

The Five Levels of Strategy



By Rob Millard

MUCH HAS BEEN written about how conventional models of strategic planning fail to achieve what is needed in today's rapidly changing world. It is obviously still critical to have a clear sense of direction and to know what the firm needs to do to ensure its ongoing competitiveness and profitability, but it is no longer enough for that to take the form only of a static 'strategic plan.' In a global survey of strategy in professional service firms conducted by the Managing Partners' Forum in August 2007, 40% of North American firm leaders reported that they had managed to execute less of their firm's strategy than they would have liked, *given changing circumstances*. A 2006 survey by Edge International revealed an even higher (significantly higher)

incidence of strategy failure amongst North American law firms. Furthermore, according to research conducted by several other major organizations including a recent study by McKinsey & Co (Dye and Sibony, 2007) this trend is by no means limited to the legal profession.

A wide range of pressures exist today, many of which are completely new, that are inexorably driving up both the rate and intensity of change in the professions. Clearly, a new way of thinking about strategy is required.

Pressures on Profitability

According to Dan DiPietro of Citibank (DiPietro, 2007,) growth in law firm profitability over the past five years has been almost solely attributable to the ability of law firms to escalate their rates at more than the inflation rate.

The other three key drivers of law firm profitability in the "profits per partner" equation (Maister, 1997- see figure 1 below) have not fared so well:

Utilization (i.e. total number of hours worked by fee earners) has remained level over the past five years (at a brutally punishing rate in some firms) and in fact associate utilization has dipped slightly since the late 1990s.

Margin (i.e. fees minus overheads, divided by fees) is under pressure, not only from normal inflationary pressures but more so from demand-supply driven increases to associate salaries and, to a lesser extent, non-legal management professionals too.

Leverage (i.e. the number of non-partners or equivalent divided by the

$$\begin{aligned} \text{Profits per Partner} &= \text{Rate} \times \text{Utilization} \times \text{Margin} \times \text{Leverage} \\ &= \frac{\text{Fees}}{\text{Hours}} \times \frac{\text{Hours}}{\text{People}} \times \frac{\text{Profit}}{\text{Fees}} \times \frac{\text{People}}{\text{Partners}} \end{aligned}$$

Fig.1: The formula for profits per partner (Maister, 1997)

number of partners) has also remained more or less constant.

How sustainable is a business model that relies solely on driving up the rate that one charges clients, when those same clients are under increasing economic pressure to cut their own operating costs? The answer is provided by the Managing Partners Forum strategy survey, where firm leaders reported that increasing client demands, downward pressure on fees and the difficulty of balancing long-term growth with short-term

profitability tied for first place as the most important strategic issues that they face today.

Globalization, Talent and Technology

Indian law schools now produce roughly the same number of graduates as those in the USA, but they start work with a salary of about \$8,000 per annum. Even if this rate doubles and quadruples as outsourced workflows to India and similar jurisdictions increase, it will still be significantly less than in western commercial law firms.

Supply and demand dictates: the stream of work being outsourced to emerging markets will increase dramatically as the talent pool increases in those markets and clients become aware of the potential for significant cost reductions. The technology to transmit large amounts of data and deliver competitive results already exists. Some firms will view this reality as a threat; others will view it as an opportunity and will seek to exploit outsourcing opportunities before their competitors do, so growing market share.

Thomas Friedman wrote in his book "The World is Flat" (Friedman, 2006) of the emerging 'perfect storm' of three interlocking drivers that will reshape the world in the 21st Century. These are:

- Technology that has the reach, the bandwidth and the computational power to enable business to be conducted real-time on a global basis
- Young people entering the market who grew up with a far wider range of collaborative and other technology than any previous generation and who are completely at ease with this new technology
- The entry of new countries into the global knowledge economy (largely driven by the technology, especially the internet)

Law firms are not immune to these drivers. In fact, their business models seem to be set to undergo an even greater metamorphosis over the next few years as protectionist structures (especially the prohibition of ownership of law firms by non-lawyers and international barriers to practice) fall away.

The environment that gave rise to the 'tournament of lawyers' model (Galanter and Palay, 1994) of associates toiling away for low pay in return for the promise of the utopia of partnership has all but disappeared. Today, the number of associates at the largest 250 commercial law firms in the United States has increased by 76% over the past decade, but the number of law school graduates has only increased by 7% (MacEwen, 2007.) Many of those graduates choose careers other than private practice. Of those that do enter the commercial firms, most defect within five years. A compensation

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frenzy has ensued. Newly minted attorneys in large commercial law firms may now earn more than mid-level managers with more than a decade experience, in their clients' organizations. The gap between compensation amongst these top commercial firms and the rest of the legal profession, where compensation has barely kept up with inflation (see figure 2) and other professions has also widened dramatically in recent years (NALP, 2007.) Whether this trend continues or not will depend largely on:

- Whether US law firms increase enrolment to increase the supply of entry level graduates suitable for employment in major commercial law firms;
- The inherent growth in the US of demand for sophisticated commercial legal services;
- The degree to which clients move towards outsourcing these sophisticated commercial legal services to less

expensive jurisdictions.

At the top end of the professional pyramid, firms are also having to scramble for alternative models to accommodate reduced partnership opportunities to preserve gearing (at least partly to dance the “profits per equity partner” tune for the published rankings) while battling to retain senior talent.

In the United Kingdom, the Legal Services Bill is poised to usher in a whole new era where ownership of law firms is not restricted to solicitors.

This raises all sorts of possibilities for external equity funding and even public ownership. Professor Stephen Mayson of the Nottingham Law School in England has predicted that over 3000 British law firms may go out of business in the next few years (Byrne, 2007) because they will not be able to evolve to adapt successfully to the new circumstances.

Age discrimination has also been outlawed so mandatory retirement ages are now illegal in the United Kingdom.

In Australia the world's first publicly owned law firm, Slater & Gordon,

listed on the Australian Stock Exchange in May 2007. In India, changes to the legislation prohibiting foreign law firms from opening offices and foreign lawyers practicing law in that country are imminent. In China, the number of international law firms operating in that market is steadily increasing as new and innovative ways are found by western firms to circumvent the restrictive trade practices there.

A New Way of Thinking About Strategy

It is clear that the rate of change in the market is accelerating rapidly. Never before has it been more critical for firms to have a clear vision of where they are going, coupled with what we in Edge International call the ‘**dynamic resilience**’ to successfully adapt and to absorb whatever the market throws at them!

To develop processes and structures to provide the continuous stream of strategic information that decision makers need in order to craft the best possible strategy for their firms; to ensure that strategy is actually executed. Simply put: to “*get good at*” strategy!

Yet the Managing Partners' Forum survey also revealed that most law firms only use the most rudimentary of analytical and other strategic tools when crafting strategy, and few of the most important kinds of strategic information. Clearly, there is scope for crafting better strategy, and so to create more competitive firms, simply by correcting this!

Viewing strategy as having five distinct levels can help to provide a framework for firms to think through how they should go about strategy differently:

Level 1: Conceptual strategy

In the older strategic planning models, this level took the form of a “Vision” or “Mission Statement” which contained the firm's overall strategic objectives.

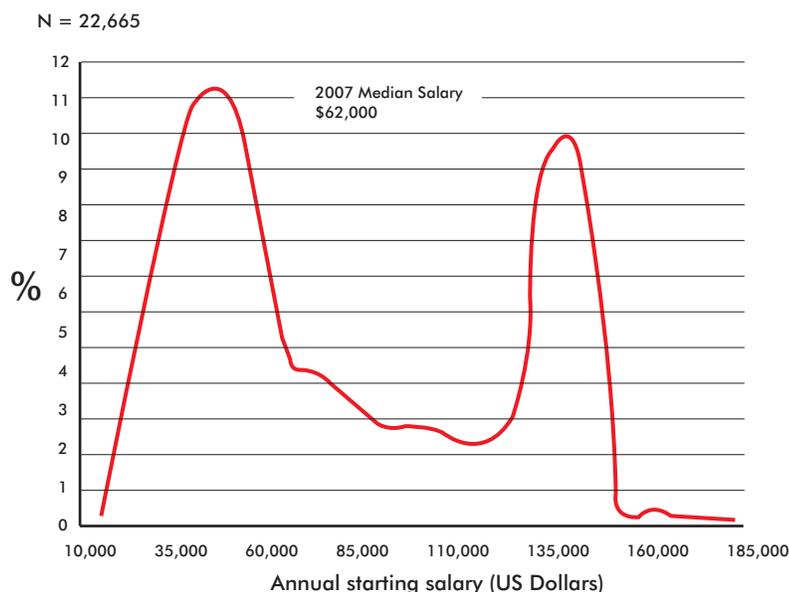


Fig. 2: Distribution of Full-Time Salaries in the US legal profession. The graph is based on 22,665 salaries. A few salaries over \$200,000 are excluded for clarity. The two gaps clearly show the widening gap between starting salaries for associates in the commercial law firms (the peak on the right) and other forms of legal practice (the peak on the left) (NALP, 2007.)

Never before has it been more critical for firms to have a clear vision of where they are going, coupled with the foresight, agility and what we in Edge International call 'dynamic resilience' to react to whatever the market chooses to throw at them as they make their way in that direction.

These documents were usually too generic to be of any use for proper planning, though, consisting as they did of abbreviated platitudes about client service, attracting and retaining talent, being a great place to work and delivering superior financial performance. Our approach to this level of strategy borrows current mission planning doctrine from the US Air Force.

It involves the crafting of a narrative that is:

Clear and unambiguous (so that

the firm's strategic intent is clear to all.)

Compelling (so that it captures the imagination and 'sticks in the mind' of those working in the firm.)

High Resolution (so that each person in the firm can make the document relevant to his or her specific level and function in the firm.)

Modular (so that it can be easily changed when circumstances dictate.)

This narrative richly defines the "desired future state" that the owners of the firm wish to achieve,

typically over a three to five year time frame. This is achieved through a process of considering the strategic options and issues facing the firm, testing owner and sometimes employee perceptions regarding these in a survey, and finally facilitating a two day retreat to consider the results and, together, to craft that "desired future state."

If the strategic issues that emerge are particularly complex, technological options exist to broaden the process into a (secure) online discussion, using sophisticated enterprise blogging technology, over several days, prior to the retreat. This has the wider advantage of opening the process to a far greater number of people in the firm, without their having to leave their desks (or their client work.) In Edge International, we call this approach "brainstorming," using the analogy of a beehive, where bees communicate and cooperate in highly constructive ways without central control. The proceedings of the online discussion are moderated and can be reduced to a written document that is distributed to the firm's owners for study prior to the retreat.

The "desired future state" document becomes an overarching guideline, governing everyday business activity in the firm and also outlining the key strategic issues that need to be addressed. When decisions need to be made, this document provides context to inform which alternative is more closely aligned with the firm's strategy. The narrative is usually about five pages in length and is a "living" document that should be formally revisited; we suggest at least every six months or so.

Where two or more mutually exclusive 'desired future states' emerge from the discussions, further facilitated debate or investigation is usually required to achieve consensus.

Level 2: Actualizing Strategy

This level of strategy is about moving the firm from its current state, to the



Fig. 4: The Five Levels of Strategy discussed in this article

desired future state. In other words: execution or implementation. In the older models of strategy, this took the form of a strategic plan that was a static and comprehensive description of the route that the firm must travel.

Instead, our approach is to focus on immediate, short-term action. We help the firm sketch out in generic terms what needs to be done to achieve its desired future state, and then we move immediately to defining a number of strategic projects that the firm can commence immediately in order to move in that direction. This represents a substantial shift away from the old fashioned notion of strategic ‘grand plans’ to small, achievable and controllable action steps.

We recommend a strong project management approach. Project milestones, responsibilities and resources required are identified, documented and allocated. Each project is broken down into its constituent actions and measures are considered to ensure successful execution.

To draw the military analogy again, these strategic projects are similar in concept to the individual “missions” that are executed by subordinate commands (e.g. fighter squadrons) to achieve the overall commander’s military strategy or desired future state. In terms of process, the first tranche of projects are usually agreed and documented at the retreat described under Level 1.

Once a strategic project is concluded, the firm reviews it for ‘lessons learnt’ and then moves on to the next project.

As with Level 1, “*getting good at*” Level 2 strategy is largely a matter of understanding what the concept well, deciding to adopt it and then constructing the systems and structures to enable it. If the firm lacks adequate action orientation in its culture for such an overt project management approach, in which case an intervention can be designed to proactively evolve

the firm’s culture to improve action orientation. This would, in itself, be a project too. Alignment of systems such as performance measurement and perhaps even compensation may also be projects that are required.

So far as is sensibly possible, we recommend ‘ring-fencing’ individual projects by defining each separately and allocating separate “buck-stops-here” responsibilities, resources and performance metrics. Ring-fencing is a powerful tool to promote accountability and to ensure that action and resources are focused on the most important areas.

Level 3: Situational Strategy

This is the level at which the firm focuses its efforts of developing **dynamic resilience**. There are two aspects to this:

Competitive Intelligence

The first aspect is developing a competitive intelligence capability (sometimes also called a business or market intelligence capability) to track key variables in the market; to consider their implications; and to develop short term strategic shifts when appropriate to address changes in these variables. Such variables may include the following:

- Client satisfaction levels
- Macro-economic environment
- Employee satisfaction
- Actions by key competitors
- Changes in the industries of key clients

The faster one can identify a change in the market; craft a strategy to address it; and execute that strategy in the firm, the greater the possibility of sustained competitive advantage that is greater

than one’s competitors. We recommend that careful thought be given to identifying a small number of the most important key metrics that the firm needs to track in order to know what is going on inside the firm and outside in the market, and then develops specific protocols to track these by:

- Collecting data on specific key market issues
- Collating the data, making sense of it and interpreting it for useful conclusions
- Converting the resulting intelligence into the format that is most useful for decision makers in the firm, and
- Communicating this intelligence to those decision makers.

This competitive intelligence cycle is illustrated in Figure 4. The intelligence

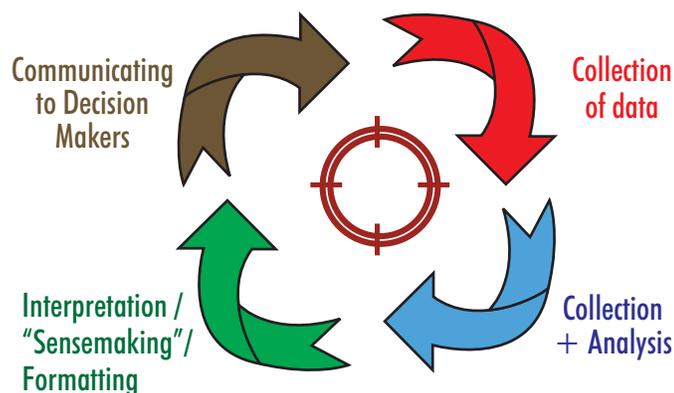


Fig. 3: The Competitive Intelligence cycle

feeds back into the strategic decision making processes that drive changes to Level 2 and Level 1 strategy.

Organizational Fitness: The second aspect is the firm’s Level 3 strategy to develop a higher level of ‘organizational fitness’ in order, firstly, to be able to execute its Level 2 strategic projects but also, secondly, to be able to respond to a range of market conditions and also unexpected events as they occur. This involves attention to accumulation and development of

resources (financial, human, technological, systemic etc) and **skills** (business development, skills transfer, client relationship development, knowledge sharing etc.) The process involves determining what level of each would be required to address a range of “what-if” scenarios (loss of a key fee earner or client; major change with a client, change in the macro socio-economic environment in one of the firm’s markets; becoming aware of a potential lateral hiring opportunity, etc.)

The deliverable at this level would be a skills and resource inventory, plus development of a strategy to bridge identified gaps and in some cases even to execute the skills training involved. (Edge International is one of the world leaders in highly sophisticated, experiential skills development for professional service firms, especially in the area of client relationship building, dealing with conflict and business development skills through a well-proven program called *Rainmaking*.)

Tying organizational fitness directly back to strategy ensures that effort and investment is focused on executing that strategy and that time and money is not wasted on development issues that are peripheral (or even contrary) to the firm’s strategy.

Level 4: Generative Strategy

Once the first three levels of strategy are in place, the firm can turn its attention to developing its ability to innovate; to constantly reinvent its services and service delivery mechanisms. Innovation is linked to culture but this is so obvious that it is as inane to simply state that, as it is to state that obesity is linked to eating too much. The question really is: what strategy does the firm need to adopt in order to foster innovation and to keep innovation focused on issues that are strategically central?

Formal and informal research over decades leads to the inescapable

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conclusion that the process of innovation, when it has worked well, has been largely unplanned, informal and even illicit. Lockheed Martin’s “skunkworks,” that were informal groups of individuals working on the fringes to develop solutions to problems without mainstream managerial control or even approval, are a good example. It is this very messiness that dictates against acceptance in professions where neatness and accuracy are prized, though. On the other hand, advances in social networking technology now create opportunities for mechanisms to allow such informal groups to operate within firms, inexpensively and informally, without interfering with the day-to-day practice of the firm. These create virtual layers at which people in the firm can share knowledge and collaborate without interfering with the formal structures and systems in place.

Level 5: Meta-Strategy

This, in essence, is what this article is all about. Meta-strategy is the firm’s “strategy about its strategy.” It transposes all four other levels. The point of meta-strategy? In a hypercompetitive environment, it is critically important for a firm to understand exactly what it is doing in

order to craft and execute good strategy. Just as every firm is different intrinsically, so ideally should be its approach to strategy.

Meta-strategy includes answering the following questions (for instance) about the strategy process itself:

- How is the firm’s desired future state to be defined and, as necessary, amended?
- Who holds strategic decision-making authority and what are the boundaries of that authority? To what extent and how is this delegated down into the firm?
- What critical areas does the firm’s leadership need current and accurate information on at all times and what processes are required to provide that?
- Of the wide array available, what specific tools to analyze data and drive strategy does the firm prefer?
- How alignment is to be reached between strategy and shorter-term priorities?
- What ‘brutal truths’ need to be faced?
- How would one define the firm’s strategic philosophy?
- Is the firm primarily externally competitive, constantly measuring itself against its competitors, or whether the competitiveness is focused inwardly on continual self-improvement? Is the dominant culture or mindset of the firm that of a “hunter,” or that of a “farmer?”
- Is the primary focus the maximization of short-term profit or long-term growth?
- Is the firm focused primarily externally on client need, or internally on the aspirations of the firm’s owners?

Within limits, there is no right or wrong answer to any of the above and the reality is usually somewhere in between but with a bias in one

direction. Understanding and accepting (or changing) how that bias is orientated creates considerably greater organizational self-awareness, though, and so more congruent strategy!

Concluding Remarks

Designing a robust and sensible strategy process is one of the most urgent and valuable things that any firm needs to do today. Strategy is simply too important and too complex to be approached on an 'ad hoc' basis any longer. Doing so risks losing what assurances are possible that the firm will remain competitive and optimally profitable as the world changes around it. To sum up: the key is to craft a carefully considered process that is a dynamic framework comprising:

- A clear desired future-state (Level 1)
- A series of carefully considered strategic projects over time to drive execution (Level 2)
- Carefully focused competitive intelligence to forewarn decision makers when a change of course or speed is required, coupled with the development of the resources and skills (i.e. organizational fitness) to be able to be dynamically resilient under a range of possible futures (Level 3)
- Initiatives to foster innovation and emergent new ideas, coupled with quickly identifying the good ones so that they can be developed further and the best of them actually translated into action (Level 4)
- Careful selection and fine-tuning of the strategy processes, tools and data sources that make the most sense for your own firm's particular circumstances (Level 5.)

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