https://doi.org/10.3926/hdbr.133

Growth Strategies for Law Firms

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Received: December, 2016.
Accepted: June, 2018.
Published: June, 2018.

Abstract

Law firms that grow intensively can experience problems with maintaining a strategic focus, structural alignment and a balanced staff. This article proposes a process through which management can plan a law firm's future, by defining a strategy and choosing an avenue for growth. We use a sample of 150 Latin American law firms to describe the differentiation strategies that have been demonstrated in practice. We find that the strategies of "Efficiency," "Grey Hair" and "Brains" are used by 15.3%, 61.3% and 23.3% of our sample, respectively. Additionally, we describe four growth strategies for law firms.

Key words

Differentiation strategies, growth strategies, law firms, service firms, leverage in services.

How to cite this article

Ketelhöhn, N., & Martínez Argüello, O. (2018). Growth Strategies for Law Firms. *Harvard Deusto Business Research,* VII(1), 47-58. https://doi.org/10.3926/hdbr.133

Many law firms in Latin America improvise their future

1. Introduction

Many law firms in Latin America improvise their future. This problem is especially acute in young companies which are successful and experience accelerated growth. Typically, they experience problems such as work overload for the supervising partners, lack of professionals in the areas of the business with the greatest growth and difficulties in retaining the most talented young lawyers. At the same time, it is common to have problems of underutilization of personnel in less relevant areas, as well as unnecessary fixed costs. Growth causes these companies to have complications in maintaining the level of service provided to their clients, who are tempted to change providers, particularly if the lawyers that served as interlocutors have left the firm. In the most extreme cases, these firms can lose focus on their original strategy and positioning in the market.

One of the interviewees in this research exemplifies precisely the problems associated with the lack of growth planning. He is the only partner in a successful firm in the Dominican Republic, specialized in litigation and court-ordered collections. He has twelve associate attorneys who work in a newly-built high-tech three-story building. In 2014 he oversaw more than four hundred cases, in 2015 nearly 500 and continued growth is planned in 2016. In the interview, he confessed: "I'm going crazy! However, I have to continue to grow in order to pay for the building, so I have to take on more cases." We asked if he considered promoting one of his lawyers to partner to help him oversee the work of others. He replied that no one was ready, despite the fact that some lawyers had already been working with him for a decade. This attorney has been very successful as a legal professional and has increased the demand for his services, but he has not planned for the growth of his business. Clients have begun to notice the deterioration of the service, which jeopardizes the future of the company.

In this article, we propose that in order to develop a successful growth strategy, a law firm must answer two basic questions:

- How do we compete? (Differentiation strategy).
- How do we grow? (Avenues of growth).

This article follows the logic implicit in these two questions to propose a process through which the companies providing legal services can define their competitive and growth strategies. In the next section, we describe the generic strategies (brains, "grey hair" and efficiency) that a firm can consider to compete and differentiate itself in the market. We explain the main operational implications of each strategy and we present an analysis of the incidence of these generic strategies in Latin America, based on a sample of law firms in the region that has been collected by the authors.

In the third section, we show the growth patterns followed between 2007 and 2015 by law firms in our sample, including their natural transition between the generic strategies as the companies grew in scale. We also present the four "avenues of growth" (organic growth, diversification, internationalization and mergers and acquisitions) that companies providing legal services can consider to increase their scale, and we discuss the implications of each avenue.

In the fourth section, we summarize the theory presented in the article and highlight the practical implications of its implementation in Latin American firms to improve the management of companies providing legal services, not only in the region, but also in a wide selection of geographical areas on a global level.

There are three generic strategies of differentiation for professional service firms: "brains," "grey hair" and "efficiency"

2. How do we compete?

David Maister (1997), professor at Harvard Business School, suggests that there are three generic strategies of differentiation for professional service companies: "brains," "grey hair" and "efficiency." These positions describe a spectrum along which a company can situate itself to be attractive to customers with different needs.

At one extreme are the companies with positioning in terms of "efficiency," which are the firms specialized in efficiently carrying out common, repetitive jobs, such as the registration of real estate, the keeping of business records, tax payments, court-ordered collections, etc. These firms usually have high levels of leverage[1] and a high turnover of associates. A well-implemented efficiency strategy implies low prices per attorney-hour and requires advanced technology and efficient processes. In the eyes of the client, professional service firms with this positioning have gone through a learning curve that allows them to perform legal tasks in less time and at lower costs than can be achieved by themselves or other providers of legal services.

At the other end of this spectrum are firms with positioning relying on "brains," who specialize in finding solutions to unusual problems. These complicated jobs require a lot of time from the senior partners, and thus the leverage levels tend to be low, accompanied by a low level of staff rotation and high prices per attorney-hour. A positioning based on "brains" involves many hours of customer contact and customized jobs. Clients choose "brain" firms because they seek the services of "star" attorneys who are specialists in their areas of expertise and are capable of finding solutions to complex, unique problems.

Firms with the positioning based on "grey hair" fall in the middle in terms of attorney-hour prices, levels of experience and leverage. The customers of these companies seek to solve unusual problems, but ones that may have been previously faced by professionals with experience (grey hair). It is common for large companies providing legal services not to have pure strategies, because diversification, internationalization and acquisitions can result in mixtures of units with heterogeneous strategies. However, the ratio of associate lawyers to partners (leverage) allows us to infer, in general terms, the strategy of a company and its evolution.

To better understand the incidence of these generic strategies in Latin American legal service firms, we analyzed a sample of companies in the region. The information comes from the journal *Latin Lawyer 250,* a publication with nearly two decades of experience monitoring the main firms providing legal services for international corporations. We selected a sample composed of all companies providing legal services that appear in the journal in both 2007 and 2015. We eliminated very small businesses employing less than ten lawyers. This process resulted in a total of 150 law firms operating in 17 countries in the region (see more details on the sample in the appendix). The results of our analysis must be interpreted taking into consideration the fact that the sample is not random. However, we believe that this is one of the more rigorous sources of systematic information in the region.

In our sample of Latin American companies, we find an average level of leverage of 3.34 associate attorneys per partner in 2015 (3.20 in 2007), with a standard deviation of 1.88 (1.89

[1] We define *leverage* as the relationship between the associate attorneys and partners. A leverage of "3" means that the company has three associates for every partner.

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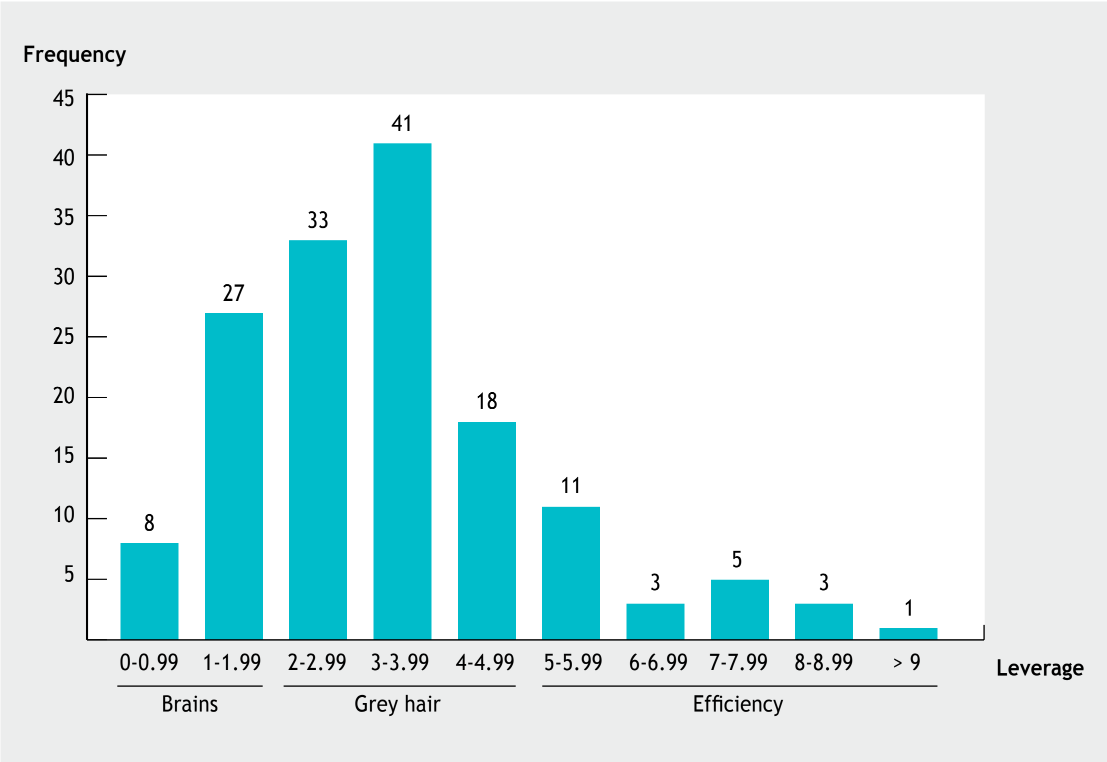
The largest firms tend to have the highest levels of leverage

in 2007). Table 1 shows the histogram of the levels of leverage among the firms in our sample. We defined a level of less than 2.0 as corresponding to a strategy of "brains," and a level greater than 5.0 as representing a strategy of "efficiency." We also defined that the intermediate levels of leverage (between 2.01 and 4.99) correspond to the "grey hair" strategy. Consequently, we found that 23.3% of the sample had a "brains" positioning, 61.3 % a "grey hair" positioning, and only 15.3 % had an "efficiency" positioning. This pattern is consistent with what we find in the United States. The AmLaw 100 reported in 2015 that 8.0% of the top service companies in the United States had a leverage less than or equal to 2.0, and 14.0 % had one equal to or higher than 5.0 (The American Lawyer, 2015).

Table 1
Leverage levels and generic strategies in 2015



Our sample also reveals that the larger firms tend to have higher levels of leverage. Table 2 shows that companies with more than 150 lawyers, with the exception of one, were leveraged at levels greater than 3.0, with an average of 5.6. In small companies (with 30 lawyers or less), leverage was much more variable, with an average of 2.4, up to a maximum of 7.5 and with a minimum of 0.5. The trend line on the chart shows the correlation between size and leverage.

Growth triggers disorder, so the first step in defining the growth strategy is to ensure consistency between the strategic positioning, structure, price levels and the operating systems and processes of the company. If there is a misalignment between the strategy and the organization, the management's agenda must begin by establishing a clear strategy to then define the appropriate organizational settings that will provide the best support for that strategy.

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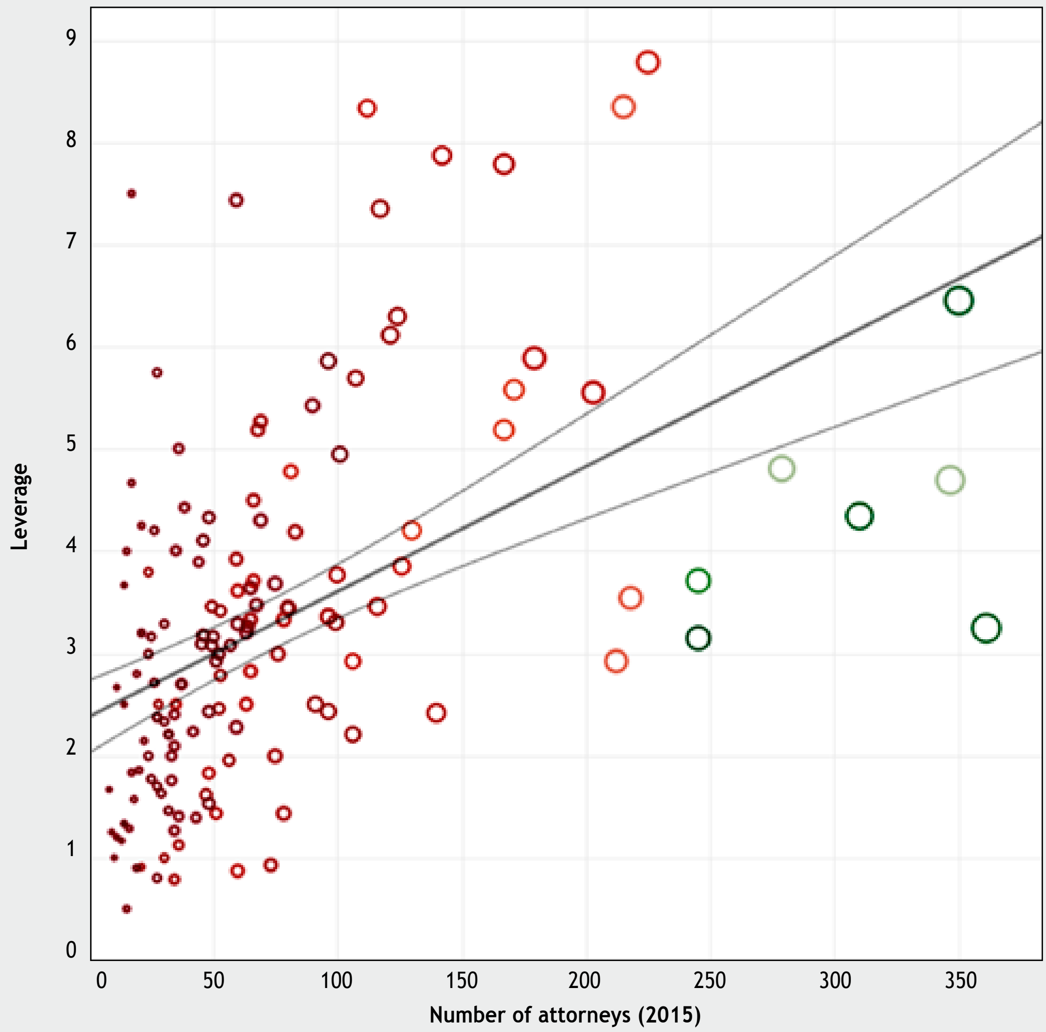
The first step in defining the growth strategy is to ensure consistency between the strategic positioning and structure

Table 2
Leverage versus firm size* in 2015



* Table 2 eliminates from the sample the observation corresponding to the firm Siqueira Castro Advogados, whose extreme leverage and size were such that they did not allow any differences to be seen among the smaller firms.

3. How do we grow?

Growth is important for the creation of value in any organization. Generally, growth makes it possible to increase the bargaining power of the company with both suppliers and clients, as well as to obtain economies of scale that allow it to operate more efficiently and make larger investments[2].

2 Although in this article we focus on the positive aspects associated with growth, we also recognize that, when this is not well managed, it can generate administrative and operational complications that affect the profitability of the company, as mentioned at the beginning of this article.

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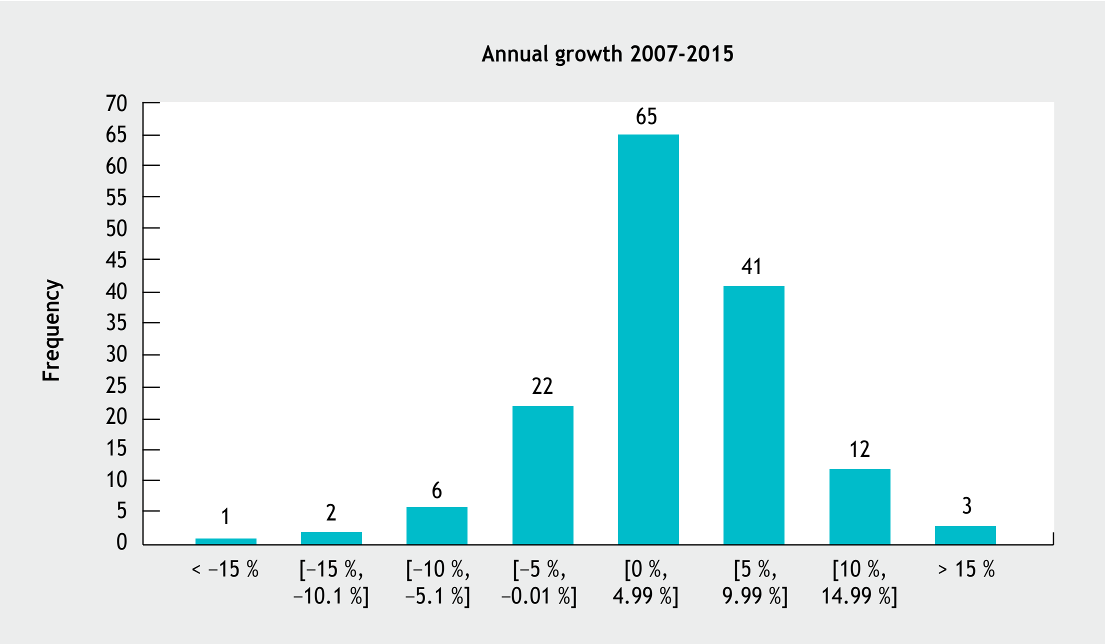
The final size, leverage, structure and positioning result from the growth strategy adopted by a legal service company

For example, as the company grows larger, it becomes more and more visible and attractive as an employer for young talent or the "stars" of other firms. That is to say, the law firm increases its bargaining power vis-à-vis the human capital, the most important resource for the success of any professional service company.

The compound annual growth[3] of the firms in our sample between 2007 and 2015[4] showed an average rate of 3.3%. In the histogram in Table 3, we can see how this growth is distributed among the firms. Most of the companies studied grew in the analysis period, although 69.3% of the sample experienced modest levels of growth (at a compound annual rate of between 0 and 10 %). Only 10 % of the sample achieved levels greater than 10 % annually during this period, and 20.6 % decreased in size.

Table 3
Histogram of the growth in employment between 2007 and 2015



The sample reflects a general shift in the continuum of strategies from "brains" to "efficiency" as the firms grow in size. Table 4 represents the position of each firm in two dimensions: the growth rate is shown on the horizontal axis, and the variation in leverage is shown on the vertical axis. We can clearly see that, of all firms that experienced growth (both quadrants on the right), most are located in the right upper quadrant (i.e., they increased their level of leverage). In particular, about two-thirds of the firms that grew in scale also increased their level of leverage between 2007 and 2015. This is consistent with the "Cravath model" (Sherer & Lee, 2002), in which the legal service companies take advantage of the increase in their scale of operation for their partners to specialize in monitoring activities and those with greater added value by assigning teams of associates to carry out less complex activities.

3 Measured by the change in employment 2007-2015.
4 As a benchmark, we include the level of growth of 5.3% that AmLaw 100 reported as the average for 2014.

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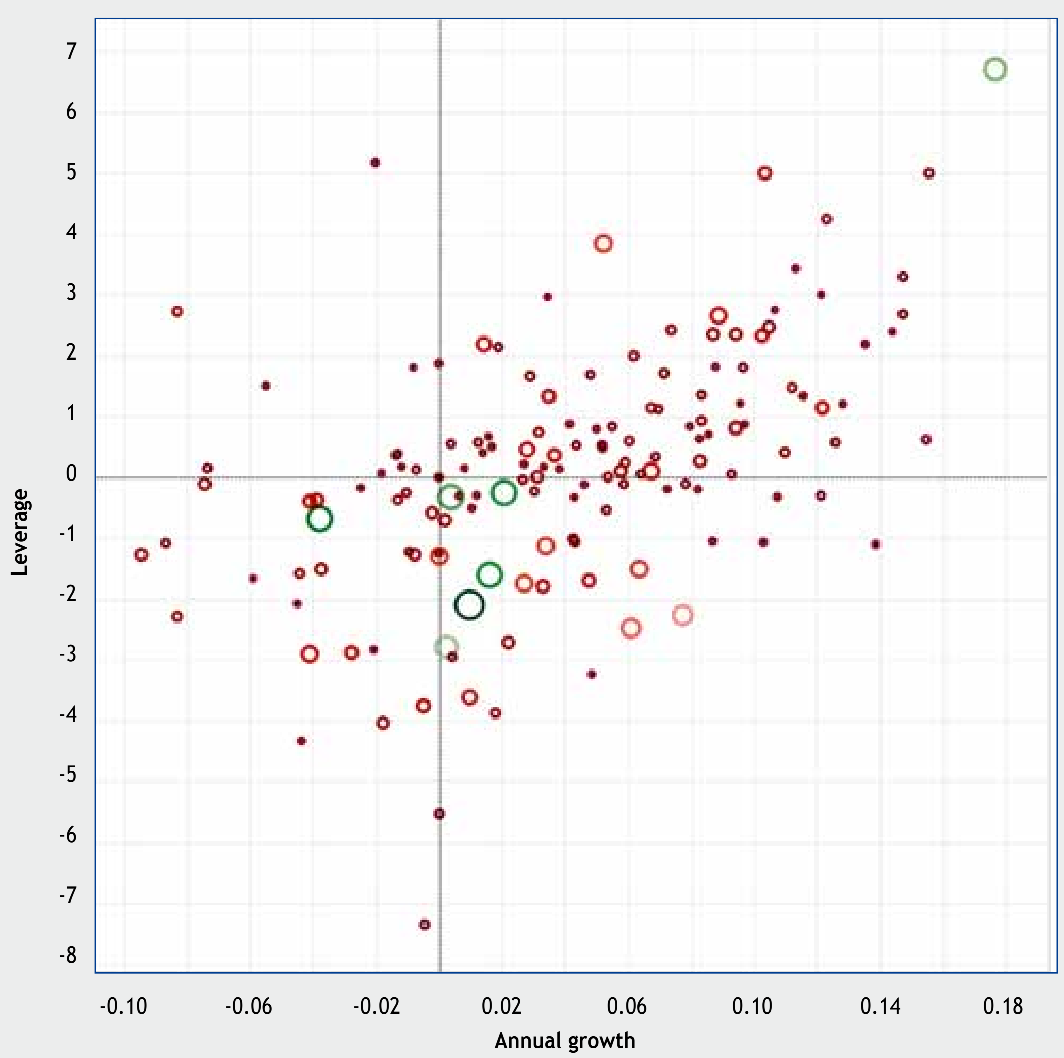
Organic growth strategies are the least risky and easiest to implement, and they result in moderate levels of growth

This pattern is also confirmed as the firms decrease in size. Table 4 shows that, of all the firms which decreased in size (both quadrants on the left), most are located in the bottom quadrant (i.e., they reduced their level of leverage). In particular, it bears noting that almost three-quarters of the firms that decreased in scale also reduced their leverage in the same period. This suggests that companies that experienced a contraction in demand for their services prioritized the retention of key talent and partners, and adapted by reducing the number of associates; that is to say, they experienced a reversal in the continuum between "efficiency" and "brains".

Table 4

Variation in leverage versus growth of the firm (2007-2015)



The final size, leverage, structure and positioning result from the growth strategy adopted by a legal service company. In general, there are four generic growth strategies: organic growth, diversification, internationalization and mergers and acquisitions.

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Organic growth typically involves penetration in existing markets or the development of new markets

3.1. Organic growth

Organic growth refers to the expansion of income through the continuation of the existing businesses. Generally, organic growth strategies are the least risky and easiest to implement, and they result in moderate levels of growth. In addition, they tend to strengthen the current positioning and competitive advantage of the organization. The management of a legal service company should consider organic growth as their first option before considering other alternatives. Here the well-known proverb applies: "better the devil you know than the devil you don't." Organic growth typically involves penetration of existing markets or the development of new markets (Ansoff, 1957).

In penetration strategies, law firms generally seek to increase their sales of services through one of two sources. On the one hand, firms may seek a larger market share in a particular segment of clients through increased marketing investment, improving public relations, intensifying sales management, broadening the client base and winning new clients served by rival firms. On the other hand, organizations can concentrate their efforts on selling a greater number of services to existing customers that currently require only one or a few services.

In their market development strategies, law firms start to venture into new areas of business. These are usually related to new customer segments and/or geographical areas. For example, often we note that as they evolve, firms which initially specialized in clients in an industry (say, free trade zones) or from a specific origin (say, Asian countries), tend to broaden their scope to clients in other industries or countries. In addition, we commonly note that firms that are founded in capitals or big cities in the region eventually expand to other cities within their own country, and even to other cities in neighboring countries. This last step is what we call *internationalization* and is discussed in further detail below.

3.2. Internationalization

It is usual for the domestic market to mature, and consequently, it is no longer sufficient to achieve the growth objectives of a law firm. The management of a legal service company must then wonder if it could exploit its competitive advantages to participate in other countries or whether the international expansion would help to strengthen their competitive advantages as compared to competitors operating in a single country (Caves, 1996).

The most visible examples that have followed this growth strategy are Dentons and Baker & McKenzie, the two largest multinational law firms in the world. Firms that follow this path are uniquely positioned to serve companies with a regional or global presence. This type of client generally seeks service providers not only with prestige and the capacity to provide multi-jurisdictional attention, but also with a high level of administrative sophistication, process standardization and uniformity in services. Therefore, firms with an exclusively domestic presence are at a disadvantage when it comes to winning accounts from these regional or multinational clients.

There are different modalities of internationalization for law firms, including some that do not necessarily involve the ownership of all units of an international business. Since the last decade, the Swiss Verein model of internationalization of law firms has become increasingly popular. According to this model, the law firms in each country are maintained as legally and fiscally independent entities, despite sharing the same "umbrella" brand, competitive strategy and technology investment costs. The two multinational firms mentioned above follow this model of internationalization.

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Decisions about diversification must be made carefully, because they tend to be more risky and difficult to implement

3.3. Diversification

The third growth strategy is diversification. This consists of the addition of new products or services in market segments (Montgomery, 1994). Diversification can be related or unrelated. The first version occurs when a specialized firm (for example, in corporate law) introduces a new legal practice (for example, real estate or criminal law). The second typically comes about when a firm incorporates non-legal services into its business portfolio. These non-legal services are commonly of an accounting-financial nature.

The key questions for a decision-maker evaluating diversification are similar to the questions raised to evaluate internationalization: Can the firm benefit from the competitive advantage developed in the current business portfolio to compete successfully in new services? And does diversification contribute to strengthening the organization's "extended" competitive advantage, as compared to specialized competitors that operate in fewer market segments?

Decisions about diversification must be made carefully, because they tend to be more risky and difficult to implement, especially those involving unrelated businesses. In law firms, these decisions often follow the logic of cross-selling. The firms intend to offer to the same segment of clients one-stop shopping, which will cover a multitude of needs for professional services. However, many times we lose sight of the complexity that the firm must overcome in order to develop new physical and human capacities, work processes and systems of management in order to implement diversification successfully. This complexity is further accentuated when diversification is unrelated, because the new skills and capabilities required are even more distant from those current employed. The situation becomes even more complicated when new services are directed to new customer segments in which the firm is not currently positioned.

In recent years, we have noted that some Latin American law firms very well positioned in the segments of corporate clients and multinational corporations have gone into accounting and financial services to cross-sell to their current client base. However, many of these firms have found that the type of client they serve with legal services prefers to work with large audit firms for their accounting and financial services (i.e., PwC, Deloitte, E&Y and KPMG). Since they are unable to cross-sell to their traditional corporate and multinational clients, some of these law firms have tried to offer their new non-legal services to new customer segments with a "less sophisticated" profile. In some cases, this has resulted in a deterioration of the positioning that the firms had achieved prior to diversification.

On the contrary, some law firms specializing in corporate law that have strengthened their competitive advantage through diversification have done so by incorporating a tax practice (related diversification) along with accounting-financial services specialized in tax issues (unrelated diversification). These firms have successfully taken advantage of diversification, on the one hand, as an avenue of growth and, on the other hand, as a way to strengthen their positioning, as proposed in their generic strategy.

3.4. Mergers and acquisitions

The last method of growth is through mergers and acquisitions (M&A) of businesses currently operating and owned by third parties (Marín & Ketelhöhn, 2007). A merger is the integration of two or more firms of similar size in order to form a single economic and legal entity, while an acquisition is the purchase of one company by the other. Although both modalities are similar, acquisitions generally involve more hierarchical relationships between the acquiring company and the acquired one, as compared to the supposed relations of alliance of the merging firms.

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Even though M&A represent an avenue of rapid growth, they usually involve greater investment, risk and complexity

M&A represent an avenue of rapid growth, albeit one that usually involves more investment, risk and complexity[5]. However, this strategy is attractive under certain conditions; for example, an acquisition may be the most viable option when a market is saturated, when required to start operations on a minimum scale or when developing a new service requires a lot of time.

To grow successfully through mergers and acquisitions, it is necessary to successfully execute all stages of the process: analysis of the strategic engagement between the companies, financial valuation, negotiation, due diligence and integration. It is common for acquiring companies to underestimate the difficulty of integration processes. Many M&As do not generate the expected value precisely because of the "irreconcilable" differences between cultures, processes and incentives between the two organizations[6].

We have observed that the M&A avenue is currently very dynamic in the legal services industry in the Central American region. Particularly, we identified multiple firms in the process of internationalization that are on the road to becoming regional competitors, merging with well-positioned firms in some of the destination markets. A recent example has been the merger of a Central American firm "A", with significant presence in the region, but with difficulty to penetrate into the largest country in the area, with firm "B", with leadership, but operating only in the latter country. In this case, it is expected that the integrated firm (A+B) will create greater value through a stronger regional positioning and new sales opportunities for regional services to the household customers of "B" and for domestic services in the latter market to the regional customers of "A".

4. Conclusions

It is not necessary to grow. Many companies providing legal services can be stable and profitable at the same time. The partners of these firms may receive lesser compensation and avoid higher levels of risk and administrative complexity. Ultimately, the decision to grow is one that reflects the personal ambitions of the partners. However, in the sample of Latin American firms considered in this study, we found that 80 % experienced positive annual growth rates between 2007 and 2015, so that the vast majority of competitors do have aspirations for growth.

The decision to grow must be motivated by the possibility of achieving higher levels of profitability, and consequently, compensation for the partners. If the partners decide to grow, they must do so in a manner that avoids the problems of misalignment between the strategy and the organization. In this article, we have presented three possible generic strategies for them to compete and differentiate themselves in the market. Each brings different organizational and operational implications that should be considered for the effective implementation of the strategy. In addition, our empirical analysis has revealed a natural evolution in the continuum of strategies from "brains" toward "efficiency" that firms should consider in order to manage their growth.

The growth alternative with the easiest deployment is that of organic growth: "keep on doing what the company did in the past." This must be regarded as the first option for growth because of its greater probability of success and the positive effect on the current positioning

5 The academic literature is divided between those who claim that mergers and acquisitions are generally successful, and those who argue otherwise. For a review of the literature, see Chapter 6 of the work by Marín and Ketelhöhn (2007).
6 For more information on how to manage an M&A process, see Marín and Ketelhöhn (2007).

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It is not necessary to grow; many companies providing legal services can be stable and profitable at the same time

and competitive advantage of the organization. Successful firms develop the skills and systems necessary to compete in the original business and withstand future growth. With the definition of a clear strategic positioning and with a projection of income, it can be mathematically deduced how many professionals must be hired, fired, and promoted.

When the original markets mature or when customers demand diverse or international services, consideration should be given to growth through diversification or internationalization. These are the most difficult to implement, due to the lack of recognition in the market or the additional administrative complexity that is involved when offering a new service or serving a new geographical area. In both cases, an attempt should be made to leverage the competitive advantages of the original business in the new services and geographic areas. Mergers and acquisitions of established companies can be one way to deploy the growth strategy. These tend to be more risky and complex, but also more effective if they are well implemented.

All of the growth strategies can be implemented simultaneously. Furthermore, an acquisition of a foreign company that offers new services provides growth in multiple dimensions. This growth introduces disorder and new challenges for the administration. The future of the company never turns out to be exactly as planned by its managers. However, the clearer the vision of the leaders, the better will be the implementation of the strategy and the closer the reality of the desired future. The future is not destiny. The future of the companies is built by their managers.

5. Appendix. Description of the sample of law firms in Latin America

The journal *Latin Lawyer 250* annually publishes a list of companies with recognized excellence in legal services for international corporations. We used a composite sample of legal service companies that appear in the journal in the years 2007 and 2015, eliminating the companies that only appear in one of the editions; that is to say, we included only the companies whose growth could be studied, as they appear in both editions. We also eliminated very small businesses employing less than ten lawyers. The resulting sample of 150 law firms includes 18 companies from Argentina, 3 from Bolivia, 27 from Brazil, 11 from Chile, 8 from Colombia, 6 from Costa Rica, 5 from Ecuador, 2 from El Salvador, 4 from Guatemala, 2 from Honduras, 21 from Mexico, 2 from Nicaragua, 6 from Panama, 4 from Paraguay, 15 from Peru, 4 from Uruguay and 12 from Venezuela. The sample is not random or representative of the universe of law firms that exist in the region. It is biased in favor of larger, more successful businesses with greater prestige. The sample includes 19 companies that had more than 100 lawyers in 2007; 44 employing 40 or more lawyers, but less than 100 in 2007; and 87 employing more than 10, but less than 40 lawyers in 2007.

As a proxy of growth in revenue, we used growth in employment between 2007 and 2015. Although we know that revenue per employee varies substantially from one company to another, there are no uniform public sources that reveal the revenue of the law firms in the region.

6. Declaration of Conflicting Interests

The authors declared no potential conflicts of interest with respect to the research, authorship, and/or publication of this article.

7. Funding

The authors received no financial support for the research, authorship, and/or publication of this article.

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