International law firms in South Africa - positive or negative disruption?

DAVID LANCASTER

In February 2011 the Lawyers Weekly in Australia published an article entitled "Attack of the Global Giants: Australia the new black for international firms".

In the year before the article was published, three leading international firms had entered the Australian market – in 2010 Norton Rose merged with Deacons, Allen & Overy took 14 partners from Clayton Utz, and King & Wood merged with Phillips Fox.

At the time, and in public, the independent Australian firms put on a brave face: "I don't think the entry of DLA Piper will change the market," Freehills CEO, Gavin Bell, said. "It is already a really competitive market and we face competition from really big Australian firms". Ironically, however, it was only a year later that Mr Bell's own firm, Freehills, merged with Herbert Smith. Also in 2012 in Australia, Blake Dawson was absorbed by Ashurst, Clyde & Co entered the market, Mallesons merged with Chinese giant King & Wood, and Allens entered into an alliance with global law firm, Linklaters. In 2013, US firm K&L Gates merged with 300 lawyer firm Middletons, leaving Minter Ellison, Clayton Utz, and Corrs Chambers Westgarth as the only three independent firms in the Australian "Big 8".

After more than a decade of unparalleled growth, Australian law firms were facing headwinds in the form of:
- declining demand for legal services;
- legal process outsourcers ("LPOs") and other substitute legal service providers making inroads into traditional sources of work;
- foreign law firms who used to be sources of referral work entering the domestic market through mergers, alliances and greenfield operations, cutting off the supply of referrals, and competing for domestic work against Australian firms; and
- increased client sophistication in the procuring of legal services.

For many years South African lawyers regarded the Australian market as very similar to ours. We believed that what happened there, was likely to be replicated here. Both countries have well developed legal systems, strong domestic legal firms (relatively large in scale), and both are seen as entry points into other markets (the rest of Africa in the case of South Africa, and Asia in the case of Australia). The historical shared belief in both markets prior to 2010 was that international firms would stay out due to the competitive nature of the local firms, domestic pricing issues, and currency fluctuations.

Although a number of international firms (primarily American) had been present in a small way in Australia prior to 2010 (Baker & McKenzie since 1964, Sullivan & Cromwell since 1983, Skadden's since 1989, and Jones Day since 1998) large scale and disruptive international entrants were not expected due to the reasons already set out. That is, of course, until the "big bang" from 2010 onwards.

Of course, as we now know, the same has happened in South Africa over the past few years and continues to unfold.
Management

At the time of writing, the South African legal landscape looked something like this:
- Webber Wentzel has entered into an alliance with global law firm Linklaters;
- Deneyes Reitz merged with Norton Rose Fullbright;
- Cliffe Dekker Hofmeyr entered into an alliance with DLA Piper, which terminated in 2015. DLA Piper has, however, now announced its intention to open in South Africa in 2016;
- Rudledge Modise was absorbed by Hogan Lovells;
- Dentons, the largest law firm in the world by number of lawyers, acquired small Cape Town based firm, KapisaTwala, and recently extended their footprint to Johannesburg;
- Clyde & Co launched last year, taking a number of partners from leading South African firms;
- Eversheds picked up the departing partners from Rudledge Modise to set up their South African operation;
- Bell Dewar merged with Fasken Martineau, and has entered into an alliance with Simmons & Simmons;
- Baker & McKenzie entered the South African market by picking up the South African Dewey team after that firm's demise;
- Allen & Overy launched in South Africa with a leading finance team from Bowman Gilfillan supplemented by other lateral hires;
- White & Case remains in South Africa having been one of the early international entrants;
- Herbert Smith Freehills have announced their launch in South Africa with three local partners recruited from Webber Wentzel;
- MacFarlanes have announced their intention to open in Johannesburg; and
- Chadbourne & Parke LLP opened an office in Johannesburg.

As a result of this there are only four major independent firms remaining in South Africa: ENSafrica, Bowman Gilfillan, Werksmans, and Cliffe Dekker Hofmeyr. (Many of the mid-sized independents have over the years either merged with one of the Big Six South African firms, particularly after the Big Six expanded to Cape Town, or tied up with international entrants. Some of the specialist IP firms remain independent (for example, Spoor & Fisher) while others merged with larger South African firms (such as John & Kernick and Bowman Gilfillan). Some mid-sized coastal firms, such as Shepstone & Wylie and Other remain independent. What does this mean for the local legal services market and, in particular, for the remaining independent South African law firms?

It is instructive to have a look at what happened in Australia before seeking to identify future trends in South Africa.

Why did international firms enter the Australian market? Their entry coincided with the global financial crisis. Facing softness in their home markets, international law firms were attracted to Australia by the buoyant domestic economy driven by a resources boom and the prospect of greater growth in Asia. The strong Australian dollar made the profit models in Australia look like a good fit for international firms. Australia seemed to offer greater growth prospects than Europe and the United States, cultural compatibility and easy financial integration of local firms into the global entrants' partner remuneration systems.

The entry of international firms into the Australian market was very disruptive for local law firms. It was marked by mergers with and acquisitions of local firms, as well as a number of "raids" on teams, whole practice groups, and individuals, Allen & Overy's entry into the market via a "raid" on Clayton Utz being a case in point.

Talent liquidity suddenly became a major issue in Australia. As Steve Mann of Kingswood noted (2015 Australia: State of the Legal Market; Melbourne Law School and Thomson Reuters): "10 years ago there were six international law firms in Australia, now there are over 25. If you add the independent local firms, there are now 45 major brands, all competing for talent in this market - this is the new norm."

Apart from lateral moves of partners, the entry of Norton Rose and others in 2010 forced Australian law firm leaders to make an early stark choice - remain independent, or become part of a law firm or alliance that has global reach. The majority of them sought to go the latter route, with five firms out of the Australian big eight entering into an international tie up.

Things have now changed in Australia - the legal services market has shrunk, the resources boom has slowed down, growth in China has stuttered, and the Australian dollar has devalued. Most of the factors that the global firms saw as attractive in Australia have changed, and as a result there have been no more "big firm" arrivals or mergers since 2012. There have now been second and third waves of partner moves from some of the international entrants as income guarantees given by the global firms expire. One of the legacies of the global law firm entry into Australia, however, is that there is still much partner movement in the Australian market - so much so that it is hardly reported in the press, according to a conversation I had with the chief executive of major Australian law firm.

What motivated the entry of international firms into the South African market? The set of factors that existed in Australia did not and do not now exist here - the South African rand is volatile and continues to weaken against global currencies, domestic economic growth is sluggish, the Chinese slowdown has affected commodity exports, and strikes and an uncertain regulatory environment in key sectors such as mining have inhibited foreign and domestic sources of investment.

In particular, the weakness of the South African rand makes it difficult for local branches of global law firms to contribute meaningfully to the global bottom line, and make it tricky to absorb South African partners, who are largely generating rand based revenue, into lockstep or other global law firm partner compensation systems. (Conversely, the weakness of the rand does of course make the South African investment more affordable for the global parent). So why the rush to enter the South African market, and how did this happen?

We have seen three models for international entry in South Africa: the alliance models (for example Webber Wentzel and Linklaters; Cliffe Dekker Hofmeyr and DLA Piper) where the local firm retains its brand, independent management and control but has the benefit of being aligned to a global player; the mergers (Deneyes Reitz and Norton Rose; Bell Dewar and Fasken Martineau; and Rudledge Modise and Hogan Lovells as examples) where the local brand is subsumed by the global brand and the local firm becomes a branch of the global parent; and the greenfields entries (Allen & Overy; Clyde & Co; Baker & McKenzie; White & Case; Herbert Smith Freehills). This article looks at the firms that have chosen latter two methods of entry.

Most international law firms establishing a presence in South Africa...
Management

have linked this move to their broader strategic plans for Africa, and by implication, therefore, do not see the South African domestic market as their primary target for growth.

Hogan Lovells say that their Johannesburg office “adds broader sub-Saharan Africa capability to Hogan Lovells’ global platform” and that “South Africa is the continent’s largest and most sophisticated sub-Saharan economy and is often regarded as the gateway into Africa.” (Website)

Clyde & Co say (on their website) that “South Africa is the second largest economy in Africa with an ever developing global legal market, and in an area of focus for clients with many of our core sectors … we provide a strong base for work across the whole of sub-Saharan Africa”.

Allen & Overy says “Johannesburg has become a key hub for local and international banks, development institutions, institutional investors, and funds looking at investment and finance opportunities in sub-Saharan Africa” and that their “team is fully integrated into” their global network, complementing their wider African capability.

Baker & McKenzie describes their Johannesburg based team as an “integrated part of our international Africa Practice” and they describe Africa as being “the new frontier for global investors and multinationals” with South Africa being a particularly attractive location due to its sophisticated financial markets and strong transportation infrastructure, amongst others.

Similar statements of an Africa focused strategy are made by all the others. It seems, therefore, in contrast to Australia where global entrants were seeking to secure high value domestic work underpinned by a strong Australian dollar and a resources fueled economic boom, the global firms opening in South Africa are doing so to enhance their Africa platforms. It is not clear in all cases what their strategy is in relation to domestic South African work.

What are some of the risks and opportunities flowing from these developments in South Africa?

There are a number of risks for these new entrants:

1. A number of the greenfields international operations in South Africa are built around one or two leading local lawyers. In an interview published in the October/November 2015 edition of IBA Global Insight, David Morley, the senior partner of Allen & Overy, acknowledged this when asked to explain why Allen & Overy had opened an office in Johannesburg. He is quoted as saying “we opened in Johannesburg because we could hire the very best finance lawyer in South Africa otherwise we wouldn’t have opened there.”

As South Africa is still a market dominated to a degree by reputation and market profile of individual lawyers, and not only the law firm brand, the question must arise as to the sustainability of those greenfield operations if the core partner or partners move on, or retire. A key stra-

This material has been copied under a DAUKO licence and is not for resale or retransmission
Management

The entry into South Africa of international firms, particularly the smaller greenfields operations, does, of course, provide a number of significant opportunities for South African lawyers and positives for the South African market:

- In my view, the fact that such a significant number of global players have chosen to enter the South African legal market is a vote of confidence in South Africa, and cements South Africa's position as the leading economy in Africa. Johannesburg is the preferred option for these firms for the moment as opposed to Lagos or Nairobi.
- The entry of foreign law firms into South Africa is an endorsement of the fact that we have an open economy, and it is commendable that our regulators have not sought to keep international law firms out of our market as has been the case in other leading emerging markets such as Nigeria, India and Brazil.
- The introduction of global best practice on such a large scale can also only be good in terms of skills development and learning.
- For clients, particularly multinational clients, the ability to use their global law firm of choice through a local office, particularly for their African operations, must be attractive.
- For South African lawyers working for an international firm, or being in an alliance with one, this must offer growth opportunities, significantly enhanced earnings in some cases, and perhaps the opportunity to practise in other parts of the world.

One of the issues unique to South Africa, and which international firms did not have to contend with in Australia, is the question of transformation and corporate social responsibility. For historical reasons, the South African economy in general, and the legal profession in particular remains dominated by white men. The country itself continues to grapple with legacy issues of poverty, inequality, racial and gender discrimination, and access to justice. South African law firms bear a particular obligation to contribute to the unfinished business of addressing these challenges in the country, particularly in view of the centrality of the constitution and the legal system in our democracy.

The “Big Six” South African law firms, together with independent mid-size players, have between them made a significant contribution to transformation and broader corporate social responsibility in the past twenty years. They currently employ significant numbers of black lawyers, have provided articles to many more over the years, and there has been slow but steady progress in changing the demographic of these firms, both from a race and gender point of view.

South African law firms are subjected to rigorous procurement protocols and procedures, particularly when they look to do work for government or state-owned enterprises. There are also a significant number of private sector players who are serious about transformation, and, particularly, companies operating in the mining and financial services sphere have driven extensive transformation in South African law firms through their legal services procurement policies, panel appointment requirements and their guidelines as to how their matters should be staffed. As a result, significant effort has been made in most leading South African law firms to increase the numbers of black lawyers trained, to ensure more equitable work distribution, and to change the demographic at partner level from both a gender and race point of view.

In addition, and in recognition of the deep inequalities in South
Management

African society, and the high levels of poverty, many South African law firms have in their own different ways made significant contributions in the areas of corporate social responsibility and the delivery of pro bono legal services. This includes the provision of bursaries and scholarships at school and university aimed at previously disadvantaged students, and financial and other support to the law faculties of our universities.

From my observations, this commitment has intensified in the Big Six and, encouragingly, has continued in the firms which are the products of mergers between large or mid-sized South African firms and global firms being Norton Rose Fulbright, Hogan Lovells, and Fasken Martineau. This is no doubt due to their history, culture, demographic makeup and commitment to transformation prior to their respective mergers.

It is to be hoped that this commitment to transformation and a fairer and more equal South African society is replicated by other international entrants, particularly the greenfields startups, especially if they are competing against local firms for government and SOE work, and for work in the mining and financial services areas where transformation is a key requirement for panel appointments.

Future trends?
The two big trends in recent years in South Africa have been consolidation of the market through mergers, and the entry of international law firms. As a result of both trends, many famous law firm names are gone. The number of large and mid-sized independent South African law firms has reduced.

I foresee further consolidation in the South African market with possibly one merger still to come amongst the Big Six. Mid and small independents may struggle to resist the pressure to look for a bigger partner.

Movement of lawyers between law firms will continue, much as the case has been in Australia. The management and retention of key talent will be a major strategic priority for law firm leaders. The environment will continue to become increasingly competitive due to all these factors and increasing sophistication in the procurement of legal services by clients in addition to the growing presence of legal process outsourcers. South African law firms will continue to grapple with the challenges of transformation and the imperative to maintain their contribution to building a fairer, more equal and just society. International law firms operating in this market will not be immune from these pressures. While there may be more international entrants over the next few years, we may also see the withdrawal of others.

In a future article I will deal with how clients have responded to these developments.

Lancaster is a law firm strategy consultant and former senior partner of Webber Wentzel.