

STRATEGY & INNOVATION

Breakthrough Insight and Ideas for Driving Growth January-February 2004 | Volume 2 | Number 1

DISRUPTIVE THINKING

Disruption in the Service Sector

BY CLAYTON M. CHRISTENSEN AND
SCOTT D. ANTHONY

Disruption in legal services

Lawyers may be the punch line to innumerable jokes, but here is a fact that is not so funny: large law firms are just about the most profitable businesses in the world. The top 100 U.S. law firms maintain profit margins of just about 40%. That is more than three times as high as the operating margins of America's largest publicly traded companies.

A Washington, D.C.-based company called eLawForum has taken advantage of these trends to develop a business model that allows companies to get higher-quality legal services at lower prices. (See "Disruptive Force" in this issue for an interview with John Henry, eLawForum's founder and CEO.)

eLawForum acts as a matchmaker between companies seeking legal services and legal service providers. It works with a client to understand precisely what problems the company seeks to solve. It aggregates that company's legal work and solicits bids from providers identified as having the requisite skills to handle the company's particular problems. Legal providers bid in terms of fixed fees, not hourly rates. This disrupts the traditional legal business model based on billable hours and shifts risk from the company seeking legal services to the company providing legal services. eLawForum has referred dozens of cases and saved companies tens of millions of dollars.

The precise technologies eLawForum uses—the Internet, database software, and so on—are available to just about anyone. The unique way eLawForum has pieced technology together and the singular services it delivers are the underpinnings of its potentially disruptive business model, offering better performance at lower prices.

eLawForum has the potential to shake up the upper tier of the legal services industry. Many people think that firms in the service sector are somehow immune from the forces that affect firms that make tangible products. They point to highly specialized skill sets and the reliance on relationships as key factors that somehow make service businesses "different." Though these differences are legitimate, they do not change the fact that the forces that act upon service-sector businesses are the same forces that act upon all companies.

Clayton M. Christensen is Robert and Jane Cizik Professor of Business Administration at Harvard Business School and author of the best-selling *The Innovator's Dilemma: When New Technologies Cause Great Firms to Fail* (Harvard Business School Press, 1997). He is also the coauthor, with Michael E. Raynor, of *The Innovator's Solution: Creating and Sustaining Successful Growth* (Harvard Business School Press, 2003).

Scott D. Anthony is a partner at Innosight. They can be reached at innovation@hbsp.harvard.edu.

PROFILE

Disruptive Force

John Henry wants to obliterate the billable hour. Conventional law firms be warned: his company is already on your case.

John Henry is the founder and CEO of eLawForum, which is currently attempting to disrupt the legal services industry. The company aggregates the legal work of client corporations and brokers fixed-fee deals through competitions among leading law firms. Henry recently spoke with Scott D. Anthony, Strategy & Innovation's editor.

How is eLawForum transforming the legal services industry?

We are transforming the way legal services are priced and delivered. We replace sole sourcing with competitive sourcing. We replace the billable hour and cost-plus pricing with all-inclusive fixed fees and, at the same time, enhance quality and performance. We create a market that requires law firms to compete on the strength of their specialization and their acceptance of risk/reward compensation.

How do you do that?

We reverse the current fractionation of the corporate legal spend. Fortune 500 corporations typically allocate their legal budgets among hundreds of law firms. Aggregating demand for a fixed fee, with an incentive for sharing in cost reductions, changes the relationship between buyer and



Disruptive Force (continued)

seller. In the sole-source cost-plus model, the law firm, compensated by the hour, is rewarded for billing as many hours as possible. The law firm has no incentive to manage costs. We approach compensation from a completely different angle. When the law firm works efficiently, it makes more money. When the firm delivers better results, it makes even more money.

What role does specialization play in your market?

My wife had her knee rebuilt after a skiing injury. Her doctor has done 4,000 knee surgeries. His fixed price was \$5,000. What used to take my wife's specialist four hours, he now does in a little over an hour. One procedure, of course, can take longer than another, but that is a risk that medical specialists take into consideration in their up-front price. Medical problems are as complex as legal problems, but doctors give fixed prices and lawyers don't. Why?

The corporate legal market is just as specialized as medicine. A corporation wouldn't hire an employment lawyer to litigate its asbestos cases any more than you would get a knee specialist to do your heart surgery. Yet lawyers charge by the hour on the basis that every matter is unique and therefore unpredictable in the length of time to resolve. There are 12 billion unique knees out there, but with the right specialist, that uniqueness is reduced to patterns and is priced on a fixed-fee basis. That doesn't mean that the subject matter is less complex. What it means is that doctors price on the basis of commonalities, and lawyers have priced on the basis of differences.

How does eLawForum capitalize on specialization?

The best lawyers can't claim to be the best in their field and, in the same breath, profess an inability to estimate what their services should cost. If a law firm truly has the best specialists for the assignment, it should have the confidence to give a fixed fee. eLawForum makes this happen.

A fixed fee shifts risk from the corporation to the law firm. We work very hard to provide law firms with as much information as they need to assess the risk. That's what happens on Wall Street every day. Markets price the future based on the past. We do the same thing. We ask the best specialists, who have reduced complex problem solving to pattern recognition—they've seen thousands of similar situations—to look at all the information we provide them and come up with a fixed price.

What role does technology play?

Technology is a sine qua non, but it doesn't create our value proposition. We spent all of 1999 and a couple of million dollars building our Web site. You can't competitively source dozens of law firms with voice and paper. You must have highly specialized Internet software to transfer many

gigabytes of information rapidly so that both sides of the market can make decisions efficiently.

Our value proposition results from a combination of highly developed techniques. After we mastered the Web, we learned how to run first-rate quality competitions. Then we mastered fixed fees, a specialization in their own right. We created a new set of rules that are more sophisticated than those applicable to the billable hour. The next specialty is aggregation. We learned the best ways to increase the attractiveness of the deal for both parties.

What is the biggest challenge you have had to overcome?

To get a hearing on the merits. You must have access to general counsel. A sales force doesn't have standing at this level. Marketing is a waste of money.

What makes this culture such a challenge?

It is a special world. The lawyers who make it in the top law firms and the lawyers who end up being general counsel for the leading corporations are cut from the same cloth. General counsel come from these law firms and often return to them. Outside counsel are viewed as colleagues, not vendors. Law firms are adept at managing relationships. Lawyers like to follow precedent, and eLawForum is something new.

What changed that?

Our advisory board of retired general counsel help us get hearings. Five years ago, it was much harder to close than it is today. We had a different business model. It was a concept sell. Today we have a track record of spectacular success. If the decision is made on the merits, we close. We do everything we can to make our deals attractive to the corporation and the law firm. We take 100% of the risk that our deals close. The buyer pays us a percentage of the savings we generate.

Where do you go from here?

We just saved a client \$55 million in two deals. We reduced the legal service cost by two-thirds. That's hard to beat. Our challenge now is to do a thousand of these deals.

What advice would you give other would-be transformers in the service industry?

What Clayton Christensen calls "disruption" is complex problem solving of the highest order. Figure out what specialties you need to develop to build your business.

The best businesses change the world. Incremental change doesn't create much value. By changing the rules of the game, we unlock huge savings. Our problem creates our opportunity. Respect the culture, speak its language and dialects, observe its rituals, build relationships, specialize as much as possible, and convince clients that the future can be better if they make the changes you suggest in the way they do business. ✧

