Legal services sourcing
The tipping point
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Legal services sourcing | The tipping point

Foreword

As with so many areas in the fourth industrial revolution, service delivery models in legal departments are changing. General Counsel (GC) and Legal functions increasingly expect their advisor to provide a fixed cost rather than pay traditional hourly rates. For project work, this requires both parties to stick to a transparent, robust, and agreed scope. In other cases services are being semi-automated, delivered with a combination of people and technology that can lend itself to a subscription based revenue model for repeat services. As technology and sourcing evolve together, the level of automation will increase with more research and routine tasks being augmented by technology such as chat bots and software.

These developments demonstrate what HR recognized some time ago: Much of what the professional provides is not unique to a once-only fact pattern. Even where there are nuances, if you can identify and strip these out, the rest of the advice can be re-used because it can be applied more generally. With this shift – recognizing that you don’t need an expert for every aspect of every piece of work – comes the realization that projects can be delivered with a mix of legal experts and non-experts who don’t need to be co-located or even based in the same country, and the repeatable components of some work can be effectively completed by a machine than a person.

Now, both Legal functions and their advisors are looking at this sourcing mix and exploring the art of the possible which offers radical new ways for companies to experience legal services which are quality assured by lawyers but not delivered entirely by them. With new ways of approaching service delivery and new revenue models, companies benefit from fast, simple, lower cost access to specialist knowledge hampered by the log jams that historically frustrated many in-house lawyers and their customers in the business.

This is an exciting time to be working in the Legal function and for the advisors (traditional law firms, alternative legal service providers and legal technology companies) supporting them that support them. New approaches are emerging based on collaboration, co-sourcing and co-investment in both teams and technology which will accompany the transformation of legal operating models that is already in process.

Luis Fernando Guerra
Global Leader, Deloitte Legal
What do we mean by sourcing?

Previously in-house Legal functions have made a simple “build or buy” choice – do we do it ourselves or do we have it done by a law firm? Typically, large groups adopted concurrent sourcing on a continuum between heavy in-house resourcing and limited recourse to outside advisors, or a small Legal function and extensive reliance on external support. Some markets such as the US, the size of Legal departments seems to vary according to the economic cycle – in an upturn, teams get larger and less is farmed out.

A second pair of eyes
In-house teams rely on external support for a number of reasons. Beyond capacity, cost and cost-effectiveness, in some cases it is useful to get a second opinion if regulators or auditors are querying an approach or if the subject is very technical. The skill set within Legal may lead to engagement with outside resource which enables knowledge transfer from external lawyers to the in-house team as they work together on complex issues. Variable volumes can highlight short-term resource needs, while legal risk management may lead to the use of a third party as a way of buying legal risk coverage by laying off the risk to the adviser. The use of external providers also varies from industry to industry. In financial services some specialist skills such as sophisticated derivatives can only be developed to the highest levels in-house, whilst other areas are so niche that it is more economical to buy them in as needed.

A range of alternatives
In recent years the sourcing decision has changed as alternative delivery models and service providers have emerged such as Legal Process Outsourcers (LPOs), interim solutions, and a changing skills mix within Legal as non-lawyers are recruited as Chief Legal Operating Officer, Legal Project Manager or with skills in areas such as data science, pricing, and risk management. At the same time – and in common with other functions – Legal has been looking at where the work is done, and considering opportunities to move some legal tasks to centers of excellence or shared service centers, either within the group or managed by their external advisors. Underpinning all of these changes has been the rapid development of new technologies which impact not only who does the work, and where they do it, but also the delivery. These changes to the sourcing mix and the use of technology also impact matter management.

The models
Today, sourcing options are driven by volume, complexity, risk, value, and the desired outcome. They can be summarized as:

- **In-house**
- **Outsource** – to a law firm, LPO, alternative legal services provider or a mix of these within or across projects
- **Co-source** – a mix of in-house and outsource and including secondments if permitted under local regulations
- **Operate** – transfer the entire function out of the company and get a service provider to operate Legal on the company’s behalf

Another variant of outsource and co-source is crowd-sourcing and contingent workforce – where large volumes of on-demand labor are needed at short notice often with a mix of skills which are not necessarily available in-house.

Across all these options there is also the question of where the work is done: on site at the company or legal service provider, or off site be that on-shore, near-shore, or off-shore in a shared service center or center of excellence.
Why are companies looking at this now?

Globalization and interconnectivity are leading (and enabling) people to look holistically and make decisions that make sense for a group as a whole, not just from center. There is also a trend amongst younger workers to demand variety and stimulation from the work they do. They don’t want to be doing the type of tasks that can now be performed by non-lawyers, moved out of the center or automated. For their part, employers recognize that they are most likely to retain their lawyers by freeing up their time to think, plan, and deliver greater value to the business.

Pressure on the GC
Globally, Legal is being asked to do more with less coupled with an expectation that Legal will be a strategic partner to the business rather than just a semi-independent scrutinizer and service provider. This has led GCs to look for ways to optimize cost and drive the most value from their legal spend. Increasingly, sourcing decisions are giving GCs greater choice and consequently greater power as they flex the mix between different providers whilst mitigating the risk of key person dependency.

Applying transaction cost economics, non-core deliverables can be sourced from third parties with better economies of scale and economies of scope than in-house resources, whilst replacing fixed with variable costs. This can be through changing the way in which tasks are resourced combined with the use of technology (either owned by the company or by the service provider). Often there is a push to do this because other functions such as Finance and HR have already transformed and Legal is expected to follow suit. Or a group splits, and the divested part is left without a Legal function – should one be built from scratch or are there other options to achieve the same result?

Although there are movements in the market as companies look at radical alternatives to the traditional approach including outsourcing the entire function under the Operate model, these are mostly at the exploratory stage with the need for cultural fit recognized as a big challenge to implementation. We may be close to a tipping point but it hasn’t been reached yet.

The future of panels
Panels are a fact of life for many large organizations and the law firms that serve them, but the level of satisfaction with them is mixed. In theory, recruiting a group of law firms to a panel achieves savings because to win a place on the panel its members have to offer highly competitive rates. Although price is not the only criteria, pricing will typically account for around 40% of the evaluation marks so it is difficult to win a panel place on quality alone if your price is not also competitive. The rates offered to get a place on a panel at least offer the buying organization greater cost predictability, but perhaps little more?

To demonstrate savings from implementing a panel you need to know what you spent prior to creating the panel. This information may not have been systematically captured, or captured with such granularity that one-offs and anomalies can be excluded to provide genuine comparability between pre-panel and panel legal spend. Recognizing this, companies are placing detailed reporting requirements on their panel members (and at their cost). This can make the decision as to whether to bid to be on a panel an increasingly marginal one. As panels are retendered it is possible to demonstrate added value to the extent that rates have been squeezed thanks to the retender process, but that is only as valid as the accuracy of assumptions as to skills mix which may be very different when real work is actually being delivered.

Measuring the benefit
As sourcing becomes more sophisticated with a range of options that is already wide, we expect to see the way in which panels are created and managed to become less about squeezing service providers’ margins with greater focus on where and by whom work is done with the support of what processes and technology. Technology will also play an increasing role in performance evaluation presenting value added beyond cost control in areas such as knowledge management, innovation, risk management, and horizon scanning. By measuring the effectiveness and efficiency of sourcing decisions, analytics-derived insights can be used to help refine the sourcing model.

With any transformation, it is essential to manage performance and measure the value being delivered from the new arrangements. As is increasingly the case in Legal, this management and measurement can be executed either in-house or outsourced and it doesn’t need to be done by a person with legal expertise. Whoever fulfills the task needs to examine the value derived from the total legal spend, both internal and external. Legal spend analytics leverages data to determine where value is being created or risk mitigated and to identify activities that are of negligible value in terms of the organization’s risks and strategic objectives, all of which can be used to refine the sourcing decision.
Who decides?

There is some divergence as to who makes the sourcing decision. In the past the GC built the team and then individual lawyers in that team decided when to use outside counsel, and often which counsel to use – even if their choice was limited to firms on their company’s panel. Long-term, trusting relationships played a central part in this decision. In many organizations today the decision is increasingly influenced by the procurement function, who may take the lead on panel selection and impose a framework which limits Legal’s room to move in terms of buying off-panel or selecting a panel firm for a project without going through a mini-tender selection process.

Some companies are using technology to support their lawyer’s in this process. When a new matter is initiated, the tooling will tell the lawyer whether the work has previously been done in-house or by outside counsel, which firms have been used and whether the use of a particular firm for the matter in-hand would trigger a volume discount or other benefit that might impact the decision. Nonetheless, trusting relationships still have a part to play when the in-house team is afforded any discretion, especially amongst those companies who have decided to remove panels altogether as they are too cumbersome to manage compared to the cost benefit.

Developing a sourcing framework
The sourcing decision should not be made in isolation from the nature of the work being done and how it is currently delivered. A variety of factors need to be considered including:

- **What does the business expect of Legal – how do service users see Legal contributing to the organization’s strategy and competitive advantage?**

- **What does Legal currently do – you cannot change the sourcing mix until you understand the department’s workload and the complexity of the tasks being delivered.**

- **What skills do we have in the team and what do we lack – should these gaps be filled through recruitment or reliance on external resource?**

- **How do we currently use outside counsel – has this evolved or is it specifically designed to underpin our risk management strategy?**

- **How does our organization define excellent legal services – and how does this impact our sourcing decisions?**

- **What does our regulatory regime permit – are there limitations on what can be “farmed out” in terms of work or data?**
Sourcing within the Legal Operating Model

Ideally sourcing should be considered within the context of a complete overhaul of the Legal Operating Model as described in our paper on "In-house Legal Service Delivery". This starts by aligning Legal with the strategy of the business as a whole, and refines Legal’s governance and roles and responsibilities within the function and in relation to other functions and operations of the business. With these in place Legal can consider its infrastructure of enablers which make it efficient and effective. Of these sourcing is one of the key components.

GCs looking for a quick fix may be tempted to use sourcing as a route to achieve some easy wins in a much shorter time frame than restructuring the operating model or investing in technology typically take to implement. This approach leverages a surplus of supply in many mature markets with pressure applied to their panel(s) of external law firms, retendering the panel, and looking at the use of alternative legal services providers. However, approaching this without taking account of the demands of the business, the potential for technology and the opportunity to re-shape the Legal function – for example by using centers of excellence for the fulfilment of particular tasks – is missing a trick and likely to yield only short term gains before the topic needs to be revisited.
Interim solutions

Filling gaps within Legal with a variety of interim labor makes good commercial sense where the resources are used on a project basis after which they can be released, or by smaller organizations who don’t have a full-time requirement and don’t want to pay time and materials costs to get this level of support from a law firm. A part-time GC can add significant value by understanding the business and acting as interpreter between it and external advisers to get the best from them.

A pre-requisite for this model is a team of qualified lawyers who can self-manage and don’t want to work in the traditional way, either in a firm or a corporate Legal function. This makes the model less common in developing economies where the supply of lawyers struggles to keep pace with demand. Often these lawyers will themselves have worked in-house and appreciate the mis-match between the way Legal wants to receive services compared to the way law firms deliver them.

Managing the model

Providers of these services use technology to manage transactions and work between client and lawyer. They may staff engagements with a combination of their own employees and contractors, or just rely on a database of freelancers. In some jurisdictions, freelancers are in such high demand that it poses continuity and resourcing risks for the providers of their services. This can be partially mitigated by having dedicated employees as well as off-payroll resources. In some cases the employed team members are focused on client recruitment, project management, or quality assurance with the independent lawyers delivering the services.

Some companies faced with a large project that lends itself to on-demand staffing are adopting a co-sourcing approach and unbundling the work to be done with some aspects being done in-house and others outsourced, or creating mixed teams of internal and external resource to create the critical mass and skills mix necessary to get the task done.

This model relies on the service provider being very clear about the needs of both the client and the lawyers they are providing. It is not available in some countries such as mainland China and Germany (if the engagement stretches beyond two years) for employment law or other regulatory reasons.

Where this works best

This model does not work for every task involving the Legal function, but e-discovery, contract and litigation reviews, and (potentially) responding to the General Data Protection Regulation (GDPR) subject access requests are prime candidates. This arises from the occasional nature of the requirement for such a project and the volume of material that can be involved which would swamp all but the largest in-house teams and distract from any team’s other responsibilities. As these exercises don’t conform to any pattern or frequency, few companies invest in the technology which is increasingly deployed to accelerate the task by reducing the volume of manual work. If a company has made this investment, they may still want to involve outside counsel in advising on search terms, “teaching” the machine and reviewing its outputs.

Even with the use of artificial intelligence (AI) the importance of these reviews can be so high that the organization wants a large proportion of the outputs reviewed by a human over and above what has been identified by the machine. This has the added advantage that the human reviewer may catch something that is useful to the client, but outside the scope of the machine’s “brief”. Most such technology is only capable of reviewing documents in letter-based languages, but some have AI-based review capabilities which can also recognize characters.
On-shore, near-shore or off-shore?

If an organization is creating its own shared service center or benefiting from that of a third party there are a number of risk management considerations which affect what is taken off-site, and how far away it is taken. There are obvious concerns about data security, but these are increasingly being mitigated with highly effective measures that reflect the business criticality of this domain. Differing time zones have pros and cons. Concerns about communication difficulties caused by a language barrier should be resolved at the recruitment or competitive tender stage. Traditional offshore destinations such as India and the Philippines have been joined more recently by South Africa which has become an outsourcing hub for law firms in the US, the UK and Australia.

Perceived complexity need not be a barrier
Often, when looking from the center it is difficult to see how standardization and automation can be applied to tasks which appear complex and demand technical legal knowledge. A key part of the decision-making is to understand the processes that it is proposed to shift and apply project management principles to break them down into their component parts. A surprising outcome from doing this exercise is to see how much of each work-stream – take-on processes, completion of standard documents, invoicing to name a few – requires no legal skills whatsoever. In some cases, although the task is essentially legal, such as the completion of a standard letting contract, its completion can be delegated to a non-lawyer as long as sufficient guide rails and parameters as to flexibility are imposed.

Such tasks lend themselves to being moved out and may further involve the use of technology to either perform them to manage execution of the workflow by other actors – either human or machine. If technology is used to support completion of a task with a legal component by a non-lawyer, controls can be built in to prevent – in the lettings example above – the completion of a contract which is non-compliant.

Benefits of centralization
Other tasks which reside in Legal but require little or no legal expertise include project management, team coordination on cross-border engagements, and panel management. These services are often successfully provided by external advisors who combine the benefits of collaboration, quality, timeliness, efficiency, and economies of scale. Some providers have also developed a winning mix of off-shore resource for routine, high volume work with near- or on-shore staff providing an additional layer of client-handling, analysis and (potentially) legal advice.

When analyzing processes to establish the extent to which they are fit for moving out of the center, don’t limit this to those which can be transferred in their entirety. There is still considerable value to be secured, even if a piece of work starts or ends in the center, by having the non-lawyer cheaper resource completing “the bit in the middle”. This should also enhance quality assurance as it effectively introduces additional layers of review.

Cost, capability, consistency and control
To capture all the benefits of shared services and centers of excellence, it is important to understand that the model offers more than just labor cost arbitrage. The additional benefits are:

- Capability – some tasks must be done by qualified lawyers within the business, others could (within reason) be done anywhere by anyone
- Consistency – putting all of a particular task in one place and executing it according to a standardized process significantly reduces the risk of something going wrong when compared to different offices, teams or geographies doing it their way
- Control – the process owner doesn’t lose control just because it is executed elsewhere.
Nuances in the legal world
Most large organizations (including government departments) are benefiting from centers in some way. But it isn’t enough to say to Legal “if others can do it so can you”. It is important to overcome the natural concern that jobs will go, quality diminish, or discretion be lost. Moving non-technical work to another team frees lawyers – who value both their time and their expertise – to do more intellectually stimulating work which adds real strategic value as a partner to the business. And a well-managed off-shore team applies processes consistently whilst understanding when service level agreements (SLAs) and key performance indicators (KPIs) can be flexed to meet the needs of the business without compromising quality.

Amongst law firms this trend has focused less on disaggregating the legal and non-technical components of processes, but instead looking for ways for some tasks to be completed by lawyers who cost less. This has included the use of resources in satellite offices in lower cost regions away from the capital, or partnering with a smaller firm. Right-sourcing projects at a lower overall cost to the client whilst maintaining margins which are acceptable to the firms involved offers a win:win and a real competitive advantage. However, it requires grown-up behavior amongst all the parties. Trust, transparency and long-term relationships are key to incentivizing the right profit sharing and leveraging down.

In our experience the majority of companies are opting to take advantage of the centers of excellence and shared service centers of their suppliers rather than going through the significant change to their own Legal Operating Model involved in setting up a center of their own. But as the quality and sophistication of shared services models continues to evolve there is no reason why in future Legal shouldn’t benefit from the investment that other functions have made to shift some of their tasks or processes into already established centers.
The “Operational Transformation” model

Operational transformation involves a third party taking over running the legal function in its entirety. As a sourcing option, Operate is more talked about than implemented.

A challenge to execute
So what are the obstacles to the operate route? The first is completeness of offering: few professional services firms currently provide all the offerings they’ll be taking over which can create a nervousness around scope of practice. The second is geographical reach – while we talk about Legal in a way that implies a single, co-located team in practice the Legal function will be spread across multiple countries so that it can be both close to the business and have expertise in the relevant local laws and regulations. Consequently, for the firm which needs a sizeable global footprint that takes this Legal function over it is more like making multiple acquisitions than a single transaction. The third challenge is balancing risk and reward – in the first instance the firm needs to understand the risk profile of the work being done and then make sure that pricing and margins adequately reflect the level of risk. The fourth is evidence to support the business case.

Since there are so few examples of Operate being undertaken, there is little proof that the model is better than the status quo. The fifth is the mobilization challenge so that the transfer is seamless and doesn’t lead to discontinuity for the business.

One step at a time
Instead of a group-wide transfer of the whole of Legal, we are seeing more incremental moves in that direction with say a focus on particular competencies or geographical concentration. A group may decide to keep its core countries in-house and outsource the rest, or do this for a particular region. Whether the transformation of Legal is full Operate or only partial, to make a success of it the parties need to be very clear about what the services to be transferred consist of, who the people are that provide those services and what specifically they do, identify opportunities to drive efficiencies through systematization and automation, and make the risk sharing appropriate to the reward.
Barriers to change

In many organizations the main barrier to change is the perception that Legal is working fine as it is – don’t fix what isn’t broken. They also recognize that changing the model is a big piece of work – a year or more is not unrealistic – with a significant learning curve. It demands a strategic approach because piloting with a particular piece of work does not necessarily provide the right level of insight into how more wide-scale adoption might work. And because of the many complexities involved it is often very difficult to assess how much such a transformation will cost, although an initial three month project can eliminate some of this uncertainty.

Aspects of risk

There are also corporate and individual risks of change which include a loss of quality, reputational risk to the organization and to the individuals who have “pushed the button”, and the cost of failure. We sometimes encounter concern that changing trends or technical evolutions could make an investment today redundant in a few years. Assessing these risks and their impact on the wider organization is an important component of any business case for change.

If suppliers propose alternative sourcing models, this can be attractive from a cost perspective, but for “Rolls Royce” projects with high potential to impact the organization, Legal tend to be less cost-sensitive and opt for a solution which means they can sit in the same room as their external counsel with little or no notice which is not possible if the service has been near- or off-shored. There is also a recoverability risk in an area such as litigation if costs are centrally accumulated and then shared out. If the costs associated with a particular case cannot be identified with sufficient granularity it may be difficult to recover them from the other side.

For those running centers of excellence, a further challenge is that they are often staffed by people from across the world. If someone wants to continue working for the center, having returned to their home country this can create a permanent establishment risk for the employing organization.

Demonstrating quality

Some organizations are reluctant to outsource where there is a near- or off-shore element because of concerns as to quality arising from past experiences of dealing with off-shore centers. These can be overcome through effective project scoping and rigorous project management. For the larger engagements it may make sense for the provider to invite the prospective client to the outsource hub to see for themselves the levels of investment and professionalism which are the hallmarks of the best-in-class shared service center.
Contact

At Deloitte, we have a broad range of skills to assist you in refining and optimizing your current approach to sourcing and refining your legal operating model. We use multifunctional teams with expertise in Legal Operations, Risk Management, Technology and Change to equip your organization for the future.

Luis Fernando Guerra  
Deloitte Global Leader, Legal Services  
+34 91 514 5000  
luguerra@deloitte.es

Karina Mowbray  
Deloitte UK  
+44 20 7007 6573  
kamowbray@deloitte.co.uk

Christophe De Waele  
Deloitte Belgium  
+ 32 2 600 65 62  
cdewaele@deloitte.com

Deepinder Lamba  
Deloitte UK  
+44 20 7007 2689  
djamba@deloitte.co.uk

Matt Bullwinkel  
Deloitte US  
+ 1 704 887 1809  
mbullwinkel@deloitte.com
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