

2 What would Poundworld do ?



Jaap BOSMAN,
consulting, a business strategy boutique for the legal sector operating
from New York, The Hague and Hong Kong

Jaap Bosman is a leading strategy consultant and an investor with over 15 years of experience in the legal sector. He has been with two of Europe's leading law firms and has extensive international experience, including in China and Africa. In 2013, his international strategic achievements were recognised by *The Financial Times* with the first ever Innovative lawyers award for International Strategy. His vision on the legal market and the future of business law firms was defined in the critically acclaimed book, *Death of a law firm : why many business law firms will collapse in the next five years*. Jaap Bosman is a co-founder and principal partner at TGO Consulting, a business strategy boutique for the legal sector operating from New York, The Hague and Hong Kong (www.tgo-consulting.com).

1 - Recently I have been watching a documentary series originally broadcast by BBC Two between 2012 and 2015, with the title « *Pound Shop Wars* ». The episodes dive into the competition between discount retail chain Poundworld and its rivals, such as Poundland and local discount shops. Poundworld is a British chain of stores that offers a product range consisting of groceries, health and beauty, toiletries, cleaning products and pet care, nearly all for £ 1. The competition is fierce and new stores are opening and closing every week. Poundworld was founded in 1974 by Yorkshire-based father and son team Chris Edwards Sr. and Chris Edwards Jr. Especially the recession since 2007 provided the retail chain with increasing sales figures. It has grown to over 6,000 employees and 340 stores in the UK.

Edwards Sr. started off with a market stall of his own in Wakefield, West Yorkshire, haggling with customers and developing a nose for what they wanted. It seems that during the rise of his company he did not retreat entirely into his head office, but kept visiting stores, talking to customers and checking if the shelves were full and neatly stacked. The stores are run by local shop managers who haul and stack products themselves alongside the other staff. If the weather forecast shows warm weather, the drink products are quickly shifted to the front of the store. On rainy days, umbrellas and ponchos take that spot. Products must be out the door as fast as possible. The essence of Poundworld is that everything they do is with the intent of making money. It is a low margin business, which requires continuous monitoring. Poundworld is constantly checking prices of the competition and adjusting accordingly. Stock that is not out on the shop floor is not making money. What store managers order and how much they have in their back room is monitored daily. Poundworld is pure business in one of its simplest forms. Investments will only be made if there is a clear return on them. It is just a calculation. It is just business.

2 - What has the likes of Poundworld got to do with the legal profession, you might wonder. Not much. But it should have. Twenty years ago, being a lawyer meant exercising a profession very much like a doctor. You did not work as a lawyer ; you were a lawyer. Since then, lawyers are increasingly forced to operate as a business : generating turnover, making investments and understanding cash flow. At some point in the past decades the *nobile officium*, the honourable profession of being a lawyer,

changed into being a business undertaking. Practicing law is a business. The lawyers and law firms that do not realise this will be left behind by reality, clinging to their status as work and profitability dwindles. And yet, when I look around and listen to topics discussed with urgency in the legal market, it usually has little or insufficiently to do with business.

1. Back to the basics of business

3 - Why do law firms behave as if they are in a regulated market ? The similarities with doctors seems to stretch also to how lawyers choose to charge for their services. Doctors operate in a market where prices are regulated and insurance often covers the costs. Lawyers on the other hand, make a living in a market where price is not regulated and clients have to pay the costs. And yet, the tariff scales are set, based on how many hours a lawyer can work in a year, and the wiggle room on how much an hourly tariff can increase per year is very small. Clients are pushing for alternative fee arrangements but, in reality, these are far from widely used. Both lawyers and clients tend to cling to the hourly rate. In the meantime, to reach budget predictability clients demand caps, which has effectively led to fixed prices and the death of the hourly rate, as declared by the Peer Monitor 2017.

Business law firms and clients are, most of the time, free to agree whatever they want. This mindset of free pricing has worked terrifically in many other industries. Consider the drastic change in pricing done by the airplane engine maker Rolls-Royce. The makers of airplane engines have very little margin on selling the engine itself, while they get many times more revenue from servicing and selling spare parts during the life time of the engine. This has of course lured independent servicing firms to enter the market and compete for the attractive margins in engine maintenance. Rolls-Royce decided to price their products differently in order to ensure loyalty and the lucrative total package. Instead of selling engines to airlines and then sign a maintenance contract, Rolls-Royce convinced its customers to pay a fee for every hour that an engine runs. Rolls-Royce in turn promises to maintain it and replace it if it breaks down. The more clients are in the air the more they earn and the happier they are to pay Rolls-Royce. I am not suggesting that lawyers should try to charge

clients for the time that the companies of those clients run smoothly. The example illustrates how approaching things differently can lead to a win-win situation.

4 - The single most disruptive factor for the legal sector is « commoditisation ». Commoditisation means that from the client's perspective a matter can be adequately handled by multiple lawyers and multiple law firms without compromising quality. Commoditisation is defined from the eye of the client, not from the perspective of the law firm. Commoditised legal services can be quite complex or require a considerable amount of skill and expertise. It is the fact that there are multiple lawyers who possess these prerequisites that makes a legal service a commodity. This means that whether a service is commoditised or not varies from market to market. But there is no such thing as slightly commoditised. A service is either commoditised or not. Most lawyers do not understand this and are still convinced that only simple work or bulk work can be commoditised. Commoditisation has already led to pressure on price and the pressure will continue to increase.

Due to the pressure on price, commoditisation will erode the profits of the law firm. Eroding profits will lead to profitable partners leaving the firm. As costs are fixed and inflexible in a law firm, the departure of profitable partners will lead to further declining profits for the remaining partners. As a result, many of them will leave and the law firm will collapse. End 2016 we saw this happening at King & Wood Mallesons Europe. The only answer to commoditisation is changing the business model, which today is solely based on leverage.

5 - Instead of getting back to the basics of business, law firms seem to keep themselves busy with other things. Some feel that they have to innovate, either trying to come up with a product clients want to buy or using it for marketing effect. Others are merging in the hope that size and reach will be the magic formula. Yet others are occupied with making their machinery leaner or considering automation and artificial intelligence (A.I.) to see if they can get ahead of the curve, not quite knowing what the curve is. That makes me think of Poundworld. What would they do? Would they invest in state-of-the-art technology? Would they open a research and development department to come up with products their customers didn't know they wanted? Poundworld embodies the core of entrepreneurship. The business of Poundworld is of such a basic form that it serves as a good example. In essence, it is still the home town market stall of Edwards Sr. Poundworld will make investments based on business only. When will it make us money and how much will it return? Profit is the first factor they consider, not the second, not the third. What's more: nothing else is expected of them either.

2. The impact of artificial intelligence on the legal sector is wildly overstated

6 - At the Davos World Economic Forum 2017, Bradford Smith, Microsoft's president and chief legal officer, declared that computers will never be able to fully replace humans. With the increase of automation and A.I., human soft skills will become more valuable. He used legal secretaries as an example. Not so long ago a secretary served two lawyers. Automation now enables one secretary to serve ten lawyers. Working for ten people requires an enormous amount of soft skills. Automation and A.I. will no doubt replace all repetitive tasks performed in law firms but it will not replace the lawyers themselves.

However, there are more reasons than the lack of soft skills as to why A.I. will not do what attorneys do. But in order to understand

why, one first has to understand what A.I. really is. I'm afraid we have to get technical. I am not an expert when it comes to computer science and A.I. But because I am convinced computers cannot do what lawyers do, I need to understand how they work in order to argue the lawyer's case. The only way to understand is to turn to experts.

7 - Law and technology has nearly taken over the agenda for legal conferences. When I attend such a conference, I tend to find two camps. The one camp is really enthusiastic about what technology will do to the legal market and use the word 'disruption' a lot. The other tend to be more cautious and approach the subject from the lawyer's side and ponder the implications technology will have on the how law is implemented and the effects on shaping justice. For some reason, the technical details are often left out when talking about legal tech, presumably because there are so few people at the intersection of technology and law. Few computer scientists are also lawyers. Fewer still, are lawyers/computer scientists that can also explain the important bits in a useful way for non-technologists.

There are a number of articles by professionals that do a good job in explaining A.I. to us lawyers. A.J. Shankar, holder of a PhD in computer science and founder of a US-based eDiscovery software company, wrote an article named « Don't worry, attorneys: A.I. comes in peace » wherein he explains what A.I. can and cannot do for the legal industry. « A.I. will undoubtedly affect white-collar jobs. It stands to make some obsolete. But as a legal technologist, I'm quite sure it won't replace attorneys any time soon. In fact, attorneys are some of the people who stand to benefit most from its advance. »

What I have come to understand by reading the material I come across from expert and by talking to people that straddle both technology and law, is that the fact that we use the word 'intelligence' when we describe machines is misleading, because it is not intelligence in the sense we use the word for humans. Machines and algorithms are just calculations. Saying that A.I. can think for itself is like saying calculators will replace maths teachers. In fact, I have found no computer scientist who says that computers will replace lawyers.

8 - Having said that, A.I. has come pretty far and is still impressive without being intelligent in the human sense. End of 2016 we could read in *The New York Times* about what Google Brain, a department within Google, had done to massively improve their Translate service. In a short timeframe, Google Translate have gone from producing comical sentences, that leaves you guessing as to the intent of the original message, to achieving near perfect and rather sophisticated translations (although, at the time of writing not all languages are implemented).

Understanding a little bit of how Google could do this leads to some valuable insights. When experts use the term A.I., they usually mean a form of machine learning system: one that can learn from input and adapt accordingly. Researchers sometimes refer to strong and weak types of A.I., where 'strong' mean human level abilities. Experts also divide A.I. into two categories of machine learning: supervised and unsupervised. The supervised system needs a teacher that will provide the machine with feedback and label all information that is put into it in order for the machine to 'learn'. Examples hereof are most legal A.I. products currently on the market, although some of them might combine it with unsupervised learning elements.

9 - The unsupervised method of machine learning does not require a teacher but leaves the system to draw conclusions using an enormous amount of data. The unsupervised kind is still in its early stages but it is the method that Google used to massively improve its translation service. You first feed the system information that will enable it to translate between two languages, say English and Japanese. Nothing special. Then you feed it the infor-

mation that will enable it to translate between English and French. After that, the unsupervised system of Google could figure out for itself how to translate between French and Japanese. It learned every new language quicker and the translations got more accurate. It did so by learning language like a child. A child learns the meaning of a word by connecting the word to the idea of what it means. You point to a car and say 'car'. Teaching the same child French, you point to a car and say 'auto'. The child brings new words back to what they represent, the image or idea of a car, and not, like a dictionary, the word in every other language it knows. This is also called symbolic learning. By adding more algorithms and levels to the unsupervised machine learning you achieve something scientists call 'deep learning'. Modelled on the human brain, information pass through nodes of algorithms before sent further through the network of computing power. This is sometimes referred to as neural networks, another example of how scientist jargon can tempt us to think of A.I. as humanised.

The unsupervised system and deep learning reaches the more 'intelligent' results in comparison to the supervised learning. What Google has achieved with its translate service made the research community quite excited. But such a system needs to be made to measure for each task it is supposed to do. It does not come as a readymade meal. Furthermore, any A.I. system needs training in order to make them useful. Because the unsupervised machine learning learns by itself it needs a massive amount of data. As A.J. Shankar explains in his article « *Don't worry, attorneys : A.I. comes in peace* », in order to make such a system produce accurate enough results you have to train it on hundreds of thousands or preferably millions of examples. The problem here is that experts do not believe that law firms or even the entire legal world have sufficient data available to train such a system to become accurate enough in advising on even the simplest of case. As Mr Shankar points out, it is not a coincidence that Google is one of the first companies to deploy a rather accurate A.I. system since it has access to a vast amount of data.

10 - Building a deep learning system is also very complex and hard to do. Another guest at the Davos forum 2017, Sergey Brin, co-founder of Google, said he felt like a Luddite listening to people's speculation on where A.I. will take the world in the near future. « Those things are really hard to do with a computer » he said, adding that he observed how people seem to take those innovations for granted and jump to start thinking of what that would mean for society rather than if they would even be possible. When I spoke to Andrew Arruda, CEO and co-founder of *Ross Intelligence*, he emphasised that *Ross* cannot make decisions that will replace the senior lawyer. It would only be the media that sometimes portrayed it that way.

3. The magic fix and its return on investment

11 - Most technological investments made by law firms are not driven by demand or a clear return on investment. How many law firms have not invested too much in a CRM system that in the end do not magically and automatically help managing their clients at all ? How many law firms did not over spend on their website, while it will be outdated in 3 years time and will not actively bring them a single client ? Or on a fancy intranet with a chat function that is never used ? And what about that app that the one partner group so desperately insisted on having ? These expenditures seem to be driven by wishful thinking rather than the result of a business calculation.

12 - In 2015, Poundworld decided to join the online retail market and launched a web shop. Poundworld did not go online

on a whim or because 'everyone else is doing it'. This investment in technology is something they did to generate sales they would otherwise not have. Everything Poundworld does revolves around money because that is what decades of being in the market has thought them. Investment in technology, just like any other investment, will only happen when there is a clear return, such as being more efficient with stock and sales turnover, or a security system that would help to prevent them from losing stock.

13 - Speaking of losing stock, if law firms are so keen on investing in technology, then the first thing they should worry about is cyber security. Confidentiality is part of the core business of law firms. Damage to the core can be potentially disastrous. Cyber criminals are a real and imminent threat to law firms. Not long ago, three hackers were revealed stealing sensitive M&A information from a New York law firm in order to get rich from trading with inside information. Each law firm thinks it will not likely happen to them. Think again. I have witnessed law firms of various size and geographic location falling victims of cyber criminals. It happens all the time. For most law firms, it will not typically be a hacker that will target them for specific information. It will more likely be a case of ransomware. On one friday in november 2016 a law firm I know received an email with an attachment. The email contained accurate information and references to an ongoing case and was addressed to a specific partner, who happened to be travelling. Since the e-mail raised no suspicions, his secretary opened the attachment. Within 30 minutes all electronic files in the entire firm were encrypted. The firm had to hire a third-party expert to go on the so-called dark web to find the ransom note – a string of code instructing how many bitcoins the cyber criminals demanded and how to deliver. After paying the ransom, the law firm's files were decrypted within one hour, all in time before start of business Monday morning. A law firm of 100 lawyers with a blended rate of €300, billing 6 hours a day each, stands to lose €180.000 every day that cannot be worked. If they make themselves easy targets, then they will be hit by cybercrime sooner or later.

4. It's the economics, stupid

14 - What is technically possible is only one factor in determining how quickly technology will 'take over'. The Mckinsey Global Institute has written a report, « *A future that works 2017* », in which they identify five factors that affect the pace and extent of adoption of automation. One of them is economics. Even if replacing humans with intelligent machines on a specific task is technically possible, it does not mean that it will happen unless it makes economic sense. The global legal market is of relatively limited size. It has been roughly, and probably generously, estimated to be around 700 billion. That might seem like a lot, but consider that Walmart alone has a turnover of more than half of that. From many investors' perspective, most part of the legal market is not a priority for funding because the return on investment is not enough. Automation is costly. The return on investment is limited because the cost of developing systems to replace lawyers is quite significant. If you can achieve economies of scale, then the cost of expensive machines will soon have been earned back. But even though the legal market is commoditising rapidly this does not mean that it will be ripe for economies of scale. In 2016, Mercedes announced that they were replacing robots with humans at the manufacturing plant of their most popular model, because the car comes with so many options that robots were no longer capable to handle it cost effectively. Humans are simply better and cheaper when it comes to adaptability and flexibility. If automation is costly, then A.I. is even more so.

15 - It is important to recognize that technology is part of the solution and not of the problem. Too many have preached that computing power will be the great disrupter of the legal sector. It will not. Commoditisation is the disruptor and A.I. is part of the solution. But let us not get carried away. Predicting the future merely by extrapolating on the past is a lousy method. Just because the computer processor used to double in power every 18 months does not mean that it will have the capacity of a super brain in 50 years time. A.I., in the form we need to have it in order to replace lawyers, is not the inevitable end of an exponential curve. It is more complex than that.

16 - Relevant legal judgement will remain the human domain for the foreseeable future. It is the human skills that provide the added value. Technology will free lawyers of the boring tasks and make them more efficient. There are already benchmark reports by third party technology advisors on the measurable impact on lawyer's work of different A.I. solutions using real-world cases. For example, one benchmark study by Blue Hill Research on the Ross tool, using 16 legal researchers in the context of US Bankruptcy Law research, showed a 20-30 % gain in time with a 30-40 % increase in the relevance of the results

using Ross as a research tool. But the business model by which most lawyers operate rely solely on leverage. When running a business largely based on the hourly rate, as many fee earners as possible must be made to write billable hours since the income generated by one single person is capped to 24 hours a day. Commoditisation will not allow law firms to increase the hourly rate to compensate for working faster and using less inexperienced people. In a market where technology will replace lawyers' inefficiencies the current model will be bad business.

17 - It is commoditisation and not technology that will force law firms to either change their business model or die. Technology is nether the great disruptor nor the holy grail. Instead, it is one of the solutions to law firm's problems. As law firms seek to compete in a commoditised market, automation and A.I. will form an integral part of their new way of working. But in order to get there in the first place, lawyers need to start treating law as a business. Because whether they like it or not, law is a business. It is time to think of what Poundworld would do. ■

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