

Seeing the LPO Forest for the Trees: A Report on the Legal Process Outsourcing (LPO) Industry



The Legal Forest LPO report is the only objective and realistic information source on the legal outsourcing industry available. The authors understand both the US legal industry and the Indian outsourcing industry from an insider perspective, and their opinions are free from the usual hyperbole. Anyone seeking to use LPO services or invest in this industry would do well to read this report and take Legal Forest’s advice.

— Alok Aggarwal, Founder and Chairman of Evalueserve

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Legal Forest is a legal-industry consulting group focused on law firm and law department operations, management and outsourcing.

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1 PREFACE

Report Format

Welcome to the spring 2011 edition of **Seeing the LPO Forest for the Trees: A Report on the Legal Process Outsourcing (LPO) Industry**. For indexing and searching purposes, the report is contained in one .pdf document. For printing purposes, it may be useful to print the report in two parts, the substantive portion of the report (pp. 1-86), which includes the body and Appendices A-C, and the directory portion of the report (pp. 87-end), Appendices D-E.

A Note to Domain Outsiders (e.g., Investors, Market Analysts)

We would like to start off with a note to prospective investors in legal outsourcing industry. This report is written primarily with potential consumers of LPO services, e.g., lawyers at corporations and law firms, as the target audience. This does not mean that the information of this report is not relevant to investors, in fact we think it is highly relevant. Reading this report will give you an extremely important market perspective, that is, insight into the psyche of the lawyers and law organizations who will be the clients of any LPO company. You might, at times, be surprised at how rudimentary this report is in terms of explaining basic strategic and operational concepts to its audience. This should be your first hint as how difficult the legal industry will be to consolidate and operationalize, given that the members that control its practices practice their craft in an environment in which they do not have to understand such concepts.

This might lead you to think that such an industry will be fairly easy to change to, due to its lack of efficiency. While, in an overarching sense, this may be true, we believe it will takes decades, not mere years, for most of these practices to start breaking down. Remember also that the members of the industry enjoy monopoly protection rules, some of can be enforced by criminal sanctions. The legal industry is as resistant to change as the medical industry is, except that it is less amenable to technological transformation, the standards and results of the field are less measurably objective (it is very difficult to evaluate the quality of a contract or patent at the time of its drafting, much less evaluate the efficiency of its production) and there is less moral charge to reforming such a system in that it is

not as important to society as medicine is.

If you have trouble understanding the relevance of some of the discussion in this report aimed specifically at lawyers, you can jump ahead to the conclusion, which summarize some of these issues for the investment-minded audience. To start with, note that \$10M is a milestone figure in the LPO industry. For it is only by 2009/2010 that a few companies, such as Mindcrest, Pangea3, Integreon, CPA Global and United Lex starting reaching this rather low threshold of revenue. Of course, large outsourcing players such as Integreon have non-LPO revenues far in excess of \$10M, but it has only achieved \$10M in LPO work recently. At the same time, until 2010 there had been no liquidity event in the LPO industry above \$10M (Intellevate's sale to CPA in 2005 being the largest event before 2010).

In late 2010, Pangea3 was acquired by Thomson Reuters for less than \$40M, according to the press.¹ Our insider sources indicate that this figure is relatively accurate. Given that Pangea3 had venture capital investment several years earlier (2006 \$4M Series B, 2007 \$7M Series C), the \$40M exit hardly represents a success liquidity event— a small return for the investors and perhaps nothing for the entrepreneurs and ESO holders. Pangea3 represents at best an infield single by venture capital standards (no run, if we want to use cricket as a metaphor instead of baseball).

By contrast, the business process outsourcing (BPO) industry has seen its share of nine-figure and billion dollar liquidity events, which is why people are so excited to paint LPO as a continuation of BPO. It is not. Pangea3 is the largest success story in the history of LPO at \$40M. What does this indicate about the future of LPO, at least from the point of view of venture investors? We do predict that the company United Lex may see a liquidity event in the next few years that may sneak into nine figures. This would be by far the largest liquidity event in the industry, and yet even this would be a very modest success by venture capital standards.

By the time you reach the end of this report, we think you will agree that while LPO will continue to grow and eventually become an important component of legal services, there will be no revenue hockey stick anytime in the near future. We

¹ www.business-standard.com/india/news/thomson-reuters-to-acquire-lpo-firm-pangea3/415460.

can't discount a hockey stick some decade or more down the road when a truly transformational set of unforeseen circumstances arises, but for now, the growth curve for the foreseeable will not be a hockey stick, but something else (and we don't have a visual metaphor for that something else because in venture capital, the hockey stick is all that is relevant).

Note that in the past few years there has been two notable private equity investments in the LPO Universe, namely Intermediate Capital Group's £440m investment in CPA Global ² and Actis's \$50m investment in Integreon, but of course, these do not represent liquidity events for the investors.³

A Note to Attorneys and Legal Domain Experts

Business people like to think of themselves as rational, number-crunching machines, relentlessly creating and seeking out new and better modes of revenue and profit. In reality, of course, the business world is just as susceptible to voguish trends, buzzwords and hype as any other milieu. Among the hottest business buzzwords in the early 21st century are globalization, 24/7, virtual corporations and outsourcing. The legal industry, perhaps a little behind the times, has, only in the past few years, seen a proliferation of LPO providers, the vast majority in India or with an Indian presence, claiming that significant operational benefits and cost savings can be realized by outsourcing one function or another.

The reason that Legal Forest sees outsourcing in the legal industry as more of a trendy topic than a finely-honed business tool is that the LPO industry as a whole is still in a validation stage. In time, over the course of the next couple of decades (rather than the next few years, as many LPO industry proponents would assert), outsourcing will become a widely-used and rational part of the legal industry. But as of now, too little data has accrued to determine with any certainty just which legal operations can be effectively outsourced, and exactly how to implement such outsourcing. Therefore, the benefits of being an early mover need to be carefully weighed against the associated risks and costs.

² www.altassets.com/private-equity-news/article/nz17801.html.

³ www.prnewswire.com/news-releases/actis-invests-us50-million-in-integreon-84461422.html.

This Legal Forest LPO industry report is the only report we are aware of which has been written by individuals with actual operational experience in the LPO industry, rather than being written by research analysts. The authors have had multiple, extensive meetings with management at many of the major LPO providers, and have visited multiple facilities. Some other distinguishing qualities of this report:

- Written by authors with legitimate US legal experience (Silicon Valley high-technology law)
- Contains sections on legal ethics, unauthorized practice of law and export controls
- Includes discussion of outsourcing geographies other than India
- Intended for potential consumers of LPO services (Western law firms and law departments) as the main audience

A few years ago, proponents of the LPO industry pointed to the few venture capital and private equity financing events in the industry, such as the 2007 \$7M Series C funding of Pangea3 by Sequoia Capital, as a sign of its legitimacy. However, in that same year, the LPO operation NeoWorth shuttered its doors, even as it was named one of the top 10 LPO providers in the Brown Wilson Group annual Black Book of Outsourcing. Similarly, in 2008, a top 10 provider in that year's Brown Wilson ranking, iDiligence, also shut down as the list was released. In 2009, Oxirient was named a top 20 LPO, and also closed.

The awarding of such top industry ranking to non-viable LPO operations obviously does not reflect well on the industry, and is particularly concerning for one that values stability and precedent as much as the law does (please see the Chapter 9 Conclusion, as well as Appendix D for further discussion of the Brown Wilson rankings). Some LPO industry analysts believe that the industry has matured significantly in the past few years, with more legitimate service providers now dominating the scene. We disagree. In the past few years we have seen the number of LPO operations in India expand from a mere handful to over a hundred, and this Cambrian explosion of LPO providers represents a lot of noise to the potential consumer. A Darwinian shakeout in the industry will indeed occur—we just haven't seen it yet.

Perhaps you, as a lawyer or other member of the legal industry, might think this is somewhat interesting, but not at all useful, as you'd immediately recognize a

shoddy operation when you saw it. Note, however, that we have seen a number of Western corporations and law firms spend an inordinate amount of time and money vetting such providers before ultimately dismissing one after the other. This may be partly because it is difficult, in this day and age, to immediately see through the façade of a decent website and promotional materials. This is particularly true of an operation that lies on the opposite side of the globe, and coming from a vastly different business culture. Combine this fact with the willingness of LPO companies to stretch the truth about their operational backgrounds, and the result is a confusing morass of options that makes it difficult to separate the wheat from the chaff, and there is a lot of chaff out there.

Perhaps worse is the situation where a Western client chooses to work with an entity with some modicum of credibility, but which turns out to be woefully unprepared for the highly-demanding standards of legal services. The amount of money, and more importantly, time, which can be wasted in such efforts, is troubling. For instance, a potential service provider might be a company that has had some success in the business process outsourcing (“BPO”) industry, but is unprepared for the complexity and subtlety of working in an intensive knowledge-based industry such as the law. The profound differences in implementing BPO vs. LPO processes will be stressed later in this report.

Why do normally smart lawyers make these mistakes? One factor is lack of experience in dealing with India and other outsourcing destinations. Often, we find that such clients are a little too willing to immediately establish a relationship in the host country, in order to ease their insecurities about operating in such a foreign and distant environment. One of the most immediate recommendations we make to clients is to allocate enough time to conduct serious due diligence before entering into any sort of partnership agreement, and this includes spending sufficient time on the ground in India before committing any money or resources. Not only should you interview a number different providers, you should visit a number of different cities, since the business environment, cost structures, infrastructure and available labor pools vary widely within India itself.

We have written this report in the hopes that it will give you some insight into the options available to you for outsourcing to India. And rather than immediately jumping into describing the options for outsourcing, this report will

take a step back and examine what outsourcing is, what it is meant to accomplish, and whether it is right for you at all. In addition, while India is certainly an attractive destination for LPO, it is by no means the only one, and we will discuss other locations for outsourcing, including some right here in the US.

As independent LPO consultants, we can speak from a position of neutrality and candor, in that we are not LPO service providers trying to make a sale. Our view on this industry is more cautiously optimistic than what you will hear from LPO providers and even other industry analysts. The Legal Forest team is available to you, beyond this report, should wish to gain further insight or guidance into the LPO industry. We encourage you to reach out to us if you are even remotely considering outsourcing as part of your organization's future.

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