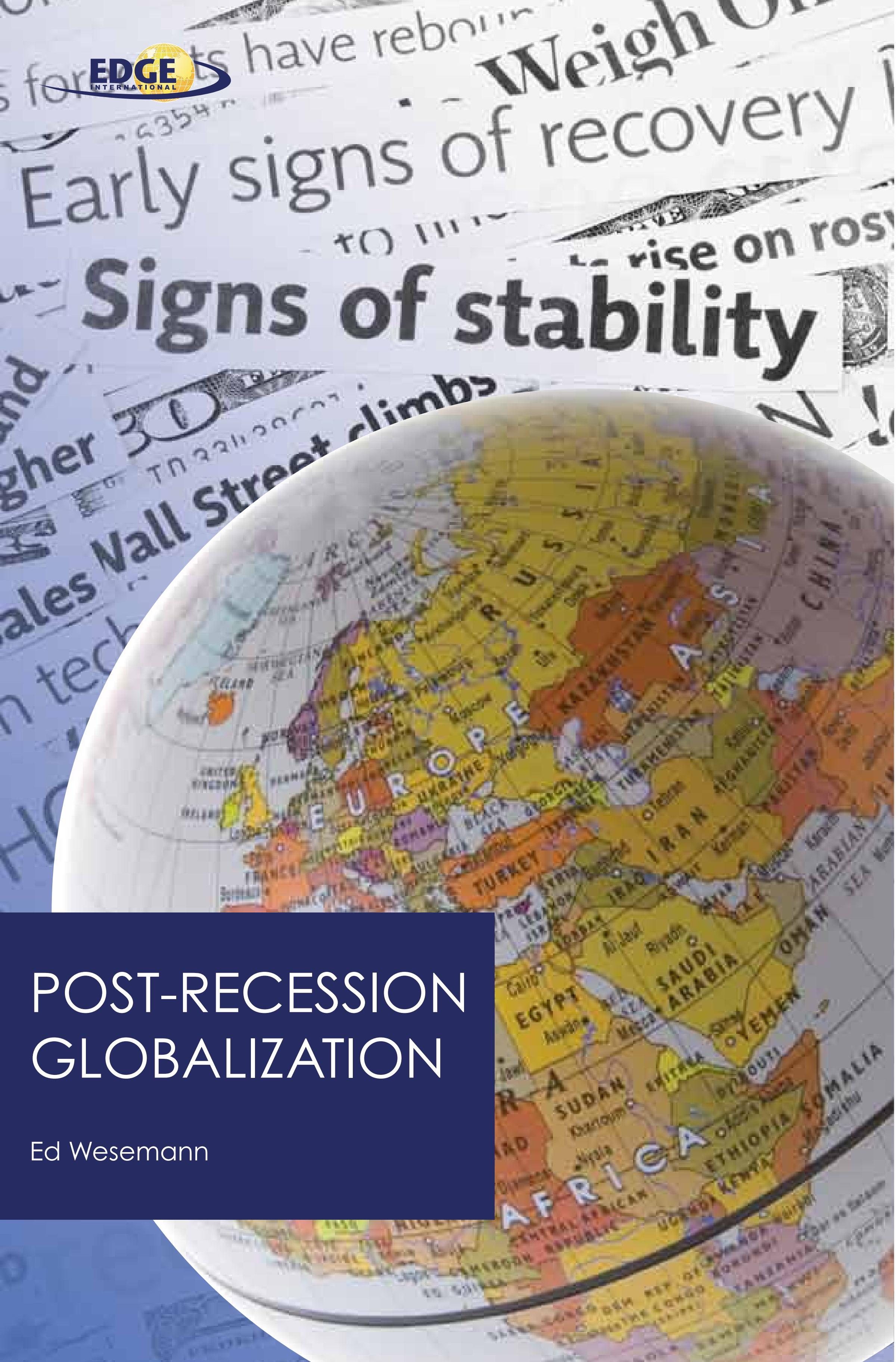
EDGE INTERNATIONAL



POST-RECESSION GLOBALIZATION

Ed Wesemann

To the extent that there is anything good about an international economic meltdown, it can be credited with having forced a lot of law firms to reconsider their globalization plans. As the recession drove red ink for the international investments of many firms, more than a few of them are looking at their international offices and saying to themselves, "*What were we thinking?*" The post recession global expansion for at least U.S. law firms may hinge on what they have learned from their international experiences. And, those experiences may be equally instructive to U.K. law firms as they consider their potential expansion to the Americas.

It is always risky putting a label on something before it is completed but, at least as of now, it would be hard for law firms to call the current decade anything but the age of international expansion. For many U.S. firms, globalization rapidly went from being a seminar topic ten years ago to an underpinning of business strategy today. In fact, of the top 200 law firms in America, 70 have an office in the United Kingdom and 66 have an office in China. Of course, those numbers are chump change compared to the number of countries where large U.K. law firms have planted their flags. But, for a country where only about 20 percent of its citizens hold passports, U.S. law firms can rightfully view themselves as being in the vanguard of American global expansion. On the other hand, for British law firms, the U.S. has to be viewed as the land of opportunity. With a legal market approaching a quarter of a trillion dollars, the value of legal services in the U.S. is larger than the rest of the world combined and almost six times bigger than the U.K., the next largest legal market. With the financing opportunities presented through the Clementi reforms, the U.K. Top 50 was busily preparing their U.S. growth plans.

" For many U.S. firms, globalization rapidly went from being a seminar topic ten years ago to an underpinning of business strategy today.

However, most of this expansion took place before the economic meltdown. Traditionally, economic downturns drive isolationism. When there is large scale unemployment and a lack of demand for goods and services worldwide, it is politically difficult for any government to advocate active international trade and foreign investment. This is nothing new. In fact, restraints on international trade and economic cooperation are frequently cited as primary factors exacerbating the severity and length of the Great Depression. So it should not come as a great surprise that, in what some have labeled the second great depression, we are currently seeing large-scale concern about any portions of governments' economic stimulus programs being used to benefit non-domestic workers and companies.

The result has been a culling of the herd of law firms seeking to become international players. As the availability of legal work, particularly in Europe and China, declines for law firms that do not have an active client base and/or a strong local practice, about half of overseas offices (at least for U.S. firms) can be expected to bleed cash at a time when the money is much needed for internal purposes. Accordingly, a lot of law firms put a halt on their plans for international expansion in response to the recession. They found it hard to convince their partners that any significant expenditures make sense during a period when the primary strategy has been to restrain spending. It's even more difficult to justify any form of growth strategy after having laid off some of their brightest and best associates, delayed or completely deferred the start date of new lawyers, fired non-equity partners and demoted under-performing equity partners.

A natural assumption is that law firms will resume pursuing their global growth strategies when the recession ends. For many law firms, however, the recession has provided a time out -- a chance to catch their breath and look at their international strategies outside the fever-pitched, bullish optimism that fueled the business decisions of the past decade. At issue for law firms is not whether globalization is good or bad or even if the increased international growth of businesses will continue. The globe has shrunk and will continue to get smaller despite the support for isolationism that invariably appears in response to economic vicissitudes. Instead, the issue is, in a world where it is hard to find a location that is underserved by lawyers, is there an international business strategy that makes sense

> Strategy is a function of understanding and coming to a consensus on where a firm is going.

for law firms? And, if there is one that a firm can identify, does it fit with the overall practice of the firm and the amount of capital the firm's partners are willing to put at risk?

DEVELOPING AN INTERNATIONAL STRATEGY

As Alice learned in Lewis Carroll's Wonderland, "*If you don't know where you are going, any road will get you there.*" Strategy is a function of understanding and coming to a consensus on where a firm is going. For many firms, new offices have traditionally been created on the initiative of one partner -- what management theorist Peter Drucker called, a "*monomaniac on a mission.*" Firm leaders give in to the nagging of a new office's proponent more because they are worn down than actually supporting the concept. As a result, it is difficult to measure the success or failure of an office because it was never the product of a specific strategy.

If firms want to get serious about the capital they are investing in international expansion it makes sense to start with a vision of what they mean to create. The process is not complex but involves dealing with some basic questions like "*what does the firm expect to get out of the office?*" For many firms the answer is simply to be able to list an office in London or New York on their web page. Such an objective points towards a minimalist office, perhaps even an office suite or an affiliation with a local firm. But if the firm expects to actually perform work for their clients and, perhaps, attract local clients with interests in other countries where the firm has offices, the vision becomes more complex.

A key to the vision is the makeup of the office's client base. For example, a U.K. firm seeking to open an office in the U.S. has four basic types of clients:

- clients whose relationship with the firm is U.K. based, who seek representation on U.S. issues;
- clients who are U.S. based or whose relationship with the firm is U.S. based, who seek representation on U.S. issues;
- U.S. clients seeking representation on U.K. issues (or issues in other countries where the U.K. firm has offices); and

- network clients with network issues, e.g., a Canadian company seeking representation on an EU matter.

UK clients with US issues	US clients with US issues
Network clients with network issues	US clients with UK / other country issues

The natural reaction of most firms would be to respond that they want all of these kinds of clients. Yet the clearer the vision as to what kind of clients the firm expects to build the office on, the easier it is to recruit and compensate talent.

Representative Office

For example, if a U.K. firm believes there is sufficient demand from existing clients for work in the U.S., it would staff a new office with highly competent U.S. lawyers who do not have a substantial portfolio of their own business. Under U.S. meritocracy based compensation systems, such lawyers would be far less costly than partners with large practices and they would be able to devote the appropriate time and attention to the firm's clients. In addition, the availability of known work makes the venture less risky for the firm and permits them to be more aggressive in their expansion.

Representative offices can be very profitable. However, if the vision is restricted to this type of client and issue, the office becomes merely a service arm of the home office and is likely to result in what my friend Alan Hodgart calls, "*a Noah's Ark office*" -- two corporate lawyers, two real estate lawyers, two litigators, etc. Moreover, there are some significant locational questions in opening a representative office, especially in the U.S. For a U.K. firm with a strong client base of manufacturing companies in Manchester, an office in Minneapolis may be of far greater value to their clients than New York City.

Local Office

On the other hand, the firm may see itself primarily serving U.S. clients on U.S. matters and using those representations to promote the firm's global capabilities to the clients. This is the typical result of offices opened through a merger with the value of the acquired firm being its local reputation and client base. It is also the result that firms pursue when they build an office through the serial acquisition of laterally hired partners bringing their client bases.

The difficulty with local offices is that they produce little positive cash flow back to headquarters. After the partners who control the business are paid (usually at a premium necessary to attract them to the merger or the office), there is little profit left to send home.

Business Development Office

For some firms, the preferred approach to a foreign market is with a small office designed to facilitate their business development efforts in attracting local clients who have business interests in the firm's home country. This is the approach that a number of U.S. firms have attempted in London as a base of operation from which they can have their lawyers present the firms' capabilities in the U.S. On a slightly larger scale, some British firms have opened New York offices to attract public offerings to the London exchange.

Business development offices are typically staffed by expatriate partners who are not licensed to practice law locally. This makes for an expensive operation in terms of providing living expenses and dealing with currency swings for compensation purposes. Worse, there are no natural means of applying revenues to a business development office so profitability calculations can be highly politicized in some firms. Recognizing the U.S. businesses with significant U.K. interests that are regularly on the ground in England (and vice versa for U.K. businesses in the U.S.), the jury is still out on the value of business development offices.

Network Offices

The final type of client is the global company where geographic location is reasonably irrelevant. Such clients hire large international law firms with the expectation that the firms will be able to serve their interests around the world. In such circumstances, the client of a U.K. based firm's New York office may be a South African company with a matter in Brazil. The client could hire local counsel in Brazil but prefers the consistency and continuity of using a limited number of global firms.

In the back of their minds, most firms probably go into international expansion with the objective of creating network offices. But it sounds presumptuous for all but a few global giants to enunciate such a vision. It is the end state of global success and the likely business model for the global economy. But if a firm even has an inkling of creating an international network, it impacts on the strategy of even opening its first foreign office.

THE BOTTOM LINE

Client base is but a single component of a vision. There are also issues of the envisioned size of the office, the areas of practice to be offered, non-legal expertise such as industry experience, pricing and billing strategies, and competitive positioning. In addition, there is the entire value proposition as to why clients should use a firm, especially in a country where that firm is not a branded name.

The simple process of defining objectives and setting out the means of accomplishing them has great value in law firm decision making. With the competitiveness of law firms and the fragility of client relationships, law firm expansion cannot be left to the whim of monomaniacs on a mission.

The recession has provided a timely bucket of water thrown on some over-exuberant law firm expansionism.

The recession has provided a timely bucket of water thrown on some over-exuberant law firm expansionism. The most successful firms will learn from some of the more expensive experiences of the past.

Ed Wesemann is a consultant and advisor to law firms in the areas of growth strategy and mergers. He has worked with a large number of U.S. and U.K. law firms in crafting their international strategies and seeking merger and affiliation opportunities. Contact him at ed@edwesemann.com.