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# Why Bigger Can Be Better

Legal spending doesn't have to break the bank when companies grow.

By Rees W. Morrison

Does size really matter? In other words, as a company grows, does legal spending grow at the same rate as the company? Or does more revenue mean more efficiency inside the law department and with its outside counsel?

Most general counsel think, erroneously, that total legal spending as a percentage of revenue increases as a company grows larger. It makes sense, they would say, for their spending on inside lawyers, staff, and other needs, plus on outside service providers—all of which is referred to as "total legal spend"—to expand as companies grow.

Management Matters

If asked why legal costs rise with corporate size, general counsel would probably rattle off several plausible reasons: Bigger companies run into antitrust issues, tend to make larger and thus more legally complex acquisitions, make new law on the frontiers of business as they push for growth, get sued more because they have high profiles and deep pockets, face more securities law issues, and have more sprawling operations and larger numbers of employees. Indeed, in absolute terms, larger companies spend more on their internal legal staff and on outside counsel than do smaller ones.

Even so, when you correct for the revenue growth of companies, the assumption is wrong. Bigger companies spend more money overall on legal staff and outside counsel—but not in relation to their revenue. That is, the first step in evaluating comparative legal spending is to normalize the data by dividing corporate total legal spending by annual turnover. When you do so with a group of companies, you will see that inside and outside legal spending together consume less and less of company revenue as companies grow larger. As compared with smaller companies in the same industries, larger companies enjoy what are called economies of scale.

It's useful to understand why legal spending shrinks in proportion to company size as companies expand. Those who grasp this principle benefit in several situations.

As general counsel, you can calibrate your metrics against available benchmark metrics. Say you read that median total legal spending as a percentage of revenue is typically around 0.5 percent. If you know the size of the law department in the study, you can adjust your figure in light of your company's size and thereby have a more accurate comparison.

When you argue for more head count and thus presumably larger legal spend, you are on firmer ground when you understand and can explain that the revenue the company expects to bring in will more than compensate for the investment in legal resources. The decline with growth sheds light on the ways legal spending often precedes revenue growth.

When you understand why economies of scale are present, why bigger is better in terms of declining aggregate legal spend, you can target more effectively some steps to trim costs. Here are some of the tools and techniques general counsel can adopt to save money. For example, you could streamline the work that comes into the department and assign it more effectively. You can plan better for a merger of new lawyers into your law department, which leads to cost savings. We see these savings as companies merge, where the resulting company benefits from increased efficiency as two legal departments merge into one that is smaller than the combined departments before the merger.

We know about the decline in spending (as normalized for revenue) from data, but no one has teased out precisely which reasons account for the decline. Based on my two decades of consulting to law departments, I offer a dozen or so reasons why revenue growth begets relatively smaller legal budgets. I have grouped the reasons into three categories: internal, outside counsel, and external.

## Internal

Differences in the people in larger law departments account for a large measure of the increased efficiency of sizable companies. (Note that law department size generally correlates well with company size. Thus, bigger companies almost always have bigger law departments, although the ratio between lawyers and nonlawyers stays quite consistently around the 1-to-1 mark.)

Larger companies have more predictable streams of similar work, so those who do the work, both lawyers and paralegals, become more expert. With volume, it is more possible and likely that the law department develops some semblance of process and consistency. For example, the department may develop guidelines for how to register a trademark.

More work of a similar kind encourages a greater degree of specialization among lawyers than is possible in a smaller company, whose lawyers tend more to be generalists.

It might also be that bigger companies staff their law departments with older, more experienced lawyers than do their smaller competitors. They can do so because they can afford to pay market rates, sprinkle in good benefits, offer attractive equity packages, and keep lawyers longer.

Another reason bigger companies enjoy economies of scale in terms of their legal spend is that managers in the law department can be more flexible and precise in work assignments, which promotes division of labor and delegation. Stated differently, managers can assign work that better matches a person's skills and costs.

Staying within a company but turning to the client side, it seems likely that bigger companies, with better-staffed law departments, can train their clients more carefully about legal issues and how to avoid them. Additionally, mature companies (to the extent that they are larger because they have been around longer) tend to have more experienced and careful clients. If a company has revenue of $500 million and only two or three lawyers, it may be relatively youthful, with less of a track record for how to act and less accumulated knowledge among its business managers about how to avoid legal issues. Its $4 billion competitor has been around longer, its managers know the ropes, and therefore the firm spends relatively less for legal matters.

Bigger companies can invest more in internal hardware and software and also enjoy better technology infrastructure and support. They can even afford to develop some customized software, such as Microsoft has done to assess patent portfolios and Cisco has done to handle document discovery. Bigger companies have IT help desks. Smaller companies, and their legal teams, need IT help.

Partly as a result of their people, clients, and resources being more effectively deployed, larger law departments spend more time, attention, and money on process improvements, knowledge management, and software development and licenses. For example, larger law departments spend more on consultants.

## Outside Counsel

Turn now to outside counsel for some other reasons why bigger companies, somewhat counterintuitively, pay a smaller portion of their revenue for legal costs. As a broad statement, prestigious clients can command the services of better law firms. If you compare the Fortune 500 clients and the primary law firms they use, you will find that pre-eminent companies bond with pre-eminent law firms. Further, in my experience, prestige clients are able to attract to their matters more capable partners and lawyers within those good firms and keep them longer.

Oddly, even though big companies hire big, and thus expensive, law firms, the companies have the volume of work, the quality of legal challenges, and the negotiating clout to extract better billing terms from their law firms. For instance, a huge company can mandate fee discounts and make them stick. Or it can insist that firms bid competitively to handle a large block of work on a fixed fee; a smaller company can't amass enough work of a similar nature to justify a fixed-fee arrangement.

## External

In addition to the reasons discussed above, three other reasons may account for some of the steady decline as size increases of total legal spending as a percent of revenue.

The larger the company, the more it has the wherewithal to settle costly lawsuits, because it has deeper pockets, and thus it can lower its outside counsel bills. Not that I think total legal spending falls because settlement dollars rise, by the way. Data are not available to prove that the decline holds true even if we include settlement amounts, but some scattered findings from my consulting projects suggest that this broader application of the principle is true.

It may also be that the big boys legally intimidate smaller companies or that they more successfully or quickly impose resolutions that don't involve legal costs that are as expensive. With more bargaining muscle, bigger companies may curtail legal costs as they enter into alliances or licensing agreements or simply overmatch a competitor. Possibly, too, big companies have more lobbying clout to shape laws and regulations in their favor than do their smaller brethren.

For all of these reasons, total legal spending in terms of a percentage of a company's revenue slopes downward as the company's revenue increases. Any single reason may contribute to this process, but the combination of reasons may increase the advantage. For instance, if more capable and experienced inside lawyers team up with cream-of-the-crop outside counsel, the results—and cost efficiencies—may well be more than simply cumulative.

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