

# The Importance of Porter's Five Forces

By Patrick Fuller

It's been more than thirty years since a young Harvard associate professor of Economics published his first *Harvard Business Review* article, "How Competitive Forces Shape Strategy." That single article has since led to multiple books and has completely redefined how organizations view and approach competitive strategy. And, as the market for legal services continues to grow in complexity, never before has this simple treatise been more relevant to the legal profession.

The Five Forces consist of the Bargaining Power of Suppliers, the Bargaining Power of Buyers, the Threat of New Entrants, and the Threat of Substitute Products & Services, all which surround the most powerful force, which is the Rivalry Amongst Existing Competitors. In the years since the article was first published, the propensity for all five forces to simultaneously impact the legal profession has not happened, until now.

The first market force is the bargaining power of suppliers. While this means different things to different industries, for the legal profession, supply is all about talent. In the last three years, the legal industry has seen a growing surplus of talent, leading to lower-cost associates, staff, and contract lawyers, enabling more adaptive firms' greater opportunities to introduce alternative fee arrangements. This provides greater efficiency and predictability for the client and profitability for the firm. At the same time, the competition for talent amongst lawyers with established books of business has never been stronger, leading to rising lateral recruiting costs and increased risk relative to the portability of client relationships.

The second market force is the bargaining power of buyers, and this is where the greatest power is being leveraged. While many in the industry will rightfully point to the ACC "Value Challenge," or the increased involvement of procurement departments in the hiring of outside counsel, or just overall price sensitivity, I believe there are two under-the-radar changes which have unleashed a great deal of transformation in the legal

profession. First, the increasing number of corporate legal departments which are not outsourcing large amounts of legal work to outside counsel, deciding instead to leverage the oversupply of legal talent in the market to staff their own departments in a much more cost-efficient manner. For many firms, this can be a very uncomfortable scenario, when the client is also the competitor. Second, about five years ago, many buyers of legal services stopped paying for research charges firms typically passed on to their clients, on top of hourly rates. For many firms, this change immediately resulted in millions of dollars of added cost, making a sudden and intense impact on profitability.

The third market force is the threat of new entrants, and this can be applied in a variety of ways. For the last decade, technology has been leveling the playing field between mid-size firms and larger firms, creating an additional layer of competition that also distributes market forces to the rivalry amongst existing competitors. Mid-size firms are posing a threat to larger firms largely because the perceived value derived from mid-size firms is being seen as equal to, if not greater than, larger firms in the eyes of many buyers. Additionally, an increasing number of international firms are making growth in the U.S. a strategic initiative, which is creating greater complexity in markets and sectors traditionally dominated by U.S.-based firms.

The fourth market force is the threat of substitutes, and like the threat of new entrants, this market force continues to exert increasing leverage in the market. Legal Process Outsourcing (LPO) and the Legal Services Act are the primary drivers of this market force. More and more companies are utilizing LPO as an alternative to both growing their in-house staff and handling work internally, as well as an alternative to some legal work that has traditionally been handled by outside counsel.



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The final market force, the hub from which the other market forces extend, is still the most powerful for the legal profession, and that's the rivalry amongst existing competitors. While the explosion in mergers over recent years has eliminated some historic rivalries, the market forces discussed earlier, specifically the threat of new entrants, the war for lateral talent, and the bargaining powers of buyers, all provide additional complexity to the rivalry amongst existing competitors. Firms continue to compete against each other for existing demand, creating commodity offerings with little differentiation, leading to increased buyer power. Unfortunately for the firms, as more legal work continues to be kept in-house or handled by LPO, the competition amongst firms will continue to intensify.

Moving forward, firms need to combat these five forces by uncovering, creating, and eventually capturing new demand. The differentiation firms seek to establish may not be in new products, so to speak, but in new service models that create separation from rivals and provide the uncontested market space necessary to limit the impact of Porter's Five Forces on their operational strategy.

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