The Alternative Becomes Mainstream? ALSPs and the Evolving Law Firm Model

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The traditional understanding of the legal services value chain for corporations (at least in North America) has traditionally (but not exclusively) been a straight line from law department, to law firms, to alternative legal services providers "ALSPs". The latter category is broad and covers entities that provide legal-adjacent services but do not provide legal advice, such as document review, e-discovery, contract management, regulatory/ compliance support, and litigation support services. Indeed, what is considered an ALSP currently started out as a service the law firms themselves provided to their corporate clients. However, the advent of disaggregation of legal services (starting with the legal outsourcing/unbundling movement 20 years ago), has progressively led to the rise of this new category of player. Even after the appearance of ALSPs on the scene, it used to be the case that once a law firm got a mandate, they would then hire an ALSP to complete a portion of the work required to complete the mandate and that ALSP was selected, managed and evaluated by the law firm (the largest exception to this model being staffing solutions such as those provided by Axiom).

Corporate counsel quickly came to two realizations. First, some law firms were engaging in rate arbitrage where the law firm marked-up the services of the ALSP they had hired before they passed the fees along to the client (this practice was widespread from what I witnessed, but not universal). Second, clients realized that different firms were using different ALSPs for identical services that caused inefficiencies in the form of duplicated efforts, multiple platforms to manage, and redundant trainings. Unsurprisingly, corporate counsel took the reins and started engaging the ALSPs directly and then instructed the law firms that they were the ones who had to use these particular ALSPs when working on their mandates. This was not a universal trend, but was directionally the way the world was moving around 2014-2016.

Against this backdrop, we now have the first report from Thompson Reuters, Georgetown University's Center for the Study of the Legal Profession, and the University of Oxford's Saïd Business School entitled "Alternative Legal Service Providers: Understanding the Growth and Benefits of These New Legal Providers." The report is an important first step in understanding the evolution of the corporate legal services value chain, and worth reading in full. However, there are a few points that particularly underscore a fundamental challenge that face law firms today. Before getting there, a review of some of the key takeaways from the report is needed.

The value proposition for an ALSP is in direct competition with law firms

The four areas corporate legal departments most commonly used ALSPs for are: regulatory risks and compliance; specialized legal services; legal research services; and intellectual property management. In every single one of these four areas, the primary reason a law department chose an ALSP was not financial at all – it was access to specialized expertise not available in house. Perhaps the most eye popping gap was in the realm of regulatory risk and compliance services. Not only was this the most commonly used ALSP by corporate law departments (29%), it was also overwhelming engaged because of its expertise (77%) rather than cost (27%).

There was a time when regulatory risk and compliance posed an exceptional threat to a company which in turn produced lots of legal work for law firms that was not particularly price sensitive (rate inelastic). This data does not test whether that work is still truly rate inelastic. However this data does suggests that the reflexive instinct that only law firms can handle this work is becoming less common. The non-lawyer has now breached what was once the exclusive domain of a guild of experts. And 29% of surveyed corporate clients, recognizing this, are voting with their wallets by sending work to ALSPs.

Technology use and adoption undergirds ALSPs value proposition

In an interview with Law Technology News, Eric Laughlin, managing director of legal managed services at Thompson Reuters, elaborated on a trend he observed emerging from the 37 in-person interviews conducted as part of preparing this report. Clients, whether law firms or legal departments, "are now looking to ALSPs with high expectations for them adopting technology." The types of technology that clients expect ALSPs to utilize include process oriented technology, such as process mapping and workflow technology, as well areas where technology bleeds into substance such as artificial intelligence and contract management.

Laughlin's most interesting comment comes when he links customers' views on technology in ALSPs with customers' views that expertise is driving ALSP marketplace adoption. "ALSPs by definition came from a place of cost savings originally, and now are migrating to be more expertise-based, but because ALSPs have that underlying DNA around process they're able to utilize technology in that process."

ALSPs have a lot of room left to grow

The above must be contextualized within the bigger picture. Only 51% of law firms use even one ALSP currently. And corporate law department adoption is not that much higher at 60%. Among corporate law departments, only two categories of ALSPs have higher than 20% adoption: regulatory/compliance and specialized legal services (29% and 21% respectively). When law departments were asked what the key barriers were that prevented them from using an ALSP, quality and inability to deliver cost savings tied as the top hurdle (43%).

Bear in mind, that because this is the first year of the survey, it is only a single data point which by definition cannot define a trend. ALSPs have achieved a toe-hold in the marketplace for legal-adjacent services in the snapshot this survey presents. As the survey makes clear, this is particularly true with higher-volume tasks. Nevertheless, ALSPs have significant work left to do in order to convince the marketplace they are truly competing with law firms on both quality and price.

Considerations for an evolving law firm strategy

The authors of the report believe that there are "business development opportunities for law firms willing to incorporate ALSPs into their delivery models, but only if law firms incorporate the right kind of ALSPs that meet the needs corporations currently have or anticipate." This statement is undeniably correct and when evaluating a law firm strategy a focus on customer demand is table-stakes. The authors then discuss their views on a "make v. buy" approach for law firms considering entering the ALSP space.

There is a deeper, structural question that the findings of this ALSP report also point toward which is the fundamental challenge mentioned at the outset of this article: can a law firm adopt a dual-modal performance model? Law firms, all too often, are professional services businesses whose entire financial infrastructure is built upon the concept that their fundamental unit of inventory is <u>time</u>. The amount of work that can be performed in a given period, the value of the work performed, utilization, and employee performance all trace back to a lawyer's (or other employee's) time. When technology enters the picture, a second performance model emerges. This is a model based on capital expenditures and a timeframe-based horizon for expected returns. For technologies focused on process improvement, this reduces the amount of time it takes to perform the task and thus existing financial KPIs within law firms will always show the investment as providing negative returns. On the other hand, technology that addresses substantive issues such as artificial intelligence, requires software development, sales, and tech support skills which are rarely found inside law firms and which require different sets of performance metrics to be managed well. To be both a technology firm and a professional services firm at the same time means developing the ability to track performance, profitability (and not merely revenue) in entirely new ways.

Any attempt by a law firm to play in the ALSP space must therefore also consider, beyond the customer need they are fulfilling, how ready they are to manage an entirely new business model with radically different performance metrics. Without the internal tools to manage the venture – whether that be a wholly-owned affiliate or with the firm playing the role of a supply chain manager – the venture will face unnecessary challenges and may be managed unfairly or incorrectly. The corollary to the need for differentiated management tools is that there must be an accompanying differentiated management. Whether that is a different leader for different aspects of the business, or a single leader that is facile with both management mindsets and tools, this is a journey of significant change for most law firms. This type of change is most successful when actively undertaken with a change management protocol that encompasses the leaders as well as the affected stakeholders.

Correlated to this point (and where this article diverges from the opinion of the authors of the ALSP report) is the necessity of law firms to enter the ALSP space. Historically, there was no concept of an ALSP. If a task was "legally adjacent" the client would naturally turn to their trusted law firms to handle the task (if they were going to not use in-house resources in the first instance). However, law firms have been very slow to adopt process improvements, incorporate technology into their service delivery models, and generally abandon "time" as their sole unit of inventory. There will always be some legal work that is most sensibly billed by the hour and there will always be certain legal work that is sent to law firms that is rate inelastic. The size of that pie, however, is shrinking every day and that trend shows no signs of abating. A limited number of law firms will survive by carving out for themselves a niche practice built around these rare, but exceptionally valuable, mandates.

The majority of law firms would be wise to consider whether their current revenue streams are threatened by ALSPs. This requires not merely looking at performance by practice area, but an understanding of how much work with each of the firms' practice areas is high-volume, repeatable work that can be performed more efficiently by technology. That work is the most vulnerable target, at present, for an ALSP to compete with law firms. This report suggests that while adoption of ALSPs is presently limited, they have leveraged their fundamentally different roots to establish a value proposition based on expertise, supported by technology. Unless and until law firms learn how to price technology-enabled services they will remain vulnerable.

Law firms <u>can</u> recapture this market share. But in order to do this, they must understand why their customers have left in the first place. Expertise used to be the exclusive domain of lawyers. However, expertise is not enough anymore. Expertise supported by the best, most efficient tools is what the marketplace is starting to demand. Law firms have the opportunity, right now, to shift their business models to one where revenue and profits are generated by capital (in the form of technology) rather than solely the expenditure of a human's time. If they do so, and demonstrate to their clients that they have changed their business model (rather than merely playing lip-service to process management and technology), they have the ability to reverse the trend toward disaggregation as well as expand the success of their businesses.