Legal Process Outsourcing: Analyzing and Managing the Prospective "Make or Buy" Decision by Ontario Law Firms

Brandon Keshen
University of Windsor, keshenb@uwindsor.ca

Follow this and additional works at: https://scholar.uwindsor.ca/major-papers

Part of the Business Administration, Management, and Operations Commons, Business Organizations Law Commons, Contracts Commons, and the Strategic Management Policy Commons

Recommended Citation
https://scholar.uwindsor.ca/major-papers/132

This Major Research Paper is brought to you for free and open access by the Theses, Dissertations, and Major Papers at Scholarship at UWindsor. It has been accepted for inclusion in Major Papers by an authorized administrator of Scholarship at UWindsor. For more information, please contact scholarship@uwindsor.ca.
LEGAL PROCESS OUTSOURCING: ANALYZING AND MANAGING THE PROSPECTIVE “MAKE OR BUY” DECISION BY ONTARIO LAW FIRMS

By

Brandon Keshen

A Major Research Paper
Submitted to the Faculty of Graduate Studies through the Odette School of Business in Partial Fulfillment of the Requirements for the Degree of Master of Business Administration at the University of Windsor

Windsor, Ontario, Canada

2020

© 2020 Brandon Keshen
LEGAL PROCESS OUTSOURCING: ANALYZING AND MANAGING THE PROSPECTIVE “MAKE OR BUY” DECISION BY ONTARIO LAW FIRMS

By

Brandon Keshen

APPROVED BY:

______________________________________________
F. Schlosser
Odette School of Business

______________________________________________
G. Kerr, Advisor
Odette School of Business

April 20, 2020
AUTHOR’S DECLARATION OF ORIGINALITY

I hereby certify that I am the sole author of this thesis and that no part of this thesis has been published or submitted for publication.

I certify that, to the best of my knowledge, my thesis does not infringe upon anyone’s copyright nor violate any proprietary rights and that any ideas, techniques, quotations, or any other material from the work of other people included in my thesis, published or otherwise, are fully acknowledged in accordance with the standard referencing practices. Furthermore, to the extent that I have included copyrighted material that surpasses the bounds of fair dealing within the meaning of the Canada Copyright Act, I certify that I have obtained a written permission from the copyright owner(s) to include such material(s) in my thesis and have included copies of such copyright clearances to my appendix.

I declare that this is a true copy of my thesis, including any final revisions, as approved by my thesis committee and the Graduate Studies office, and that this thesis has not been submitted for a higher degree to any other University or Institution.
ABSTRACT

This paper examines the costs, risks and benefits associated with law firms outsourcing some of their core business activities to legal process outsourcers (“LPOs”). Similar to other outsourcing operations, LPOs supply services for a fraction of the cost of what law firms charge for similar services. Common in manufacturing industries, the decision to outsource, or keep work in-house (also referred to as a “make or buy” decision), has become more prevalent in the area of business services, including client service industries such as consulting and financial management. With respect to legal services, recent and rapid changes to the legal profession, caused in part by macro-environmental and industry-level forces, have brought this common business dilemma to the doorstep of Ontario’s legal profession.

Clients are placing downward pressure on the price of legal services. Clients no longer want to pay lawyers by the hour to perform certain routinized legal work. In response, law firms can outsource the work to LPOs. LPOs are an option to reduce client costs and, in turn, deliver increased value to clients. This paper provides a strategic framework for assessing the relevant costs, risks and benefits associated with law firms’ contracting with outsourcing vendors. It is clear that engaging with LPOs is risky. Nevertheless, if firms are well prepared and understand how to manage the outsourcing relationship, outsourcing work to LPOs can be a profitable strategy. There are numerous available LPO vendors with which law firms can contract. Controlling costs, minimizing risks, capitalizing on benefits and engaging with the right LPO are keys to successful outsourcing for law firms.
# TABLE OF CONTENTS

AUTHOR’S DECLARATION OF ORIGINALITY .......................................................... iii

ABSTRACT .................................................................................................................... iv

LIST OF FIGURES ........................................................................................................ vii

CHAPTER 1: INTRODUCTION .................................................................................. 1
  The Research Question ............................................................................................. 2

CHAPTER 2: THE BUSINESS OF LAW ...................................................................... 4
  A Law Firm’s Organizational Structure .................................................................. 5
  Hourly Billing Model ............................................................................................... 6

CHAPTER 3: MACRO-ENVIRONMENTAL ANALYSIS ....... ................................. 7
  The Political Impact of Liberalizing The Legal Marketplace ............................. 8
  The Economic Impact of Commoditizing Legal Services ................................. 10
  The Social Impact Of The Access to Justice Issue ............................................. 12
  Technology as a Conduit to Globalization ......................................................... 13
  A Lawyer’s Ethical and Compliance Obligations .............................................. 16
  The Impact of Covid-19 ....................................................................................... 17

CHAPTER 4: INDUSTRY-LEVEL ANALYSIS ....................................................... 18
  Threat of New Entrants ......................................................................................... 19
  Power of Suppliers ................................................................................................. 23
  Power of Buyers ..................................................................................................... 24
  Threat of Substitutes .............................................................................................. 26
  Rivalry Among Existing Competitors ................................................................. 27

CHAPTER 5: FIRM-LEVEL ANALYSIS ................................................................. 29
  Key Resources ....................................................................................................... 30
  Core Capabilities/Competencies ......................................................................... 30

CHAPTER 6: STRATEGIC OUTSOURCING ...................................................... 32
  Key Factors ............................................................................................................ 33
LIST OF FIGURES

Figure 1. Porter's Five Forces Model

Figure 2. Law Firm Value Chain

Source: Sako (2009), p. 23
Figure 3. Types of Vertical Relationships

Source: Grant, Jordan & Walsh (2015), p. 254
Figure 4. U.S. LPO Market

Source: Grandview Research (2019)
CHAPTER 1: INTRODUCTION

Vertical integration, or a firm’s ownership and control of different business activities along its value chain, has long been a strategy employed by law firms to control costs, increase revenue and maintain quality of work. Changes to the legal services industry across the globe, caused in part by macro-environmental and industry-level forces, are reshaping the legal industry’s structure and shifting the balance of power from firms to clients. Clients now expect more for less from their legal service providers (Canadian Bar Association, 2013, p. 28).

Ontario’s legal marketplace has been slow to respond to the changes. Tight entry barriers and strict regulations have, until recently, allowed lawyers and paralegals to hold a monopoly over Canada’s legal marketplace. An enforced and regulated monopoly, coupled with a profitable billing model and corporate structure, have created a risk-averse organizational culture that prefers to be fast followers instead of first movers (Henderson, 2017). Legal process outsourcers (“LPOs”), an alternative legal service provider, recognized the client-driven demand in the marketplace for an innovative legal service delivery model and pitted their business models against those of traditional law firms.

As a direct substitute to integrated law firms, LPOs capitalize on the commoditization of legal services caused by advancements in technology and globalization. LPOs offer services that are predominantly low in value but time-consuming. Basic legal research and writing, document review and corporate due diligence are examples of work typically performed by LPOs (Susskind, 2012, p. 8). The identical nature of the services offered by LPOs should alert law firms to the threat that LPOs pose to their
profits and industry structures. By leveraging operation centres in low-cost locations such as India, China and the Philippines, LPOs can charge clients a fraction of the price for legal services compared to incumbent, North American law firms (Kowalski, 2008; Ross, 2011). Furthermore, LPOs are just one alternative legal service provider among many new substitutes competing with law firms for the same clientele.

In response, law firms must re-evaluate their strategy to remain competitive in today’s marketplace. As part of the re-evaluation process, there are several strategic corporate options available to law firms. A common growth strategy for many law firms has been to consolidate with other law firms in jurisdictions marked by either a high demand for legal services, a foreign location, or both. The increase in firm resources and capabilities associated with mergers and acquisitions (“M&A”) have allowed many firms to realize competitive advantages associated with extensions to their vertical, product and geographical scopes, thereby insulating themselves from the threat imposed by substitute providers of legal services. Beyond M&A, there exists other alternative growth strategies. Firms can enter into a wide range of strategic relationships with other law firms or legal service providers either through strategic alliances, partnerships, spot and long-term contracts and joint ventures, to name a few (Grant, Jordan and Walsh, 2015).

**The Research Question**

Outsourcing work to LPOs is one particularly intriguing strategy for law firms in Ontario. Common in manufacturing industries, firms outsource certain less profitable business activities to external suppliers who could perform the same activity at a similar (or sometimes higher) level of quality and sell it to the firm at a sometimes substantially lower price than the firm’s cost to perform the same activity in-house. Outsourcing certain
legal work might be an effective strategy for law firms to reduce costs, meet client expectations, develop new clients and sustain their profits.

LPOs present an interesting strategic dilemma for law firms. On one hand, entering into an outsourcing relationship with LPOs could provide law firms with a means to increase their value proposition; on the other hand, procuring the services of LPOs can serve to ‘hollow out’ the outsourcing firm’s capabilities, and it can strengthen and increase the foothold that a substitute competitor has on the legal marketplace. Nevertheless, the opportunity for law firms to reduce costs and strengthen relationships with clientele warrants further research. With specific emphasis placed on Ontario’s regulatory and business environment, this paper provides a framework for law firms to adopt when deciding whether to continue making certain work in-house or consider buying that work from LPOs.

To determine whether the benefits of outsourcing work to LPOs outweigh the costs and risks, firms must complete a cost-benefit analysis. An effective cost-benefit analysis consists of, first, giving proper consideration to the competitive environment in which a firm operates; second, objectively appraising a firm’s resources; and, third, effectively implementing a strategy (Grant, Jordan and Walsh, 2015, p. 2-3). A useful approach to studying the “make or buy” question for law firms is:

1) Exploring the business of law, the partnership structure and the hourly billing model;

2) Analyzing macro-environmental and industry-level pressures;

3) Gaining a high-level understanding of strategic outsourcing;
4) Performing a firm-level analysis (i.e., assessing a law firm’s resources, core-competencies and value chain);

5) Scanning the LPO marketplace for LPO partners;

6) Performing a cost-benefit analysis of outsourcing to LPOs;

7) Making conclusions.

CHAPTER 2: THE BUSINESS OF LAW

The law firm is a group of lawyers, hired for their expertise and grouped under a single brand name (Furlong, 2016, p. 37). Firms are often classified by lawyers and non-lawyers – the former generates revenue and the latter provides support functions (Furlong, 2016, p. 37). Unlike associates who are employees of the firm, law partners are both co-owners and employees who earn money from their human capital (Ribstein, 2010, p. 753). Ultimately, firms earn revenue from charging clients for the value of the firm’s reputation and outputs (Ribstein, 2010, p. 753). A law firm’s value to customers derives from the asymmetry of information between lawyers and clients (Ribstein, 2010, p. 753). The asymmetry of information makes the quality of a legal service difficult to evaluate for clients.

The information asymmetry can lead to and exacerbate inherent agency costs in the lawyer-client relationship (Ribstein, 1998). Clients delegate power to the lawyer over their matter, and the lawyers’ and clients’ interests differ. For law firms that bill clients by the hour (which are many), lawyers are incentivized to spend more time than necessary to complete a task. In turn, clients who pay by the hour want the least number of hours billed. Furthermore, clients are willing to pay premiums to established firms because the
reputation of these firms is often founded upon honest and faithful service (Ribstein, 2010, p. 753). Young, individual lawyers have not yet developed a reputation, and thus benefit from being employed by firms with strong reputations (Ribstein, 2010, p. 754).

**A LAW FIRM’S ORGANIZATIONAL STRUCTURE**

Firms maintain their reputations by motivating lawyers to screen, mentor, and monitor new attorneys in order to build and maintain the firm’s reputation (Ribstein, 2010, p. 754). Lawyers must balance allocating time and effort to building the firm’s reputation with building their own client lists. They key is striking a proper balance between what is good for the lawyer and what is good for the firm. A firm’s corporate hierarchical structure achieves the balance (Ribstein, 2010, p. 754). The limited liability partnership (“LLP”) is the most common business structure for law firms in Ontario. Alchian and Demsetz (1972) argue that professional firms must be partnerships because non-lawyers cannot adequately monitor legal work. The LLP limits the liability of both associate-employees and “limited” partners. The general partner holds liability for the firm’s actions and is solely responsible for managing the firm’s business. While the general partner oversees the business operations of the firm, all partners are responsible for maintaining the integrity of the firm’s brand – which can be complicated as firms grow and organizational complexity increases.

As firms grow in size and complexity, the ability to effectively monitor employees weakens. Firms respond by aligning incentives through pay, promotion and limited liability (Ribstein, 2010, p. 755). Lawyer-partners, as owners, are compensated based on a percentage of firm profits (also referred to as “profit per partner”) that are normally adjusted to reflect seniority, not their individual billing contributions (Gilson and Mnookin, 1985). Seniority-based, or “lockstep” compensation incentivizes owners to monitor the
work and behaviour of associates and students rather than focusing solely on building their books of business (Ribstein, 2010, p. 756). In addition to seniority-based compensation, firms incentivize employees through a “cravath system” of promotion where only the top associates are asked to enter the partnership (Henderson, 2008). A cravath system incentivizes employees to act ethically and to bill the most hours possible. Through an “up-or-out” tournament, associates that meet a certain standard are promoted, while those that do not are asked to leave (Ribstein, 2010, p. 756). In addition to pay and promotion incentives, the LLP structure insulates individual lawyers from liability for the firm’s actions, which further incentivizes employees to remain loyal members of the firm.

**Hourly Billing Model**

The traditional law firm business model is built on billing clients by the hour. This mode of pricing legal services does not align with what clients really intend to buy, which is solutions to their legal problems (Ribstein, 2010, p. 768). Time billed is often not an accurate measure of the value of legal services. One explanation for time-based billing is that it strikes a compromise between the needs of lawyers and clients. Hourly billing gives firms a simple way to monitor the productivity of their lawyers, and clients receive an extensive breakdown of the services rendered as opposed to a bill with a simple balance (Ribstein, 2010, p. 769). The problem with hourly billing for clients is that the accountability associated with extensive invoices is misleading given that they, as non-lawyers, are unable to accurately assess how many hours were necessary to sufficiently perform tasks (Garoupa and Gomez-Pomar, 2008). Hourly billing increases lawyer-client agency costs by tempting law firms to spend unnecessary time on rendering legal services. Thus, partners have an incentive to hire as many associate employees as possible and have
them bill more hours in order to increase their profits per partner. Although the hourly fee is a measure of a firm’s reputational capital, clients (small and large) are increasingly becoming cost-conscious with respect to their legal service providers (Cox and Smith, 1985; Canadian Bar Association, 2013).

To increase the goodwill and maintain the close relationships between lawyers and clients, many firms are beginning to explore alternative fee arrangements to time-based/hourly billing. Referred to as “unbundling,” the commoditization and standardization of legal and other corporate services is revolutionizing professional industries around the world (Ertel and Gordon, 2012; Karmakar, 2004). Centred on value creation, clients are increasingly skeptical of the value they receive from hourly billing. Larger, institutional clients who possess increased negotiating power can demand their legal service providers accept arrangements they deem more valuable. As a result, the stability once offered by the traditional law firm business model is eroding. Firms are facing pressure from forces in both their remote and industry environments. In turn, the following chapters explore the two sources of pressure.

**CHAPTER 3: MACRO-ENVIRONMENTAL ANALYSIS**

A firm’s business environment includes all external factors that influence a firm’s strategy. A classic framework for monitoring and analyzing the environmental conditions that affect a firm’s decisions and performance begins with an assessment of remote, macro-environmental forces (Grant, Jordan and Walsh, 2015, p. 32 and 33). Identifying macro-environmental forces helps a firm to predict future developments in an industry and prepare for future scenarios (Grant, Jordan and Walsh, 2015, p. 32 and 33). For law firms that are
interested in pursuing an outsourcing strategy, an important initial step is undertaking a sufficient environmental scan of key factors impacting the opportunities and threats facing the legal services industry. A proper environmental scan for the legal services industry would take into account (where possible) political, economic, social, technological, environmental and legal factors. The key to an effective environmental scan is to reduce information overload and devote attention to the most important factors (Grant, Jordan and Walsh, 2015, p. 34).

THE POLITICAL IMPACT OF LIBERALIZING THE LEGAL MARKETPLACE

In several common law jurisdictions, most notably Australia and the U.K., the legal profession is becoming increasingly liberalized and competitive. Regulations are easing on who can practice law and the business structures that lawyers can adopt, among other changes (Pearce, Semple and Knake, 2014, p. 19). The liberalizations, in turn, pressure law firms to innovate their business models and/or alter their corporate structures to remain competitive (Passarella, 2010).

In 2001, Australia became the first common law jurisdiction in the world to permit lawyers to adopt “alternative business structures” (Law Society of Upper Canada, 2014, p. 9). This change was significant as it allowed non-lawyers, for the first time, to own or take part (either solely or jointly) in the management of law firms (Law Society of Upper Canada, 2014, p. 9). Since 2001, several Australian law firms’ initial public offerings were approved, thereby making it possible for the first time for a law firm to raise money through the capital markets (Ho, 2015). Shortly thereafter, the Legal Services Act 2007 (the “LSA”) was passed by the Parliament of the United Kingdom, opening up ownership and management of law firms and other legal service providers to non-lawyers in England and
Wales (Legal Services Act 2007, c. 29). Similar to Australia, the LSA also allowed law firms to adopt a wide range of different alternative business structures in addition to going public (Legal Services Act 2007, c. 29).

The changes in Australia, England and Wales have caused a rippling effect across Canada, particularly in Ontario, Canada’s largest legal service marketplace. Prompted by changes in other jurisdictions, coupled with a growing realization by many legal industry stakeholders that the market for legal services in Canada was changing, Ontario recognized the need to study the impacts of liberalizing the marketplace. In 2014, the Law Society of Upper Canada1 (the authority responsible for overseeing and regulating the legal profession in Ontario) embarked on a study to consider whether Ontario should permit lawyers to adopt alternative business structures (Law Society of Upper Canada, 2014, p. 4-5). Although the study did not result in Ontario making significant liberalizations comparable to Australia, England and Wales, the study confirmed that changes to Ontario’s legal profession are coming2 – whether law firms are ready or not.

Susskind (2012) notes that jurisdictions that do not liberalize are less market friendly than those who do liberalize and therefore will be at a competitive disadvantage (p. 9). The advantages for liberalization in Ontario’s legal services marketplace are, first, to keep up with other jurisdictions, but also to act as a catalyst for modernizing and improving their offerings (Susskind, 2012, p. 9). Liberalizations to Ontario’s legal profession

---

1 Now formally known as the Law Society of Ontario (“LSO”).
2 One amendment that came about as a result of the Law Society of Upper Canada’s study of alternative business structures was permitting lawyers and paralegals licensed in Ontario to provide legal services as employees of registered charities and not-for-profit corporations, collectively referred to as “civil society organizations”; see Law Society of Ontario By-Law 7, Part VI, subsection 41(1) to section 53.
marketplace would likely result in permitting non-lawyer ownership of law firms. Hypothetically, firms could then offer ownership stakes to individuals with business and other professional expertise which could be leveraged when embarking on new corporate and business strategies like outsourcing, for example. One could also argue that increased competition from a liberalized market would prompt more law firms to innovate their delivery models, which could enhance the affordability of legal services.

THE ECONOMIC IMPACT OF COMMODITIZING LEGAL SERVICES

A general trend of recent years has been the de-integration and commoditization of services (Karmakar, 2005), including more knowledge-intensive professional services (Sako, 2015). One significant effect of the recent and ongoing changes to the legal services industry, therefore, has been the commoditization and standardization of legal work. Complex legal work that once required ‘bespoke’ tailoring by a legal expert has now been standardized or systematized, thus reducing the need for traditional lawyers (Susskind, 2012, p. 8). Some law firms and other legal service providers are “unbundling” legal work as opposed to requiring an up-front retainer for carriage of the entire matter.

Commoditizing a service that is traditionally billed hourly is pressuring law firms to innovate their delivery models to meet the changing demands of clients. The commoditization of legal services is a current threat to traditional law firms’ hourly billing model. However, the impact will likely be felt most significantly for lawyers practicing in areas that involve high-volume, low-margin work, such as basic legal research and writing, document review and corporate due diligence (Susskind, 2012, p. 8).

The segment most impacted by commoditization will be younger, less experienced lawyers. Lawyers’ hourly billing rates are based on their level of seniority – the less the
experience, the less law firms can charge clients per hour, and vice versa. For less skilled work, it is more accepted for clients to pay associate rates instead of the rates of senior lawyers. Thus, it is the low hourly rate employees, i.e., associates and students, that perform the basic, routinized tasks on a file.

Commoditization can also impact a firm’s bottom line. Although firms charge less for routinized tasks, they often take longer to perform, which results in fair margins. The commoditization of routine tasks impacts firm profits because these activities are now being supplied by alternative legal service providers, like LPOs, for example.

Moreover, the effect that commoditization will have on firm profitability will likely be felt disproportionately across the marketplace. Only certain firms are positioned to withstand the economic impact commoditization poses. In the case of full-service firms that employ a team of lawyers who practice in a number of different practice areas, the risk of commoditization overthrowing their ability to compete in the marketplace is hedged by the diversification of their talent (practicing in numerous areas of the law) and product scope. The same cannot be said for solo practitioners or boutique law firms practicing in one area of the law, especially if the work is a ripe candidate for commoditization. However, the possibility for firms and alternative legal service providers who offer commoditized products to increase market share is a threat to which all firms should be alert.

Fortunately, firms can mitigate the impact that commoditization will have. In addition to diversifying practice areas, firms can extend their product scopes (Susskind, 2012, p. 8). For example, law firms that commoditize their legal work through proprietary standard form documents can sell this work, creating a new revenue-generating product
and providing a source of competitive advantage. Outsourcing is another alternative strategy for mitigating the effects of commoditization. Firms can decide to purchase the low-margin, commoditized work from external suppliers and transfer their human capital to other high-margin work that requires increased expertise and that is not so easily outsourced.

**The Social Impact of The Access to Justice Issue**

Policy makers, and economically advanced societies more generally, have long been concerned with the availability and affordability of essential services (Macfarlane, 2013). In 2007, Canadians pursued legal representation for only 11.7% of their justiciable events (Currie, 2007, p. 61). Since 2013, a team of lawyers and researchers have embarked on understanding and drawing attention to the plight of self-represented litigants (“SRL”), individuals who choose to not procure the services of lawyers when faced with legal issues. Many SRLs belong to the middle-class segment of Canadian society and attribute their decision to self-represent to the exorbitant cost of legal fees and dissatisfaction with past legal representation (Macfarlane, 2013, p. 39-48).

The rise of SRLs and the general unaffordability to access legal services in Canada are often referred to as “access to justice” issues. Why is it that Canadians only rarely seek the advice of lawyers to assist them with their legal needs? Perhaps the answer lies in a lack of innovation – mainly, the unchanging structure, delivery and cost of legal services in Canada. Although the current state of Canadian legal services may not appeal to the large majority of Canadians, there are several innovative trends in the legal services industry that, if widely adopted throughout Canada, would likely increase the affordability and appeal of legal services to Canadians.
One innovative trend is the rise in LPOs as an alternative legal service provider. LPOs act as a strategic resource for law firms who are under increasing pressure to deliver more results to clients for less cost (Kowalski, 2008). Outsourcing the lower-skilled work thus represents a more cost-effective, client-focused solution. Sako (2015) points out that in addition to substantial cost-savings, outsourcing legal services has the potential to uncover a latent market of legal service clients who had previously been unable to afford legal services, i.e., SRLs (Kowalski, 2008). Furthermore, LPOs are also a resource for SRLs and clients. While riskier, clients and SRLs can procure the services of LPOs directly, without going through law firms as an intermediary.

**TECHNOLOGY AS A CONDUIT TO GLOBALIZATION**

In addition to LPOs, technology is a broad catalyst for innovations to legal services. Today’s economy is shaped by technology and globalization. Revolutions in information and communication technology have facilitated a global interconnectedness (MacLuhan, 1966; Sako, 2009). Technology driven, the global marketplace has facilitated geographically distanced relationships and has enabled the disaggregation of routine legal work (Friedman, 2014). Legal service providers and clients are able to capitalize on the new opportunities available in a globalized and technologically developed marketplace.

Clients are no longer limited to seeking legal advice from local lawyers. Rather, globalization has afforded clients the ability to select from a host of local and foreign legal service providers. The rise in potential competitors to the legal industry is another reason why law firms must reconsider their corporate and business strategy. While globalization has opened up new competitive threats, firms similarly benefit from the opportunities that globalization presents. Globalization and technology have enabled access to offshore, low-
cost pools of skilled labour (Sako, 2009, p. 7; Friedman, 2014). The ability for firms to access low-cost locations results in cost-saving opportunities. Technology has fostered the ability to communicate and forge relationships with foreign suppliers and establish offshore operations to take advantage of global labour arbitrage.

The rapid spread of emerging technologies is closely aligned with globalizing and seizing opportunities (Canadian Bar Association, 2013, p. 1). Emerging technologies are powerful both in their capabilities and in their potential to disrupt every industry in the world. Susskind (2013) suggests that the disruptive capabilities of emerging technologies are perhaps the most misunderstood and underappreciated catalyst of change in legal service delivery (p. 10). While the common belief is that legal professionals are vulnerable to being replaced by emerging technologies like artificial intelligence (“A.I.”), Susskind (2013) opines that the nature of legal work renders it compatible, rather than combative, with the abilities of computers. The intertwining of emerging technologies with existing and newer structures is the future of legal practice, and lawyers and law firms should be cognisant of the nature and types of emerging technologies.

Technology has empowered new organizations and enterprising individuals to compete with incumbent companies and industries and, in some cases, supplant them (Business Wire, 2019). Technology creates new platforms for the marketing and delivery of services. As A.I. evolves, there may be increased opportunities for customization of services, including the provision of legal advice (Business Wire, 2019). As suppliers and clients increase their use of electronic networks, they are able to reduce several barriers to communication. The reduction in barriers to communicate on a global scale allows firms to communicate quicker, more efficiently and through long distances (Thomson Reuters,
Because of the increased speed and enhanced knowledge management capabilities of the latest technology, people are able to make quicker and more informed decisions.

Technological advancements and innovations in the legal industry are expected to offer new growth avenues in the sector, helping law firms gain new competitive advantages while achieving heightened levels of transparency with clients (Thomson Reuters, 2019). For example, law firms are deploying A.I.-based document automation capabilities to innovate their work processes (Surden, 2019). Software equipped with A.I. capabilities are regarded with utmost importance among lawyers and firms to better allocate resources and time (Surden, 2019). Document production and proofreading of documents are efficiently done with the help of automation software. The use of team collaboration software is further streamlining the execution of all documentation processes (Surden, 2019).

The widespread use of electronic discovery services (also known as “e-discovery”) makes electronically stored information (“E.S.I.”) such as e-mails and e-calendars discoverable on handheld mobile devices (Business Wire, 2019): “The development of E.S.I. will reduce the complexity and cost of e-discovery processes and is expected to simplify large-scale litigation processes” (Business Wire, 2019, p. 2). In addition to e-discovery, other examples of A.I. and machine learning being used in the legal services setting include reviewing large numbers of contracts, automatically drafting contracts and other legal documents, A.I. document assembly, and A.I.-assisted legal research (Thomson Reuters, 2019). All such technological developments have greatly aided lawyers by decreasing firm and client costs while increasing efficiency and convenience (Business Wire, 2019).
A LAWYER’S ETHICAL AND COMPLIANCE OBLIGATIONS

The social need for essential goods and services has often been met with government action. As a result, the legal profession in Canada (and in most common law jurisdictions) is tightly regulated. The nature of the lawyer-client relationship is one of a fiduciary, and upon the triggering of the lawyer-client relationship, a lawyer has several duties they are required to uphold. The following professional duties are integral to upholding the lawyer-client relationship: 1) the duty to put the client’s interests before the lawyer’s; 2) the duty to perform legal services to the standard of a competent lawyer, 3) the duty to deliver a sufficient quality of service, 4) the duty maintain a level of candour and honesty, 5) the duty to preserve client confidentiality, i.e., maintain lawyer-client privilege, 6) the duty to avoid or manage conflicts of interest and 7) the duty to maintain adequate professional liability insurance coverage (Rules of Professional Conduct, 2020, ss 3.1, 3.2, 3.3 and 3.4; Law Society of Ontario, 2020, By-Law 6).

Lawyers must continuously monitor their actions and work to ensure they are meeting their ethical and professional obligations to their law societies and their clients. The regulated nature of the Ontario’s legal profession presents an obstacle to implementing innovative delivery models, including outsourcing work to external suppliers. Thus, the outsourcing of legal work raises ethical and compliance issues. Yet, the LSO has remained silent on the practice of lawyers outsourcing legal work. Nonetheless, LSO’s rules of professional conduct, coupled with LSO By-Laws, provide guidance to lawyers interested in pursuing an outsourcing relationship with LPOs. Chapters 7 and 8 of the Major Paper offer further guidance on the ethical and compliance issues involved in the practice of outsourcing work to LPOs.
THE IMPACT OF COVID-19

Corporate life during Covid-19 is bleak for some and devastating for others. The Covid-19 pandemic and the accompanying safety measures in force across the globe have placed immense amounts of pressure on firms. Those operating in industries characterized as “essential” are forced to adapt their corporate functioning to mandatory physical distancing and a state of financial uncertainty. In contrast, firms operating in “non-essential” industries are struggling to remain solvent as a result of a halt in business.

Yet, the changes to firm operations during Covid-19, although necessary, can be characterized as positive in some respects. The spread and wide transmission of Covid-19 has forced firms to adopt innovative modes of delivery and communication in order to continue operating. For a profession characterized as “risk-averse”, Covid-19 is a positive catalyst for change among the legal profession.

Although the impact of Covid-19 on business can be characterized as positive to some extent, Covid-19 adds another layer of risk for lawyers and law firms involved in outsourcing work to offshore LPOs. In the wake of Covid-19, contracting with an onshore LPO partner might be the less risky outsourcing strategy. While lawyers in Ontario have been deemed an “essential service” by the Ontario government, an LPO partners’ operations might be deemed “non-essential” by the government authority in their jurisdiction. It is therefore possible for a law firm to be operating while their LPO partner, on whom they are dependent, is shut down. Thus, the possibility for governments to enact differing policies for virus containment is an additional risk factor to take account of when considering whether to offshore legal work to LPOs.
The legal service industry’s macro-environment is changing. Market liberalizations, the commoditization of services, progress in technology, the effects of globalization, access to justice and Covid-19 are placing pressure on firms to innovate their business models. The strategic implications of a changing remote environment require law firms to deliver legal services in a manner that is more technologically driven, accessible and affordable. However, the highly regulated nature of the legal profession underscores the importance of a lawyer’s duties to their law society and the greater public. Thus, a successful pivot in firm strategy must always include strict compliance to the rules and regulations governing the legal profession. While an analysis of the macro-environment is necessary to underpin any strategic decision, a diligent firm will also take into account industry-level pressures on the legal services industry. The following chapter explores this source of pressure.

CHAPTER 4: INDUSTRY-LEVEL ANALYSIS

Once a sufficient macro-environmental analysis is complete, attention must shift to industry-level forces. Here, the focus is trained on the nature and intensity of competition between industry rivals. In the legal industry, competition is intensifying. Law firms and lawyers must better understand the factors increasing levels of competition in order to position their firms and practices to remain profitable. To do this, law firms must successfully identify the different sources of competitive pressure within the industry. Michael Porter, a renowned economist and professor at Harvard Business School, developed a useful framework for understanding an industry’s underlying structure and the nature of competition for profits within a given industry (Porter, 2008, p. 79). Porter’s Five
Forces Model (See Figure 1) was founded upon the understanding that competition for profits goes beyond industry rivals to include potential entrants, customers, suppliers and substitute products (Porter, 2008, p. 79). The greater the intensity of a particular force (or forces) determines industry attractiveness and competitive rivalry and becomes most critical to formulating firm strategy (Porter, 2008, p. 80). The changing nature of the global legal services industry makes Porter’s Five Forces Model more relevant to the industry than in the past.

**THREAT OF NEW ENTRANTS**

The desire for new entrants to gain market share puts pressure on prices, costs and the rate of investment required to remain competitive (Porter, 2008, p. 80). New entrants that diversify can leverage existing resources and capabilities and “shake up” an industry (Porter, 2008, p. 80). The threat of entry requires incumbents to deter entrants by either competing on price or investing in innovations. When the barriers to entry are low, the threat of entry is high, and vice-versa. Barriers to entry include cost economies, customer switching costs, capital requirements, incumbency advantages independent of size, unequal access to distribution channels and restrictive government policy (Porter, 2008, p. 81-82).

*Cost Economies*

Firms that can spread fixed costs over the production of a large volume of goods enjoy lower costs per unit. Firms that produce in large volumes can also secure better terms from suppliers. This theory holds that firms of larger sizes can achieve scale economies that smaller firms cannot. The applicability of this concept to law firms in Ontario’s legal industry depends largely on entrants’ competitive target. If entrants are aiming to compete with large-sized firms, then depending on the size, resources and capabilities of the entrant,
they might not enjoy the same cost economies as the incumbent firm. However, if entrants are aiming to compete with firms of smaller size who do not enjoy the same cost economies as larger firms, then entrants are not disadvantaged from their inability to achieve economies of scale.

**Customer Switching Costs**

“Switching costs” are incurred when customers change suppliers (Porter, 2008). The larger the switching costs, the harder it is for entrants to gain new customers and take the market share of incumbents. The switching costs for changing legal service providers are low. The process of initiating the formation of the lawyer-client relationship involves the communication between the lawyer and client and the negotiation of the retainer. There are few financial costs associated with doing so. In addition to minimal switching costs, there are zero sunk costs realized when switching legal providers – unless the change in legal service provider comes midway through a legal matter.

**Capital Requirements**

When entering into a new industry, there is often a significant capital requirement necessary to make the entry profitable. In the case of firms diversifying into the legal services industry, depending on whether the diversification is related or unrelated dictates the extent of the capital investment (Grant, Jordan and Walsh, 2015, p. 246). Corporate service firms diversifying into legal services are positioned to leverage their resources and capabilities to enter the industry. Customers of firms who are diversifying into related services would benefit from the firm’s extended product scope and would realize demand-side economies of scale, also known as “network effects” (Porter, 2008, p. 81). Conversely, firms whose business is unrelated to law or corporate services would need to invest more
capital than firms with related businesses. Therefore, the capital requirements of entering the legal industry are high if the firm’s original products and services are unrelated to legal services, but relatively low if related.

**Incumbency Advantages Independent of Size**

Law firms do not possess significant advantages associated with being an incumbent. While a law firm’s brand and reputation are an important source of competitive advantage, the brand and reputation are founded upon the expertise and client list of a firm’s individual lawyers – who are ultimately free to divest from the firm and seek other employment opportunities. Thus, while a law firm’s goodwill is an important differentiator, the true source of competitive advantage remains the human capital who are not bound to any one firm. Although lawyers benefit from working under the umbrella of a reputable firm brand, it is the salary and promotions that align the incentives of individual lawyers and the firm. If a firm fails to effectively incentivize its lawyers, it risks losing its human capital and, in turn, its competitive advantage.

**Unequal Access to Distribution Channels**

The legal industry’s distribution channels remain the justice system which, from a supply standpoint, is accessible to all licensees of the LSO. Thus, entrants must attract and hire competent, licensed lawyers to access the distribution channel. Firms aiming to hire top legal talents must attract them with worthwhile compensation packages.

**Restrictive Government Policy**

The most significant barrier to enter Ontario’s legal industry are the restrictions put in place by the LSO to govern the legal profession. Both individual entrants who aim to practice law and firms that aim to provide legal services must remain within tight
guidelines set by the LSO. For individual entrants, the barriers to enter the legal market are low and, for the most part, uniform across different jurisdictions in Canada and the U.S. In Ontario, licensing candidates must graduate from an accredited law school, fulfill requirements to be “called to the bar” and then pay the required fees to their overseeing law societies (the LSO in Ontario) (Woolley, Devlin, Cotter and Law, 2017, p. 91).

With respect to firm entrants, there are several barriers to enter the legal industry. First, there are restrictive policy measures put in place by the LSO and other law associations in common law jurisdictions across the globe. The LSO prohibits law firms from establishing corporate/organizational structures beyond a sole proprietorship, a general partnership, a LLP, a professional corporation and an employee of a “civil society organization” (Law Society of Ontario, 2019, By-Law 7). In addition to restricting law firm structures (among other restrictions), the LSO prohibits the following activities: 1) non-licensees from owning and managing law firms, 2) firms from engaging in certain advertising and marketing practices, and 3) non-licensees from offering and providing legal advice (Law Society of Ontario, 2019, By-Law 7). The restrictions are borne out of the societal importance of lawyers as gatekeepers to the legal system and facilitators of justice. While the restrictions can be daunting for some firms, others who are willing to devote resources to understanding and navigating the regulations can develop strategies to enter into the legal industry — a difficult but achievable endeavour.4

3 Although, as previously mentioned in Chapter 2, the LSO has been exploring the possibility of permitting law firms to establish alternative business structures.
4 Ernst & Young and KPMG are examples of two corporate service firms that have successfully navigated regulatory obstacles and now benefit from their expanded foothold in the broader corporate services industry.
Policy restrictions present the only true significant barrier for firms to enter the legal services industry. For corporate service firms offering insurance, consulting and other knowledge-specific services, there are fewer capital requirements for these firms, because they maintain pre-existing networks and business infrastructure. The attraction of legal talent is the obstacle which could be overcome if competitive compensation packages are offered. Corporate service firms entering into the legal industry achieve economies of scope and scale on both the demand- and supply-side, perhaps enjoying even stronger cost economies compared to large, full-service law firms.

**POWER OF SUPPLIERS**

Suppliers are powerful if they are more concentrated than the industry it supplies, if their profitability does not depend heavily on the industry, if vendors face switching costs in changing suppliers, if suppliers offer products that are differentiated, if there is no substitute for what the group of suppliers provides and if the suppliers are more profitable than the vendors (Porter, 2008, p. 82-83). Legal services are unlike many other industries in that the production of legal work does not heavily depend upon the supply of materials from external suppliers.

In the legal services industry, aside from the supply of back-house services such as information technology (“I.T.”), accounting, finance and human resources (“H.R.”), the legal service product is supplied by a firm’s human capital – its lawyers. The power that lawyers possess as suppliers of legal services depends upon their expertise and reputations in their areas of practice. In the case of incoming lawyers, once licensed, the employment options available to them are broad and diverse (Woolley, Devlin, Cotter and Law, 2017, p. 91). While firms are in competition for the best young legal talent entering the market,
a recent LSO annual report reported 2,389 new licensed lawyers in 2018, and as of December 31, 2018, a total of 53,732 lawyers were practicing in Ontario (Law Society of Ontario, 2019). There is no shortage of legal talent in Ontario’s market, thus lessening the bargaining power of incoming lawyers. Conversely, lawyers with years of experience, and who are recognized in their areas of practice, can pressure firms with the threat of exit if lucrative compensation and/or membership to the partnership or ownership team (depending on the firm’s capital structure) is not granted. A firm’s brand, reputation and even client lists are developed in significant part by the individual lawyers. Firms potentially risk devaluations to their brand and bottom lines if an expert lawyer leaves the firm.

POWER OF BUYERS

Powerful customers place downward pressure on prices, demand better quality or more service (which increases costs), and, they gain leverage from the availability of multiple vendors in an industry (Porter, 2008, p. 83). Customers in the legal industry – both large and small – have more bargaining power than ever (Canadian Bar Association, 2013, p. 9). On a global scale, the legal industry has experienced a shift in market power to the demand/buyer’s side (Canadian Bar Association, 2013, p. 9). The downward pressure on pricing, colloquially referred to as the “more for less” phenomenon, is a driving force of change in the legal services industry.

There are distinct groups of customers within the legal services industry, each with differing amounts of buying power based on the proportionate amount to which they contribute to any one law firm’s profitability. For many “big law” firms, large corporate clients possess more bargaining power than smaller corporations and individual clients.
Many larger, full-service law firms have invested significant capital cultivating and nurturing ongoing relationships with their “blue chip” clientele, and these long-term relationships, in turn, provide a sustainable source of revenue. But the growing sense of cost consciousness among many corporate clients, coupled with growing concerns with hourly billing practices, place large corporate clients in a prime position to exercise their leverage and pressure their law firms to drive down their legal costs (Deloitte, 2019, p. 5). As Susskind (2012, p. 7) notes, many stakeholders forecast that legal budgets will be cut by 30-50% in the foreseeable future, but more research is needed to verify whether this has occurred.

For law firms, such as those specializing in personal injury matters whose primary clientele are low-to-middle income earners, individual consumers with justiciable issues also possess a good deal of bargaining power. Firms are brainstorming ways to address the challenge, and they are adamantly opposed to liberalizing the legal marketplace (Taddese, 2015). In response, some law firms and solo practitioners alike have adopted innovative practices both in the scope of services offered and in billing arrangements to enhance the affordability of legal services and address the access to justice problem. The shift from high-margin hourly billing to unbundled, alternative fee arrangements, although lower in margins, perhaps benefits this segment of clientele the most (Kowalski, 2008; Herrera, 2014, p. 5).

In summary, the challenge of addressing the increased pressure on legal costs requires lawyers to brainstorm strategies to provide legal services at more affordable prices. Outsourcing work to LPOs is one strategy to better serve cost-conscious, low-income clientele. As suppliers to clients and law firms, the novelty of outsourcing work to LPOs
in Ontario’s legal market would likely render LPOs with little bargaining power today. Bargaining power could increase if the number of law firms and lawyers that retain the services of LPOs increases disproportionately to the increase in LPO vendors. However, an impediment to LPOs increasing their leverage is the availability of other cost-focused solutions, such as alternative billing arrangements and substitute legal service providers.

**THREAT OF SUBSTITUTES**

Substitutes are defined by their ability to perform the same or similar functions as an industry’s product through different means (Porter, 2008, p. 84). When the threat of substitutes is high, industry profitability suffers due to the mitigating ceiling on prices (Porter, 2008, p. 84). Incumbents must differentiate themselves from substitute products through performance, marketing and other means or risk losing profitability (Porter, 2008, p. 84). Porter (2008) notes that the threat of substitutes is high if: 1) they offer cheaper products with similar performance and 2) buyers incur low switching costs to the substitutes.

Concerns over the general lack of innovation among traditional law firms have opened the door for alternative legal service providers whose business models and product offerings are inherently innovative. LPOs, virtual law firms, online providers of legal documents, A.I. and technology-based legal applications are all substitute legal service providers (Kowalski, 2008; Fuchs, 2014; IBM Cognitive Business, 2017; Cellan-Jones, 2017). Based on market size, LPOs present the most significant substitute product to which law firms should be particularly alert. In 2018, the global LPO market was valued at $5.2B USD and is expected to be worth $35.9B USD by 2025 (Grandview Research, 2019). LPOs
embody the prevalent trend of increasing the affordability, accessibility and diversity of legal services.

LPOs operating out of low-cost locations offer especially attractive price-performance trade-offs compared to traditional law firms. However, the switching costs involved in contracting with LPOs can be high. The costs to switch to LPO providers include the transaction and management costs involved in establishing and overseeing the outsourcing relationship. But since corporate clients are increasingly retaining the services of LPOs, it appears the benefits in price they offer outweigh the risks of incurring switching costs (Deloitte, 2019).

In addition to LPOs, the market for legal services is effectively shrinking. Corporations are increasing the size and scope of their legal departments, thus removing the need in some cases to retain outside law firms (Bagust, 2013). Rather than pressure law firms to reduce prices, some corporations have attempted to cut their entire spending on external legal counsel (Bagust, 2013). By building up their in-house counsels, the firms no longer rely as heavily on law firms, which reduces the customer base for many (Bagust, 2013). Furthermore, increases in the size of in-house counsel teams and the plethora of substitute products are increasing the rivalry among existing law firms.

RIVALRY AMONG EXISTING COMPETITORS

Rivalry among Ontario’s legal service providers is intense. There are numerous law firms in Ontario in a range of different sizes and product scopes. For example, large, full-service law firms compete not only with firms of similar size, but also with boutique firms whose speciality overlaps with an area of the law also offered by a full-service firm. The same goes for mid- and small-sized firms, as well as solo practitioners. Although firms
differentiate through size and scope, the practice of law is inherently homogenous. While firms can differentiate by specializing, the nature and types of legal services offered by different law firms are nearly identical when focusing specifically on one area of practice.

The standardization of service across the legal industry forces firms to compete on the same dimensions. Price competition is the most common basis for law firm competition. Low switching costs means that rivals must cut prices to attract new customers. Law firms also carry high fixed costs, stemming from overhead and employment salaries, while the variable costs associated with delivering legal work are comparatively low. But law firms in Ontario differentiate themselves through size, global reach and individual legal talent. Competition is, therefore, segmented according to firms of similar size, firms with similar global reach and firms with similar calibre of legal talent.

In each segment, the ability for firms to increase price depends heavily upon the hourly rates of their lawyers, which is often a product of seniority and expertise. Clients prefer not to spend more money to have senior lawyers perform the bulk of work on their matters because their hourly rates tend to be higher. Rather, senior lawyers supervise the file by overseeing and checking the quality of associate’s work and offering their expertise on more complex issues. Law firms (especially mid- and large-sized) need to strike the proper balance between the number of associates who can charge less per hour for labour-intensive tasks and the number of junior and senior partners who can charge more per hour for their heightened expertise.

The legal services industry is more competitive than ever. Low entry barriers, moderate power of suppliers, high power of buyers, high threat of substitutes and high rivalry among existing law firms are forcing firms to reconsider their strategies to regain
market share. The shift in industry structure caused by multiple industry-level forces requires firms to compete more heavily on price than in the past. Firms must set prices that attract clients to their firm and away from substitutes and rival law firms alike. In addition to competing on price, successful firms will re-evaluate their strategy. Aligning a firm’s external environment with its internal environment is key to a successful strategy. To achieve alignment, law firms must also take into account their key resources and core competencies. The following chapter provides insight into a law firm’s internal environment, (i.e., its key resources and core competencies).

CHAPTER 5: FIRM-LEVEL ANALYSIS

The traditional business model of the law firm is being challenged by macro-environmental and industry-level forces. In the wake of these disruptions, law firms must proactively explore new strategies to sustain and develop competitive advantages. As previously mentioned, a successful strategy aligns a firm’s internal environment with its external environment. Therefore, once the remote and industry environments are scanned and assessed, the analysis shifts to a firm’s internal environment. A firm’s internal environment can be characterized by a firm’s resources and capabilities, its goals and values, and its structure and systems (Grant, Jordan and Walsh, 2015, p. 98). Many strategy theorists, including Prahalad and Hamel (1990) and Grant (1991), posit that internal resources and capabilities can provide a secure basis for long-term strategy formulation, especially when a firm’s external environment is in a state of flux. A helpful framework to analyze a firm’s resources and capabilities is to: 1) identify a firm’s resources and
capabilities, 2) appraise resources and capabilities and 3) develop strategy implications (Grant, Jordan and Walsh, 2015, p. 99).

KEY RESOURCES

There are three types of firm resources: tangible, intangible and human resources. Tangible resources are located in a firm’s financial statements (i.e., the balance sheet) and include financial resources and physical assets. Intangible resources include brand names, trademarks, copyrights and patents. Grant, Jordan and Walsh (2015) hold that intangible assets are a form of “reputational asset” in that they instill confidence in customers and help to orient customers to a particular firm (p. 85). As a measure of brand value (or brand equity), some believe intangible resources are more valuable than tangible resources. Human resources comprise the knowledge and expertise of a firm’s employees. Similar to intangible resources, human resources do not appear on a firm’s balance sheet and are thus often undervalued (Grant, Jordan and Walsh, 2015, p. 87).

Human resources supersede all others in a law firm. In a law firm, the lawyers are usually the only revenue-generating resource. In addition to generating revenue, lawyers contribute to building firm brand and reputation. Lawyers are thus the most integral asset to law firm profits.

CORE CAPABILITIES/COMPETENCIES

An organizational capability is a “firm’s capacity to deploy resources for a desired end result.” (Helfat and Lieberman, 2002). Core competencies are those that contribute to customer value or the delivery of such and provide a basis for entering new markets (Hamel

5 The terms “competency” and “capability” are used interchangeably.
and Prahalad, 1990, p. 81). One particularly useful method for identifying a firm’s core competencies is to assess a firm’s overall activities and then classify them as core and non-core to delivering value. This is done by analyzing a firm’s value chain.

The value chain describes the process steps taken by firms to transform inputs into outputs, and to market and distribute them to customers (Sako, 2009, p. 3). Value chain analysis involves identifying the process steps, and of which steps can be carried out in-house and which out-of-house (Sako, 2009, p. 3). For many firms, legal services are one such support function that may be performed within the organization or out-of-house by external lawyers. For law firms, by comparison, legal services are the primary activities in the value chain, and some of these activities can also be done in-house or out-of-house via outsourcing.

The law firm value chain (see Figure 2) can be separated into core and non-core components. I.T., finance, accounting and H.R. are non-core in that these business activities serve to support, rather than produce, the core-activities in a law firm. Although essential to firm functioning, supporting activities are inessential to the core activity of rendering legal work and legal advice.

The core activities of a law firm consist of three separable components: 1) knowledge and information management (“KIM”), 2) consultative advice and representation (“CAR”) and 3) client relationship management (“CRM”) (Sako, 2009, p. 8). According to Sako (2009), KIM consists of document discovery, legal research, case development/documentation, library services, training and research. CAR consists of litigation, corporate transactions and intellectual property (“I.P.”) management. CRM
consists of managing client relationships, soliciting new clients, organizing seminars, responding to referral requests, branding and marketing activities.

While the ability to develop and maintain high levels of KIM, CAR and CRM are integral to law firm profitability, macro- and industry-level forces such as commoditization and downward pressure on prices require law firms to decide how to continuously maintain the equilibrium between profitability and client satisfaction. Although there are several strategic options a firm can choose to achieve competitive advantages, attention will be trained on outsourcing certain activities. The next chapter is devoted to explaining the impact of outsourcing on firm strategy, why outsourcing is beneficial and outlining what risks are involved when outsourcing.

CHAPTER 6: STRATEGIC OUTSOURCING

Once a firm’s resources and competencies are identified, a strategy can be devised to achieve competitive advantages. Competitive advantages are realized by reducing a firm’s costs or differentiating their products or services (Grant, Jordan and Walsh, 2015, p. 131). Some firms gain competitive advantages through corporate strategic decisions – choices that alter the scope of a firm’s activities. These decisions include the range of products a firm supplies (product scope), the range of activities the firm is involved in along the firm’s value chain (vertical scope) and the geographic spread of the firm’s activities (geographic scope) (Grant, Jordan and Walsh, 2015, p. 231-232). With respect to a firm’s vertical scope, in-house sourcing refers to a set of activities that a firm chooses to allocate resources to produce internally. In contrast, outsourcing refers to the transfer of a business activity to an external contractor who performs that function off the company’s
balance sheet and sells the function back to the company (Tadelis, 2007, p. 264 and 271). When firms choose to source work in-house, they involve themselves in more functions along the value chain (Grant, Jordan and Walsh, 2015, p. 236). Alternatively, when firms outsource work, they are effectively limiting their involvement along the value chain. A firm’s decision on how to manage and procure a specific activity is usually not indicative of how integral that activity is to the firm’s economic viability. Rather, the decision to outsource or in-house source work – or “make or buy” work – is typically the result of a cost-benefit analysis that takes several important factors into account (Tadelis, 2007, p. 262).

**KEY FACTORS**

When focusing on for-profit firms, one can assume that changes to the scope of activities are done to benefit shareholders either by increasing firm revenue, reducing costs, or both (Grant, Jordan and Walsh, 2015, p. 236). When deciding whether to make or buy work, firms should be cognisant of economies of scope, transaction costs, hidden costs and costs of corporate complexity (Grant, Jordan and Walsh, 2015, p. 236). Each will be discussed in turn.

*Economies of scope* refer to cost savings achieved by a firm when the use of a resource is spread over the production of multiple outputs (Grant, Jordan and Walsh, 2015, p. 236). Additionally, economies of scope can be achieved on the demand side, i.e., when customers are able to purchase different goods from one supplier (Grant, Jordan and Walsh, 2015, p. 236). While the nature and extent of the economies of scope differ depending on what type of resource is facilitating the activity, an activity that ultimately achieves significant economies of scope should be brought in-house. Economies of scope are one
reason why firms might consider extending their scope of in-house activities, but there are other considerations as well (Grant, Jordan and Walsh, 2015, p. 236-237).

*Transaction costs* are another important factor that firms should consider when determining whether to make or buy activities. Making and buying activities are two different categories of economic organization. Making is a product of the “administrative mechanism” whereby decisions concerning the extent of product scope are made internally by managers. In contrast, buying is said to be a function of the “market mechanism” whereby a firm’s decisions are made by reference to both the market prices and the associated costs of buying activities (Grant, Jordan and Walsh, 2015, p. 238). Firms outsource when the market price of the activity, the costs of searching for vendors, the costs of negotiating and drafting a contract, the cost of monitoring the outsourcing relationship and the enforcement costs of dispute resolution are less than the administrative costs of coordinating, planning and executing the production of the activity in-house (Grant, Jordan and Walsh, 2015, p. 239). Monitoring and/or managing the outsourcing relationship is a cost that is often difficult to identify prior to entering into the relationship. Because the cost is difficult to see up-front, it is often referred to as hidden costs (Tadelis, 2007, p. 261).

*Hidden costs* in the outsourcing relationship stem from an inherent conflict of interest present in any outsourcing relationship. The customer desires to buy an activity at a price lower than bringing the activity in-house, whereas the supplier aims to sell at a high profit margin. The tension can be alleviated by carefully and accurately describing the activity to be outsourced, the mechanisms guiding the relationship, and the value delivered to each party, thus aligning the customer and vendor (Iacobucci and Trebilcock, 2013, p.
Problems arise when the activity outsourced is difficult to define and monitor, often leading to an ineffective contract that fails to account for one or both party’s expectations (Tadelis, 2007, p. 262).

As organizations choose to allocate resources to produce a good or service in-house, they extend their scope of activities and, as a result, increase their organizational complexity (Grant, Jordan and Walsh, 2015, p. 241-242). There is a cost associated with additional corporate complexity. While firms can avoid transaction costs by sourcing work in-house, they incur additional management costs from the need to effectively integrate, monitor and execute the activities within a firm (Grant, Jordan and Walsh, 2015, p. 241).

**VERTICAL INTEGRATION AND VERTICAL DE-INTEGRATION**

Economies of scope, transaction costs, hidden costs and costs of corporate complexity are key factors to consider when firms undertake strategic decisions like whether to extend their range of activities along the value chain (vertical integration) (Jordan, Grant and Walsh, 2015, p. 236 and 242). Firms that vertically integrate their activities achieve cost savings from physically integrating their processes, thus eliminating certain transaction costs. In addition, the linking of different elements of the production process from the same location results in economies of scale from being able to spread fixed costs over increased units of production, thereby reducing the average cost per unit (Grant, Jordan and Walsh, 2015, p. 250 and 251).

In contrast, firms that are de-integrated are involved in vertically related activities but do not own the different activities along the value chain. These firms choose to outsource or buy vertically related activities from suppliers. De-integrated firms utilize the market mechanism to enter into outsourcing relationships with external suppliers.
Importantly, a successful outsourcing strategy depends on a well-functioning market mechanism which is achieved when a sufficient number of willing buyers and suppliers exists, information about each supplier is readily available, and switching costs are identifiable (Grant, Jordan and Walsh, 2015, p. 251). A competitive market mechanism allows firms to reduce transactions costs and secure the best price possible for the outsourcing activity. However, if firms were to engage solely with one buyer or supplier, the benefits of the market mechanism would be lost, and they would be relying on their relative bargaining power to achieve the best price. A successful outsourcing strategy, thus, depends heavily upon a market of potential outsourcing partners, especially in the case of firms that engage in transaction- and relationship-specific investments.

Firms engaged in transaction- and relationship-specific investments are at an increased risk of incurring significant transaction costs if there does not exist the presence of a well-functioning market mechanism (Williamson, 1975). For example, suppliers of a particular good or service who have entered into a long-term contract with one purchaser, wherein the supplier’s facilities are constructed to the purchaser’s specific product specifications, each party is given the opportunity to exercise its bargaining power and “hold up” the other party (Williamson, 1975; Grant, Jordan and Walsh, 2015, p. 251). Firms must anticipate the hold-up costs that result from entering into sunk, transaction-specific relationships.

The hold-up problem can be dealt with in one of two ways. The first is to enter into a long-term, detailed contract prior to making any relationship-specific investment (Iacobucci and Trebilcock, 2013, p. 7). These contracts are costly to draft and enforce and can result in contract and pricing terms that may fail to account for changing market
conditions (Erickson and Goldberg, 1987). The second is to vertically integrate the operations of the purchaser and supplier within a single firm (Iacobucci and Trebilcock, 2013, p. 7-8). While vertical integration removes the hold-up problem altogether, there is a great deal of risk involved with vertically integrated firms that critically depend on one of their internal suppliers. For example, problems at one stage of production, can potentially threaten successive stages of production, which exposes a firm to compounding risks (Grant, Jordan and Walsh, 2015, p. 253).

As part of a firm’s decision-making process when deciding to vertically integrate or de-integrate (i.e., outsource), firms should be cognisant of the different types of vertical relationships into which they can enter. Full or partial vertical integration, long-term contracts, spot contracts, joint ventures, agency agreements, vendor partnership agreements and franchise agreements are just a few types of relationships. Each offers its own set of advantages and disadvantages (See Figure 3) (Grant, Jordan and Walsh, 2015, p. 254).

Once a firm determines whether or not a particular activity is a good candidate for outsourcing, a firm must then decide from which location it is going to outsource the activity. According to Tadelis (2007), offshoring occurs when a company outsources a business activity to a contractor in a foreign country (p. 264). In contrast to offshoring, onshoring is where the outsourcing partner is located in the same jurisdiction as the vendor. Onshoring removes some of the cost considerations associated with contracting with outsourcing partners in remote or foreign locations (Tadelis, 2007).

The location from which to offshove an activity is a function of many factors, like labour costs, the guiding global strategy, and the cultural distance of the foreign country,
to name a few. In addition, Tadelis (2007) and Ghemawat (2001) cite several “distances” that firms must take into account when narrowing locations from which to outsource the work. Geographical distance refers to the relative cost of transitioning the work to a certain jurisdiction and the cost of managing the outsourcing relationship, i.e., travel costs (Tadelis, 2007, p. 273). The language and cultural distance is the cost of dealing with and adapting to an outsourcing partner whose linguistic and cultural customs require upfront costs, i.e., translators. The regulatory, policy and legal distances refer to need for firms to learn and adapt to different regulatory and government policies as well as the legal system in the prospective jurisdictions. Firms should be aware of the benefits and drawbacks to doing business in different jurisdictions.

**TRENDS IN THE OUTSOURCING RELATIONSHIP**

While vertical integration was once believed to be more advantageous, firms have trended for years to outsourcing and de-integration (Grant, Jordan and Walsh, 2015, p. 235). But, the success rate of outsourcing relationships is unclear. In a 2008 Deloitte Consulting global outsourcing survey, one-quarter of the companies surveyed back-sourced functions (i.e., brought outsourced functions back in-house), and one-half of the respondents identified hidden costs as the most common problem with managing outsourcing relationships (Deloitte Consulting, 2008). Hidden costs of outsourcing include the transfer of knowledge, changes in the scope of work and the costs of ongoing management of the outsourcing relationship (Tadelis, 2007, p. 262). Conversely, respondents to a 2018 Deloitte Consulting U.S. global outsourcing survey stated that disruptive technological solutions in the outsourcing relationship are not only transforming traditional outsourcing but are leading to stronger and more successful outsourcing
relationships (Plotkin and Tweardy, 2019). For example, more and more firms are using cloud computing and robotic process automation initiatives to reduce costs. Yet, even with technological solutions, firms are consistently citing cyber risks such as data protection as a primary concern (Plotkin and Tweardy, 2019, p. 11). As a result, outsourcing relationships that involve the transfer of sensitive data must devote resources and control efforts to data risk and cyber security protocols to ensure success (Igbanugo, 2009, p. 6).

As demonstrated, firms can make different corporate strategic decisions to impact their ability to compete and earn profits. However, each decision has its associated costs, risks and benefits. Prior to identifying and assessing the costs, risks and benefits of outsourcing legal work, firms must gain an understanding of the LPO market as part of the search for potential LPO partners.

CHAPTER 7: THE LPO MARKET AND POTENTIAL PARTNERSHIPS

To capitalize on the opportunity that LPOs present, law firms must understand the general nature of LPO market, the services that LPOs offer, the competencies of different LPO providers, and where their operations are located: Information gathering is a key part of the process.

With expected year-over-year growth of 32% from 2019 to 2025, combined with an expected valuation of USD $35.9B, LPOs are the fastest-growing segment of the legal market (See Figure 4) (Business Wire, 2019; Grandview Research, 2019; Young Lawyer Editorial Board, 2019). LPOs offer a combination of specialized work, unique delivery models, digital solutions in the form of legal technology and cost-effective pricing models
(Young Lawyer Editorial Board, 2019). LPOs offer an attractive value proposition based on lower costs due to global labour arbitrage and additional business benefits such as increased use of technology, faster turnaround time, extensive process documentation and standardization (Lacity and Wilcocks, 2013). Traditionally, LPOs focused on delivering services ranging from administrative work to back-office support functions such as finance, H.R., word processing and I.T. (Young Lawyer Editorial Board, 2019). More recently, however, LPOs have evolved to deliver more sophisticated legal services, including litigation and investigation support, corporate due diligence, contract and document review, risk and compliance matters and legal research and writing – work traditionally handled by law firm associates and students (Young Lawyer Editorial Board, 2019; Sako, 2009).

The LPO provider landscape is diverse. Key players in the LPO market include Pangea3 LLC, UnitedLex Corporation, Integreon, Inc., Elevate Services Inc., QuisLex Inc., Mindcrest Inc., Clutch Group and Axiom Global. These companies are expanding their offerings beyond regulatory and litigation investigation support services and are increasingly focusing on offering high-value services (Grandview Research, 2019). Market incumbents emphasize expanding their service portfolio and offering high-level services at affordable costs (Grandview Research, 2019). Leading LPOs are also launching new tools and adopting strategies such as target marketing in order to gain a competitive edge and strengthen their position in the industry (Grandview Research, 2019).

Pangea3 LLC is headquartered in New York City, with satellite locations in Noida, Bangalore and Mumbai, India. Founded in 2004 by David Perla and Sanjay Kamlami, two former General Counsels, Pangea3 opened its first office in Mumbai, India with 35
employees (EY Legal Operations, 2019). Since then, the number of people employed by Pangea3 is over 1000 and growing (EY Legal Operations, 2019). Pangea3 offers the following services: contract management, entity compliance and governance services, legal research and regulatory mapping, discovery services, document review and analysis, investigation support, technology-enabled operations and project management (Ernst & Young, 2020). In 2010, Thomson Reuters acquired Pangea3 for USD $100 billion, and, in 2019, Pangea3 was acquired by Ernst Young in another private acquisition (Thomson Reuters, 2010; Milazzo, 2019). With this acquisition, Ernst Young offers legal consulting services in more than 80 jurisdictions around the world, thereby cementing a presence as a major player in the global legal services industry (Milazzo, 2019).

Axiom Global, a virtual LPO operating out of the U.S., offers a web-based platform where clients and attorneys log in to the user-interface to access their client file or legal matter (Axiom Global, n.d.). The lawyer-client relationship and the associated correspondence and exchange of work products are undertaken via Axiom’s virtual software. Axiom Law is marketed as a legal recruitment agency and leverages its virtual platform to attract and employ legal talent (Axiom Global, n.d.). Through a network of geographically dispersed lawyers, Axiom Law performs spot and long-term contracts for law firms and corporate clients.

Clairvolex serves I.P. law firms and legal departments. According to Clairvolex’s website (2020), the company provides complete IP asset management services as well as individual IP services. Clairvolex’s competitive advantage stems from its niche corporate strategy coupled with its “seamless processes, global expertise and proprietary technology”
(Clairvolex, 2020). With three offices based in California and India, Clairvolex is well positioned to service clients requiring IP-related services at lower costs (Clairvolex, 2020).

Several LPOs offer their services in Ontario. Taran Virtual Associates (‘‘TVA’’) and Legalwise are examples of an onshoring LPO and an offshoring LPO, respectively. TVA employs a network of 75 lawyers, most of whom are licensed to practice in Ontario, who undertake a wide variety of assignments like, inter alia, conducting document review, drafting documents, conducting legal research, and appearing in court as a lawyer’s agent in ex parte motions (LawPro, 2018). TVA is often hired by larger firms that cannot justify the cost of an associate or partner to perform a routinized, less complex task (LawPro, 2018). TVA’s work process is operated much like a project management team in the sense that a project manager – often a more experienced senior lawyer – works with the client to complete client intake, perform conflict checks, receive instructions and determine budgets and timelines (LawPro, 2018). TVA’s project management style of handling client files is unique and allows for the LPO to maintain the quality of the deliverable (LawPro, 2018). In contract, Legalwise employs a network of lawyers in India that are trained in Canadian law and work exclusively for the company (LawPro, 2018). The work that is outsourced to Legalwise is very much like the work outsourced to other LPOs, like TVA and Pangea3, but their quality of work, and, therefore, pricing differs based on brand reputation and employee experience (LawPro, 2018; Ernst & Young, 2019).

Pangea3 LLC, Axiom Law, Clairvolex, TVA and Legalwise comprise a microscopic segment of the vast and highly fragmented LPO provider landscape. India, the Philippines and China are believed to be the largest global providers of LPOs in descending order, but more recent data is needed to confirm this fact (Lacity and Wilcocks, 2013;
Grandview Research, 2020). One certainty is that the majority of LPO providers are maintaining an onshore head office typically in the U.S. with satellite and back office departments in Asia to both capitalize on cheap labour and to strengthen their global reach (Business Wire, 2019; Grandview Research, 2020).

CHAPTER 8: COST-BENEFIT ANALYSIS

COSTS

A significant cost disadvantage associated with outsourcing legal work to LPOs is increases to a firm’s costs per unit. Engaging the services of LPOs effectively limits the number of products across which a firm can spread fixed costs. However, in today’s legal marketplace, reducing economies of scale has become necessary to maintain client satisfaction.

The trade-off inherent in the dilemma is borne out of weaknesses in the hourly billing and partnership structure of many law firms. As mentioned in Chapter 1, a firm’s reputation requires aligning the incentives of associates/employees and the firm. Firms align incentives through lucrative pay and promotion in exchange for associates’ development and contribution to the firm’s brand and reputation. Firms spread the costs of extensive compensation packages by tasking associates with time-consuming work on files. The hourly billing targets set by a firm’s partnership ensure that the margin between employee compensation and hourly billing targets is profitable. Outsourcing laborious work to LPOs means that firms no longer generate the same levels of revenue from these tasks. Profits per partner are reduced, in turn, which requires firms to compensate either by reducing their levels of associate compensation or hiring fewer associates. Moreover,
reducing levels of compensation limits a firm’s ability to attract the best and brightest legal talent, while hiring fewer associates means a potential loss of economies of scope and scale.

The economic costs of outsourcing work are not limited to losses in revenue and profits. Firms also incur the transaction costs associated with searching for and entering into contractual relationships with outsourcing partners. The costs of travel, drafting and negotiating a contract and enforcing the contract in the case of a dispute, are just a few examples of some transaction costs involved in engaging LPOs. In addition, firms incur significant opportunity costs associated with monitoring the LPO’s work product. As previously mentioned, the rules of professional conduct require lawyers to supervise the LPO partner and ensure that they are delivering a quality of service on par with a competent lawyer. Lawyers must devote time away from billing and building their clienteles to monitor the LPO partner. Firms must take into account multiple increases to firm expenses when deciding whether to outsource.

RISKS

Engaging with LPOs is risky. Lawyers have to abide by their professional obligations, which include delivering quality work, protecting solicitor-client privilege, ensuring client confidences and avoiding or managing conflicts of interest. The ability to meet obligations is impacted when a portion of tasks on a file is transferred (usually) overseas. The electronic transfer of a client’s confidential information results in data security risks. Firms also incur risks associated with conflicts of interest. For instance, LPOs that provide outsourcing services to separate clients engaged in a dispute with each other would result in a conflict of interest. As a result, firms need to establish an open and transparent relationship with the LPO about its processes for securing data, client
confidentiality and avoiding conflicts of interest. Crucially, the supervising lawyer is liable if the LPO fails to mitigate and reduce risks. Lawyers cannot limit their liability with respect to professional duties and obligations. An unhappy client will ultimately look to hold lawyers responsible for work done by them or under their supervision. Any infractions by the LPO thus results in the supervising lawyers being sued, facing disciplinary action by the LSO and/or losing their employment.

Under the LSO, lawyers must have errors & omissions (i.e., negligence) insurance through LawPro. A 2012 UK case of *West African Gas Pipeline Company Ltd v Willbros Global Holdings Inc* provides a reminder that lawyers need insurance and that unless proper checks and balances are in place the use of LPO services could end up costing more than initially anticipated (Igbanugo, 2009). In *West African Gas Pipeline*, the England and Wales High Court found that West African Gas Pipeline Company Ltd had failed to undertake proper discovery and ordered it to pay the defendant's wasted costs of £135,000 (Igbanugo, 2009). In this case, the claimant engaged two external litigation support providers, one of which was based in India, to outsource its discovery obligations (Igbanugo, 2009). Firms need to ensure that the work being undertaken by the LPO is satisfactory or they could lose motions or cases and have costs awarded against them.

Firms also incur risks associated with long-term relationships with any one particular LPO partner. The longer and more specific the relationship, the greater bargaining power each party possesses (Williamson, 1975). This allows each party to exercise leverage and hold-up the other party. The risk is exacerbated if a functioning market mechanism is not engaged, i.e., with the presence of willing buyers and suppliers/LPOs. The maturity and growth rate of the global LPO market suggests the
presence of a strong market mechanism (Young Lawyer Editorial Board, 2019); however, firms must forecast and build the associated risk into their cost-benefit analysis.

**BENEFITS**

From a client’s perspective, LPO is a strategy to leverage the most cost-effective provider for certain types of legal services. The maturity and incumbency of certain LPO providers have allowed clients to substitute high-cost labour for a combination of “lower cost labour, superior technology and process maturity.” (Friedman, 2014). LPOs in offshore locations possess the ability to deliver legal solutions with a faster turnaround time. Offshore LPOs can operate in time zones different from their customer, which results in increased effectiveness under tight deadlines.

From the perspective of law firms, LPOs allow for extensions in their global reach and capabilities. LPO has a promising value proposition based on lower costs due to global labour arbitrage and on business benefits such as faster turnaround times, extensive process documentation and standardization, and the increased use of technologies (Lacity and Wilcocks, 2013). In addition, LPOs allow firms to deliver value to their clients through increased transparency. The willingness to engage the services of LPOs could, in effect, signal to clients the desire for a law firm to be creative in delivering solutions. The trade-off between delivering value and reducing revenue (because of diminished billable hours) strengthens a firm’s reputational brand with clientele.
CHAPTER 9: KEYS TO SUCCESSFUL OUTSOURCING

BALANCE OUTSOURCING WITH HOURLY BILLING

Successful management requires coordination and control of a number of factors. Billing by the hour affords cost economies to firms. However, billing by the hour also exacerbates agency costs where the use of LPOs enhances client transparency and mitigates agency costs. Thus, the key for law firms is striking the right balance between the use of LPOs and engaging in hourly billing.

Firms should establish relationships with LPOs and keep them on-call when clients demand their use. The privileged and confidential nature of legal work requires law firms to take every precaution necessary to maintain client confidentiality and secure client data. Lawyers and law firms are best positioned to fulfill the duties. If the LPO is not vertically integrated, firms should outsource work only when clients demand so. Firms benefit because they can 1) control the quality of work, 2) control client confidentiality and 3) maintain cost economies from increased involvement along the value chain. Larger, full-service law firms likely possess greater resources than smaller firms and are thus more capable of integrating an LPO partner.

MONITOR AND REDUCE TRANSACTION COSTS

Firms need to actively monitor and reduce transactions costs in order to make outsourcing profitable. Significant financial costs can be incurred in searching for outsourcing vendors, drafting and negotiating a contract, monitoring the outsourcing relationship and resolving disputes in the event of a fundamental disagreement. Firms that grow dissatisfied with their LPOs incur more transaction costs in an effort to locate and
hire a new LPO (i.e., switching costs). Transaction costs (and certain switching costs) are especially important to monitor and reduce because these costs are sunk. Lawyers who do not possess the acumen required to evaluate the costs of outsourcing should consult with an external advisor or not engage in the activity at all.

**BE ALERT TO HIDDEN COSTS**

Transaction costs are necessary to initiate an outsourcing relationship. Once established, firms also incur costs associated with managing the outsourcing relationship. Hidden costs stem from the misalignment of customer and supplier interests. The customer (i.e., the law firm) wants to buy the activity at the lowest possible price point, whereas the supplier (i.e., the LPO) wants to sell the activity at a good margin. Firms can align their interests with LPOs through carefully drafted and accurate outsourcing contracts; the outsourcing activity and the expectations of the firm and client should be made particularly clear. A carefully drafted outsourcing contract will help to align the law firm and the LPO.

Another hidden cost involved in the outsourcing relationship is the lost opportunity for the overseeing lawyer to take part in revenue-generating activities. Opportunity costs are particularly important for law firms, given that lawyers (for the most part) bill by the hour. Endeavouring to outsource work forces lawyers to devote their time and attention away from billing hourly and strengthening their books of business to entering into a contract with and managing and monitoring the work of LPOs.

Although important, being alert to hidden costs is not enough. Drafting a well-constructed and carefully worded contract is crucial to mitigate risks involved in outsourcing work. Without a solid contract, firms increase the risk of incurring sunk costs, which, in turn, increases the chances of the outsourcing relationship being unsuccessful.
MINIMIZE POTENTIAL HOLD-UP COSTS

Law firms must be wary of entering into relationship-specific investments with a single LPO provider. While firms can benefit from entering into long-term relationships with one LPO, the longer, more specified and irreplaceable the relationship, the more opportunity the LPO has to exercise bargaining power and hold-up the law firm. This is especially problematic when one considers that legal services are often delivered under timelines imposed either by courts in litigatory files or by clients in transactional files.

LEVERAGE LABOUR ARBITRAGE

In conjunction with the costs to initiate the outsourcing relationship, the reductions in hourly billing make outsourcing a relatively low-profit strategy. Firms can increase profits through savings from contracting with LPOs based in low-cost locations. The reductions associated with cheap labour allows firms to increase their margins, pass the savings on to clients and reinforce/build their firm’s reputation. For firms whose clients request an LPO, firms must pass some of the cost savings on to clients or risk them switching to a competitor law firm. Firms consistently pressured by clients should consider extending their geographical and vertical scopes by vertically integrating an LPO with an office in a low-cost location. Firms that vertically integrate offshore LPOs can control their margins by dictating how much of the savings to pass on to clients.

BREAK DOWN LEGAL TASKS AND TRANSACTIONS

Lawyers need to be precise when instructing LPOs to perform work. By deconstructing processes, firms can determine which elements of a product require greater expertise and which elements require less expertise. The tasks with less expertise are better
suited for outsourcing. By identifying tasks requiring less expertise, are routinized and cost
more, firms can concentrate on performing work that delivers greater value to clients.

**COLLABORATE WITH LPO TO DEVISE PROCESSES AND PROTOCOLS**

Once work is outsourced, LPOs should not perform their work independently from
the supervision of the contracting lawyer/law firm. Outsourcing work to LPOs requires
consistent oversight and back-and-forth communication. To reduce the costs associated
with monitoring and managing LPOs, firms and LPOs should collaborate with LPOs to
develop a set of protocols and processes to be undertaken by the LPO.

Sarvath Misra (2013), the co-founder and director of NewGalaxy Services Ltd. (an
LPO), suggests developing a “playbook.” The playbook sets standards for what law firms
expect from their LPO provider, which, in turn, allows the LPO to understand how to best
execute the deliverable. Misra (2013) further outlines that a playbook should include a
workflow and review manual (similar to a decision tree), a mechanism for discussing and
agreeing to timelines, pre-determined lines of and responsibilities for communication, the
reporting requirements for the LPOs, and service and quality assurance processes to which
the LPO will adhere.

**SEEK EXCESS INSURANCE FROM LAWPRO**

Firms generally enter into group insurance contracts for their individual lawyers.
The total coverage through LawPro is $1M per claim and $2M in aggregate (LawPro,
2020). Firms engaging with LPOs on a consistent basis should consider purchasing
additional insurance coverage to absorb the additional risks associated with outsourcing
work. When purchasing the coverage, firms should receive written confirmation from their insurer that outsourcing work to LPOs is not excluded from coverage.

**SUFFICIENTLY SCAN THE LPO MARKET AND LEARN THE COMPETENCIES OF DIFFERENT LPOS**

LPO providers specialize in different aspects of legal work and transactions. Firms should canvass the LPO market to identify potential LPO partners. Once scanned, the credentials and work products of the individual LPO partners should be verified prior to contracting their services. Vetting potential partners can be achieved through a request for past contracts and their outcomes and/or referral sources. The LPO should provide information about its work processes and about how client confidentiality and quality control are ensured.

**BE TRANSPARENT WITH THE CLIENT AND SEEK PRIOR CONSENT**

Clients should also be well informed and consent in advance to the outsourcing of work to LPOs. The prospects of cost savings for clients is not enough to imply client consent. Risks should be communicated to the client (i.e., conflicts of interest, client confidentiality and privilege, quality control, etc.), along with the outsourcing costs and how the client will be billed for the work.

**CHAPTER 10: MANAGING THE LPO RELATIONSHIP**

A law firm’s equilibrium is fracturing across billing hourly, increasing profit per partner and ensuring client satisfaction. The traditional method of managing a law firm is being disrupted by competitive forces in both the external and internal environments of the legal industry and law firms. By first scanning the macro- and industry-level environments,
law firms can systematically assess various remote and competitive pressures impacting their industries and marketplaces. Liberalizations to the legal profession, advancements in technology and globalization, and the ethical obligations and duties of lawyers are remote factors that are reshaping the legal industry. At the industry-level, the threat of new entrants, the increased power of customers/buyers and the threat of substitutes are strong sources of operating pressure. The transformation of the legal industry is inducing law firms to innovate in order to remain profitable.

However, firms can successfully innovate. By taking account of a firm’s key resources, core competencies and value chain, firms can better align their internal and external environments to implement effective strategies. One such strategy is outsourcing. By strategically outsourcing certain activities from the value chain that are costly for clients yet low in difficulty, law firms can increase their value proposition, strengthen their brand and reinforce relationships with clients.

To determine whether or not outsourcing is the appropriate strategy for any law firm, a cost-benefit analysis should be performed. There are significant costs involved with outsourcing. Transaction costs, hidden/management costs, hold-up costs, opportunity costs and losses in economies can be expensive. The risks involved with outsourcing include the assurance of quality work, the protection of client data and confidentiality, the avoidance of conflicts of interest, insurance claims and lawsuits. The benefits of outsourcing include increased value to clients, faster turnaround time, increased transparency to clients and strengthening of firm brand and reputation.

In some cases, the benefits of outsourcing outweigh the costs and risks, and in others, they do not. To be effective, the outsourcing relationship must be carefully and
deliberately managed. An effective outsourcing strategy would heed the following: (1) balance outsourcing with hourly billing, (2) monitor and reduce transaction costs, (3) be alert to hidden costs, (4) minimize potential hold-up costs, (5) leverage global labour arbitrage, (6) de-construct legal tasks and transactions, (7) collaborate closely with the LPO to devise work processes and protocols, (8) seek ample additional insurance from your professional insurance provider, (9) analyze the LPO market and learn the competencies of different LPO partners, (10) be transparent and honest with their client and (11) always gain consent from the client prior to outsourcing work.

Outsourcing is a difficult strategy, but, if done effectively, it can provide law firms with the competitive advantage necessary to remain profitable during this current period of disruption. In Ontario, law firms have been slow to adopt innovative solutions to meet changing client demands. However, liberalizations to the legal profession, as seen in Australia, England and Wales, are on the cusp of being implemented in Ontario. Firms need to be prepared and agile in their strategic decision-making. Outsourcing is not a panacea, but it might be a catalyst for the change that the legal profession needs.
REFERENCES


Legal Services Act, 2007, c. 29.


VITA AUCTORIS

NAME: Brandon Keshen

PLACE OF BIRTH: Thornhill, ON

YEAR OF BIRTH: 1993

EDUCATION: Thornhill Secondary School, Thornhill, ON, 2011

University of Guelph, B.A., Guelph, ON, 2015

University of Windsor, M.B.A./J.D., Windsor, ON, 2020