that leader is sustaining its position and maintaining a strong and healthy relationship with its clients.

Building an effective international position can be a very expensive exercise and there is a considerable downside risk. Firms who do not have multinational client

base already or who are not leaders domestically in a practice area where there is particular value from an international capability should consider their domestic options very seriously before embarking on the international option. There is a very real danger that pursuing an international strategy becomes a way of avoiding making major decisions about the home practice, where it should focus and how it intends to compete. The attitude is to take the firm out into the broader market and hope that it can stay in its unfocused state by playing on a bigger field. At some point decisions will need to be made about the firm's competitiveness, they should be addressed as soon as possible and not hidden behind an 'international smoke screen'. In today's competitive legal markets, especially in the major and more mature markets, firms do not compete on the basis of having a full service, there may be a service range that is reasonably close to what might be described as full service, but unless it builds a strong market position in terms of specific client types, specific practice areas, or a combination of both, it will be increasingly outflanked in any market, home or abroad. Competition means adding more value to clients than do (or can) competitors and this occurs through specialist skills and knowledge and through focused delivery systems, not simply presenting a 'full service'.

D. Emerging International Focuses

We noted before that the early development of global law firms was in the area of major transactions because these had an international dimension as well as the opportunity to add value over that provided by local suppliers. This also met the principles outlined above, it had a clear client type/practice area focus (multinational businesses and transaction services); there was an international dimension to this market in that many large deals were across borders; the leaders were leaders in this position at home; they both followed clients into the new regions and also opened up a market that did not exist previously; they understood (or have come to understand) what had to be done to build competitiveness in each geographical market (as well as firmwide) and they have invested to achieve this; and they have built (or are building) a high degree of integration across their firm.

As the market for global law firms has expanded other opportunities to build a global position have also emerged. In essence these are all characterized by a particular client type; practice area focus that has an international driver to it. It is this international driver that creates the conditions under which a global firm, with the appropriate capabilities, can add more value than a purely local supplier. Some of these positions might apply more to specific regions rather than the world, due to local business conditions, but they still represent a valid approach to building an international business. In summary, these positions are:

- a mid-market transactions position which is being created as more and more mid-sized companies pursue opportunities abroad. In addition, the funding of

mid-sized companies is moving away from traditional domestic sources of finance to more diverse and complex methods, including international sources;

- an international industry sector approach. This is applicable where an industry is on a global scale and where a deep knowledge of that industry can add the additional value required to support a global strategy;
- a global practice area approach. This could apply in an area such as labour law where, around the world, governments are implementing regulations on employers in respect to their employees. Multinational companies need to be kept abreast of changes in these regulations on a world-wide basis. The differing regulations could also influence where particular investments are made. It is likely that a firm in this position will build a package of related services around the core and could well become more of a consulting business than a law firm.

All of these opportunities have variations around them. The key point is that they contain a clear client type/practice area focus and there is an international driver that creates a situation where a global firm could compete effectively against leading local firms. Firms who wish to pursue these opportunities will still need to meet the principles set out in the previous section. In particular, building the capabilities to provide a consistent service quality across all locations and a 'one-firm' approach to client service will be critical, as will be the need to start from a position of real strength in the home country (particularly in terms of having a strong multinational core client base).

Any firm that wishes to embark on an international strategy based on these types must also remember the other key point; the need to build a competitive position quickly in each location, and this must be seen across a number of dimensions, not only service quality. An important area here will be critical mass. In order to become a leader in each location an international firm will need to at least match the number of lawyers in its core area compared with number that the local leaders deploy. Hence the need to grow the core area quickly in each location will be critical factor of succes and this will, in turn, put strain on resources, particularly cash. Managing the spread of offices so that the firm can start to generate work from multinationals by presenting a credible network of offices without destroying profitability of the overall firm is a complex juggling trick for management.

Finally, it also must be realized that all of these potential strategies will bring a firm into competition with the major global transactions firms in some way. These firms will compete in the mid-transactions market, they will compete globally in higher value practice areas and they will compete in global industries. So selecting an alternative strategic position does not isolate a firm from competition with these large competitors. There will be a need to demonstrate some of the same characteristics as these firms are building, particularly the seamlessness of delivery and the focus on high quality delivery systems and client management skills. The competitiveness of a firm in one of these alternative positions is that it can focus on building ways of creating value-advantages within this much narrower area of focus

whereas the attention of the global transaction players is more on doing the same in the large transactions market. Firms who select an alternative strategy need to examine the four part business model outlined earlier, decide on the required components of each part and then configure the combination of parts to compete effectively with leading domestic specialists in each major market and with the global transactions players, the competitive formula is likely to vary in each case.

E. The Developing European Market

The transformation of the business environment is well underway at the upper end of the mainland European market and is moving rapidly down to the mid-sized corporate market. The two key trends in this transformation are:

- a consolidation across Europe by major industry sectors, leading to the creation of leading European companies in all sectors rather than domestic leaders in each country. This is being fuelled by a much more aggressive approach to take-overs, something that was absent in Europe in the past;
- and, partly as a consequence of the above but also for historical reasons, a major change in the funding policies of both large and mid-sized corporates. There is a strong move away from the historical dependence of Europe's corporate sector on conservative lending from banks towards the much more innovative and complex funding structures that have operated in Anglo-Saxon countries for some years.

A key factor in these trends is the historical nature of corporate growth in Europe. While a number of corporates have a very long history, a high percentage of larger and medium-sized corporates either started in the post-WW II period or were re-organized and re-shaped in this period. Many of these businesses, even some of the very large, have remained largely in private hands or are effectively controlled ('influenced') by individuals and their families.

This situation is breaking down as the 'founders' or controlling influences retire or die, or where the families are now fighting over control. In the latter case there are a number of powerful 'corporate' families in Europe where the new generation have no interest in the business and simply wish to cash out, other family members have a different agenda and the tensions are now surfacing in a number of large and successful European businesses. In any case, the sheer size and funding requirements of many of these businesses means that they have outgrown the ability of their influential shareholders to retain such tight control and some shift in ownership was inevitable.

An additional factor is the increasing deregulation of European industry and a weakening of unionized labour's power which is supporting the growing integration across the European business landscape. Anti-competition laws are being viewed

more at a regional level than solely country specific and economies of scale and market concentration measures are regional rather than local, this combination of factors is supporting a European consolidation by major industry sectors. Some of this consolidation is also on a global scale (e.g., the automotive industry) and this introduces major cross-border issues. While these changes are more noticeable in areas such as Telecommunications and Technology, it is occurring also in many of the more traditional industries. As a consequence of all this there is a massive growth in mergers and acquisitions throughout Europe and these are creating a demand for further financing. This same pattern is apparent at the mid-market level throughout Europe with a particular emphasis on Germany because of the huge size of the mid-market in the business sector of that country. In this sector there is rapid growth in financing and also in IPOs and MBOs. As a consequence there has been a rapid accompanying growth in the providers of venture capital and private equity funding.

The final key factor in this pattern is a fundamental change in the European banking industry as the banks respond to the competitive pressures of global financial markets. This has been particularly the case in Germany and Italy. In Germany the major banks had cross-holdings and loans in the major corporates, effectively blocking mergers, takeovers etc, where they wished to do so. In Italy, a web of interlocking financial support between major companies was built up over the last forty years or so, protecting Italian companies from unwanted take-overs and also preventing them from becoming a target due to financial difficulties.

All of these barriers to change are breaking down as banks respond to competition in their own sector and are forced to both raise returns on their loan portfolios and develop a range of investment banking services to respond to new entrants into the market. As is being seen in a number of countries the banks themselves are being pushed into mergers as their own sector consolidates. Likewise, the ability of companies to support other domestic companies through loans and cross-holdings is reducing rapidly as the corporate sector is forced to generate competitive returns on their funds (and their interlocking deals tend to not produce competitive returns).

A further factor in the banking sector is the role of London in capital market flows and whether its position will weaken given the trends in mainland Europe and the UK's position in regard to the common currency issue. At present it would appear that while Frankfurt is likely to grow in importance in terms of funding in Euro currency issues, London will remain the pre-eminent international capital markets centre in Europe, primarily because it has all of the necessary infrastructure to support such a market, and it will take a very long time before any other centre is able to challenge this dominance. Hence any law firm that wishes to have a Capital Markets and Finance practice in Europe will need to have a competitive position in both London and Frankfurt (with Paris as the third centre).

While much of the publicity in the business press about these changes in Europe has focused on the Fortune 500 end of the market there is a tremendous amount of M&A and refinancing activity occurring in the mid-market sector of a number of countries, especially Germany, Italy and Spain. Exactly the same forces are driving these businesses towards amalgamation and refinancing as is driving the upper end.

While the creation of the Euro currency is seen by some commentators as the major influence we think it coincidental that the merger/re-financing wave coincided with the start of the new currency. While this facilitates cross-border transactions (allowing the financing to be expressed in one currency and reducing transaction costs) the competitive pressures in European markets, coupled with the changes noted above, have been building for some time.

The other interesting aspect of the European market is that the corporate transformation is only partly about new technology businesses and dotcom companies. A significant part of the activity is in traditional business sectors who are adopting new technologies but are not becoming technology businesses. The technology sectors are growing in influence but the transformation is across all sectors.

Over the last three or four years all of the major investment banks plus the leading venture capital funds have been gearing up to meet the expected demand flowing from these changes. Global investment banks are interested in not just the mega-deals but have set up mid-market teams to handle the transactions flowing from that part of the market. A number of leading US investment funds and venture capitalists have also opened major European operations in order to seize a share of this market.

All of this is having an equally massive impact on the shape of the legal profession in mainland Europe. The most obvious feature of this is a rapid consolidation at the top end of the European market, around the UK Magic Circle firms and the few high level Wall St. firms with European offices. At the next level there are a large number of firms in all European countries presently studying their options. Many have a majority of partners accepting the need for merger with a UK or US firm, the issue is less about 'whether' but more about whom and when. There are, however, some firms committed to remaining independent and who are seeking to carve out a successful domestic position. One thing is clear in talking with partners in the more domestic European firms and this is that the changes at the top end of the market, with formerly leading firms joining 'the Anglo-Saxons', have sent a shockwave through the European legal profession. It is not that long ago that the senior partners in many of the bigger firms were adamant that they would never 'surrender' to the British and Americans. The pace with which this has occurred has shocked and frightened many in smaller firms.

The rapid change is illustrated by the recent link-ups between 'upper-end' German firms and UK/US firms. In a very short period of time the top end of the legal market has either joined or allied with Anglo-Saxon firms. The current list is:

- Bruckhaus Westrick Heller Löber – merged with Freshfields;
- Oppenhoff & Rädler – allied with Linklaters & Alliance;
- Pünder, Volhard, Weber & Axster – merged with Clifford Chance;
- Boesebeck Droste – merged with Lovells;
- Hasche Sigle Eschenlohr Peltzer – in alliance with CMS (Cameron McKenna);
- Heuking Kühn Lüer Heussen Wojtek – in alliance with Denton Wilde Sapte;
- Hengeler Mueller Weitzel Wirtz – in alliance with Slaughter and May;
- Feddersen Laule Ewerwahn Scherzberg Finkelmburg Clemm – to merge with White & Case;

- Gleiss Lutz Hootz Hirsch Rechtsanwälte in a formal alliance with Herbert Smith.

In addition, the well-respected corporate firm of Schilling, Zutt & Anschütz is dissolving because half the partners elected to join Shearman & Sterling and the other half Allen & Overy. Other German firms at the next level are rumoured to be seeking merger partners in either the UK or US and this would mean the all of the top 15 were linked to an Anglo-Saxon firm in some way. This has all happened within a couple of years and the same pattern is true in France, the Netherlands, Spain and Italy.

The current situation in France is that the UK Magic Circle firms and several US firms (e.g., Cleary's and Shearman's) have a dominant position in the large transactions market. With only two French firms, Gide Loyrette Nouel and Jeantet, having any real strength in the market. Both have, however, lost a number of partners primarily to Magic Circle firms but also to US firms. There are several smaller boutique French firms who have a reasonable market share of transactions but they do not feature on the big deals (unless supporting a major UK or US firm). Likewise, the Magic Circle are following a very similar strategy in both Italy and Spain. The only difference in Spain compared with the other countries discussed above is that the accountants also have law firms at the upper end of the market.

What this activity demonstrates is the intention of the top end UK firms and a number of US firms to establish themselves as the dominant transaction firms (i.e., M&A, Capital Markets, Finance) throughout Europe. By leveraging themselves into the main centres of corporate activity in Europe they are seeking to win a major market share of the higher value deals and other related work, even in countries that are not major centres. In addition, in each location they intend to push down into mid-value transactions and into better quality commercial work, even where this is mainly domestic. Hence they intend to compete domestically in each country where they are located in core commercial specialisms. (These specialisms are generally those essential to support a 'deals' practice, they will compete domestically in order to maintain a sufficient volume of work between deals in order to be profitable).

The UK/US majors bring four particular competitive advantages with them to the European market and these are an integral part of their business model. These are:

- a first class transactions reputation and strong relationships with the major investment banks (who are major influencers of this work to law firms);
- a track record of success with multinational companies in large and complex cross-border transactions of all types and strong relationships with the key decision-makers in these companies;
- critical mass in all of the key transaction practice areas;
- all of the necessary back-up and support (including technology) required to complete a transaction effectively and as efficiently as possible.

As noted previously they have, more than many other firms, developed a successful business model that provide a coherent competitive strategy and which has mutual support through all of the components.

Alongside these four advantages they also have one other attribute which is at least a partial advantage and one which they are seeking to turn into a major advantage over local firms. This is their ability to do deals under UK and US (primarily New York) law, supported by a capability in the law of any major European jurisdiction, and to do so with a highly consistent quality of service. We say partial advantage because they are not yet able to provide a highly consistent service across all locations (although the market view is that they are improving rapidly); consequently, there is a part of the market that still prefers to use a range of local firms or an alliance of local firms across the appropriate locations. Nevertheless, the four competitive advantages noted in the previous paragraph, plus their partial success in this one, have given them a significant market share of medium to large transactions across Europe already and they are determined to increase this. Given that the Magic Circle firms, over the last three years, have achieved a market share of 68 per cent of all M&A transactions in the UK over GBP100m (based on the value of deals), the probability of them achieving their aims in Europe must be seen as high.

At present there are few of the major domestic, mainland European firms who can sustain a share of the larger transactions market alongside the UK/US global players. Bruckhaus' merger with Freshfields was a sign of this in Germany, Bruckhaus was one of a few firms who had retained a position in the market for large transactions but still felt the need to merge with a UK major firm. A key issue here is that while major local European firms have held on to some of the 'pure' M&A work which was only European, they have found it extremely difficult once funding issues have been introduced. Given the importance of London and New York in the flow of capital into Europe, the lack of a sufficiently large high calibre capability in finance work under UK and US law has become a major disadvantage. The issue here is not addressed by a European firm 'bolting on' a few UK qualified finance lawyers; the banks and others involved in this work want to see the financing issues dealt with by a firm that has a depth of high calibre talent and experience comparable to that in the top end UK firms and a few of the US firms in London.

The only rival at present to the expansionary four UK Magic Circle firms (i.e., Clifford Chance, Freshfields, Linklaters & Alliance and Allen & Overy) and the few Wall St firms with a presence in Europe is the Slaughter and May 'best friends' alliance. This group includes Hengeler Mueller Weitzel Wirtz (Germany), Uria & Menéndez (Spain), Davis Polk & Wardwell (USA), all pre-eminent firms in their own jurisdiction. The local strengths of these firms has allowed them to compete without merging but:

(i) this is probably the only grouping of firms that could to do so, given their strong position in their local market; and
(ii) their ability to continue to compete will depend very much on being able to match their global competitors with a seamless service delivery between offices, even though they are separate firms. The evidence in other

> professions is that the one-firm approach, over time, is superior in building a seamless service than any alliance of separate firms. In no other profession has a group of independent firms been able to compete as if they were one firm over a lengthy period of time, once a few competitors had achieved a one-firm approach across all major offices. Whether the legal profession can achieve where others have failed remains to be seen but if any is to succeed it will be this group.

Hence the shift towards a concentration of mid to large transactions around a small number of 'European/International' firms is well underway and the competitive advantages of this group make it difficult for any other firm to succeed in building an upper-end transactions market share in mainland Europe. Furthermore, the Magic Circle firms in particular see the mid-sized market in Europe as a legitimate target, and are investing heavily in standardizing their processes, but without driving out the value to the client, primarily through the use of technology; this will challenge one of the few competitive weapons that good quality local firms have had until now in this market, that of cost.

This concentration of transactions activity at the upper end of firms is having a very serious impact on the better quality domestic firms in Europe. Their share of the larger and more complex transactions within their own geographical boundaries is, in general, declining. There would be very few exceptions to this in countries where the 'Anglo-Saxons' have located and even outside that in some cases.

It is the transactions lawyers in these firms who have seen 'the white heat of competition' face to face, whereas many of their more domestically concerned colleagues have, until now, not been confronted by the prospect of head-to-head competition. Part of the reason for this is that commercial work is not as transparent in competitiveness as transactions, it is known who did the major transactions but it is much less apparent when a client gives, say, some labour law work to an Anglo-Saxon firm rather than a domestic firm. We are aware, from our market research, that much more domestic commercial work has moved to the Anglo-Saxons in some countries than the local lawyers perceive but it is not knowledge that is available in the market.

As a consequence, however, many European firms are becoming divided, on the one hand there are the transactions lawyers who argue the need for their firm to merge with an Anglo-Saxon firm in order to regain some competitive advantage; whereas the domestic commercial lawyers, who feel much less threatened (wrongly), believe that such a merger is not required and that the firm can survive very well as an independent. The danger with the latter argument is not so much that no European firm can survive as an independent but, to do so will require some major reshaping and repositioning, whereas many of those advocating this view see no need for any change at all. It is indisputable that a number of domestic commercial specialist firms could compete effectively for a long time in Europe but this will still require fundamental changes from where most firms are today. What these firms will have to accept, and restructure around, is the loss of much of their transactions business. The upshot of this is considerable tension in many of these firms. In a

number of cases the transactions partners have 'voted with their feet' and gone to the Anglo-Saxons. In others there is a real threat of a split in the firm given the difference in aspirations.

This is particularly true in Germany at present. As shown before most of the major German transactions firms are either linked already to leading UK or US firms or are in the process of considering such a link. Those who do not have or who are not considering a link tend to have little strength in the upper end transactions market.

This does not mean, however, that other firms should abandon the German transactions market. Both France and the UK have exhibited a similar trend and we see this as the next stage in Germany. As the top end of the market concentrates so we see opportunities for a few smaller specialist transaction firms to emerge, firms who have many of the competitive advantages of the top end firms but who are smaller and focus on the mid-sized transactions market. In the UK this has happened with firms such as MacFarlanes, Olswang, Travers Smith Braithwaite, Taylor Joynson Garrett and S J Berwin, and a similar trend is starting in other countries.

These firms outperform competitors of a similar size in the domestic market and can perform as well as the larger firms up to a point. There is a point at which the size of a deal is seen to go beyond their capability and moves to the major firms but it is the size of the deal that triggers this, not a drop in service standards. The cost structure of these firms is held below that of their larger competitors so they can also compete on price against the majors but still within a healthy profit margin. While price is not a serious consideration in the very large deals it is a factor in the mid-sized market. The critical issues for firms who wish to focus here are:

1. they must want to work in this position and be committed to the mid-market. They should not see this as a step towards moving up into the bigger deals;
2. on all measures other than critical mass they must be seen as comparable to the top end firms;
3. they must constantly seek ways to reduce the costs of their transaction processes particularly through the use of technology (because this will be the challenge from the Magic Circle who see good quality work available if they can lower their costs per transaction);
4. they must maintain all the elements of their business model while, at the same time, continually adapting it so that their capabilities, competencies and processes develop and deliver a value to their clients that is constantly above that of their direct competitors in this part of the market (including the bigger players).

The scope for this approach to develop in Germany is huge, given the size of the mid-company market where there is a major amount of M&A and Finance restructuring work. It is this mid-market in Germany which is expected to exhibit much of the transactions activity over the next decade, hence many of the financial institutions are building positions around (but not exclusively) venture capital, private equity

and IPOs. This middle market will be attacked by the global firms who, while focused more on the bigger end deals, see the need to push down into the mid-sized deals market and build a strong position there also.

The reason for this is two fold, the global law firms need to maintain a large number of transactions lawyers in order to have the critical mass available for the large deals. The large deals market is relatively smaller in proportion in Germany (and in Europe generally) than either the UK or US, although it is growing fast. Hence they need to be more active in the mid-market in order to keep up a high utilization and maintain profitability. The second reason is their expectation that mergers at the mid-sized level will create more large corporates who will need a global law firm, by building a strong position in the mid-market they are well placed to continue working with their mid-sized clients as they develop into much larger businesses.

On the other hand, many mid-sized companies in Germany (and elsewhere in Europe) are not comfortable with the large Anglo-Saxon firms and many of the venture capital/private equity financial institutions are less committed to pushing their clients towards the top end City and Wall Street firms. One reason for this is cost, the top City and Wall Street firms are seen to be the most expensive in the market and by a considerable margin relative to European charge rates. A second reason is a lack of cultural compatibility. People in mid-sized corporates in Germany and elsewhere often feel that they are seen as unsophisticated by the leading lawyers and financial advisors, they are much more comfortable with advisors who are more on their level. Finally, there is a perception in the mid-sized market that this market is a second priority for the big firms and, should they become busy on a major deal, then it is the mid-market deal that will suffer from a lack of attention.

Hence there is a real opportunity for firms who are prepared to specialize in mid-market companies, both for their better value commercial work and their transactions work. Such firms will be required to deliver the cutting edge technical advice and high quality service delivery that the major firms can deliver but to do so by building very strong relationships with the mid-sized corporates, to be on the same cultural level as management in these companies and to meet their pricing requirements.

Foreign firms who can demonstrate strong mid-market leadership in their domestic practice, who can compete on technical and service quality in this market, and who have an integrated corporate and commercial practice in this area are very well placed to carve out a significant market share at this level in Germany and elsewhere in Europe. This is particularly relevant for many UK and US firms whose mid-sized clients are starting to invest in Europe and who would like to have the same level and quality of legal service there is at home.

Hence no firm should take the attitude that the game is up because of the arrival of the large, global players, nor should they see the only way forward as merging with a UK or US firm. There are positions in the market that now require this if that is where a firm wants to compete but there are a number of alternative competitive positions available as well as we have shown above. What we stress, however, is that

there are no easy answers. No matter what answer emerges, the only way to find the best solution is to go through the thinking necessary to build a business model that demonstrates how a firm might compete in its desired market position. If this demonstrates that there will be a need to merge (domestically or cross-border) a firm can still examine other business models for other market positions that do not require merger and decide which they prefer. The decision to merge should not be taken because 'no other choice exists' without examining those other choices, choices exist and it is a question of which choice to make. Finally, whatever the choice all law firms in Europe who want to be successful in any market position will need to address the issue of building a powerfully competitive firm over the next few years, and this will require some bold and radical thinking and will not be devoid of pain. Nevertheless, there are some big prizes available to those who play the competitive game well and an enormous amount to lose for those who do not. Every lawyer has a choice.