



*Electronic Discovery in Litigation*

# EDD Supplier Landscape

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## IX. Conclusions

By way of closing out this volume, we reach beyond the responses to our Supplier surveys to include secondary research performed during the past year, as well as the odd bit of business wisdom we may have acquired over the years. It takes a bit of art added to the science to answer the question – “What of it?” So, we’ve spiced-up with some data points with some points of view.

### A. Overview

- ▶ **Market Size.** Given a broad definition of EDD – one that encompasses forensic investigation, electronic discovery, paper document scanning and coding, as well as processing of electronic documents – **we estimate the current EDD market size to be \$1.3 billion in annual revenues**, based on the sum of EDD Supplier revenues.

We would argue for an even broader definition of the EDD marketplace, including the value of legal review activities by law firms, since these are subject to significant time and cost reduction through improvements in EDD technology and procedures. (Note: values not yet reflected in our projections.)

- ▶ **Qualitative View of the Market in 2010.** Extrapolating forward current trends, we envision a future marketplace where ...
  - **Corporations have: (i) gained greater control over their data (wherever resident), (ii) established a new C-level office of Chief Compliance Officer, (iii) implemented and now aggressively manage document retention policies and (iv) deployed active data management systems which code, index and store virtually all corporate documents and records.**
  - **Electronic discovery, processing and management have become routinized.**
  - **Forensic activity is largely focused on data inaccessibility due to malfeasance and accident.**
  - **Corporate KM implementation and greater control over data enable most Collection and Extraction processes to be executed by the end client litigant.**
  - **Improvements in search and filtering techniques dramatically reduce human review time and cost.**
  - **Litigation support software provides the front-end access for most human review activities.**
  - **Native file format is the standard for collection, processing and production.**
- ▶ **EDD is a market not a standalone industry.** We view electronic discovery as a **vertical application market which has been, is and will be supplied by vendors in other industries for which EDD is a line extension and/or a piece of a larger product/service framework.**

We identify and describe the characteristics of **three principal EDD Supplier types -- Processors, Enablers and Consultants** – and place EDD functions in the context of 14 market adjacencies.

- ▶ **Factors broadening the EDD market...**
  - **Substitution of electronic documents for paper-based**
  - **Pioneering of law, technology and processes in larger cases**
  - **Broader base of EDD practitioners**

- ▶ **Factors deepening the EDD market...**
  - **Proliferation of electronic communication forms**
  - **Broadening the definition of *document***
  - **Developments in Legislation and Regulation, e.g. the Sarbanes-Oxley Act**
- ▶ **Supplier topline and bottom lines growing with the market**
- ▶ **Despite more than 200 companies in the space, we view the EDD marketplace as unusually non-competitive ...**
  - **A few EDD Suppliers control the marketplace.**
  - **Market-controlling Suppliers are not always directly competitive.**
  - **The process of EDD Supplier selection is not particularly competitive.**
- ▶ **We predict market rationalization over the next 3-5 years consisting of ...**
  - **Movement toward feature/function parity among top tier Suppliers. We do not view electronic discovery as a market where it is possible to establish any true sustainable competitive advantage in the feature/function arena, apart from brand franchise. Although there are barriers to entry and replication, all barriers can be surmounted by a focused competitor with time, money, skill and market execution.**
  - **Over the next five years, there will be a shift in both the locus of Supplier selection decision making and in the methods of selection. We see greater end client litigant influence in the decision making process and cost management, resulting in a more competitive process.**
- ▶ **The next five years will see the growth of a large submarket of small matter electronic discovery projects, the needs of which are unlikely to be addressed by today's top tier EDD Suppliers, whose business models, products and services do not scale downward particularly well.**
- ▶ **Over the next 5 - 10 years, we are looking for a more fundamental realignment of the EDD market ...**
  - **We are looking for the already present trend toward horizontal consolidation – absorption of EDD operations into market adjacencies – to accelerate.**
  - **We believe the future EDD marketplace will be dominated at the large matter end by subsidiaries of very large, diversified corporations. Five to seven standalone EDD Suppliers will compete for mid-sized matter engagements. And a very broad small matter marketplace will be serviced by several hundred modest sized consulting firms.**

## **B. EDD Market Size**

As with most things, the question we ask determines the answer we get. If we define the EDD market as including all activities (pre-matter consulting through testimony) directly related to electronic discovery and production in litigation and administrative matters, we will arrive at one set of numbers for market size. Alternatively, if we narrow the defined scope of activity to include only production, or only culling and review, or only discovery and production of documents which originate in electronic form<sup>5</sup>, we will arrive at materially different market size estimates.

## 1. MicroView – The Sum of EDD Supplier Revenues

Assuming an agreed upon definition of which firms to include as *EDD Suppliers* and what activities constitutes *electronic discovery*, **the sum of EDD Supplier revenues is one approach to sizing the market.** At this point, we have primary data for a very small sample of Suppliers, (15 out of more than 200), and we readily acknowledge that our group comprises a cross-section of vendor firms rather than a weighted sample. Undeterred (and with said qualification), we applied assumptions against both our primary data and secondary market information to arrive at an estimated EDD market sizing.

**We estimate the current EDD market size at \$1.3 billion in annual revenues.**

### EDD Market Size Estimates -- MicroView

SEGMENT	REVENUES			x	COMPANIES BY SEGMENT			=	EDDIX REVENUE ESTIMATES			
Size	Low	Mid	High		Low	Mid	High		Low	Mid	High	Avg
0-5	0.2	<b>0.5</b>	2.5		<b>84</b>	<b>149</b>	<b>211</b>		<b>42</b>	<b>75</b>	<b>106</b>	<b>74</b>
5-10	5	<b>7</b>	9		<b>3</b>	<b>8</b>	<b>12</b>		<b>21</b>	<b>56</b>	<b>84</b>	<b>54</b>
10-15	10	<b>12</b>	14		<b>2</b>	<b>3</b>	<b>5</b>		<b>24</b>	<b>36</b>	<b>60</b>	<b>40</b>
15-25	15	<b>20</b>	23		<b>2</b>	<b>3</b>	<b>4</b>		<b>39</b>	<b>58</b>	<b>77</b>	<b>58</b>
25-40	25	<b>33</b>	38		<b>3</b>	<b>4</b>	<b>6</b>		<b>96</b>	<b>128</b>	<b>192</b>	<b>139</b>
40-75	40	<b>60</b>	70		<b>3</b>	<b>4</b>	<b>6</b>		<b>170</b>	<b>227</b>	<b>340</b>	<b>246</b>
75-125	75	<b>100</b>	120		<b>1</b>	<b>1</b>	<b>2</b>		<b>98</b>	<b>98</b>	<b>197</b>	<b>131</b>
125-200	125	<b>150</b>	190		<b>1</b>	<b>2</b>	<b>2</b>		<b>155</b>	<b>310</b>	<b>310</b>	<b>258</b>
>200	200	<b>250</b>	300		<b>1</b>	<b>1</b>	<b>2</b>		<b>250</b>	<b>250</b>	<b>500</b>	<b>333</b>
<b>Totals</b>					<b>100</b>	<b>175</b>	<b>250</b>		<b>906</b>	<b>1,249</b>	<b>1,888</b>	<b>1,347</b>

### Assumptions

- ▶ **Market Segmentation by Size of Supplier.** We applied the same company size stratification approach as used in our interviews – nine segments based on annual revenues attributable to electronic discovery activities. We created slightly more conservative ranges and then determined a midpoint value for each band.

To be conservative, the assigned midpoint is often lower than the arithmetic average of high and low values. For example, in the first segment (< \$5M EDD revenues), we assigned a midpoint of \$500,000. Therefore, the midpoint values are perhaps best thought of in terms of an estimated and assigned median value.

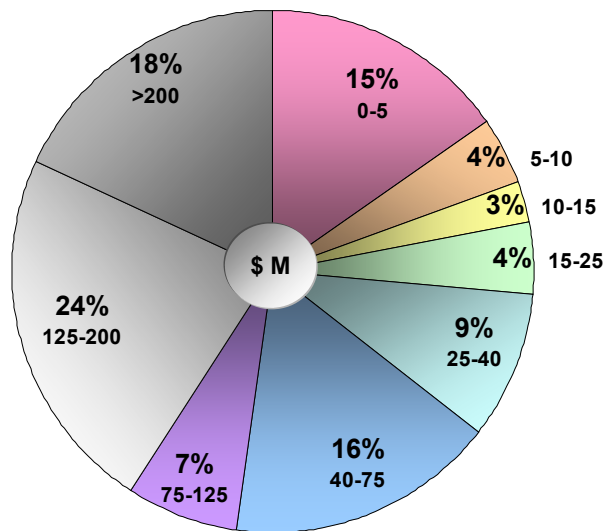
- ▶ **Distribution of Suppliers by Segment.** Using \$500,000 in annual EDD revenues as a conservative midpoint for the segment < \$5 million, we estimated that the universe of those companies ranges from a low of 100 to a maximum of 250, with a midpoint of 175. Then we distributed the companies back into the nine revenue segment matrix. The result is that 85% of all EDD Suppliers are in the lowest revenue segment (< \$5 million), and are assumed to be generating an average of the \$500,000 million each in EDD revenues.

Applying the midpoint value for revenue in each segment to the distribution matrix ...

- ▶ The low end estimate for 100 EDD Suppliers is \$906 million.
- ▶ The high end of the range (250 Suppliers) is \$1.9 billion.
- ▶ The average of the high and low estimates is \$1.3 billion.
- ▶ The sum of the midpoints is \$1.2 billion.

### ... Market Shares by Supplier Size ...

161 companies, representing 92% of all electronic discovery Suppliers – each with less than \$15 million in EDD revenues annually – account for 22% market share or \$286 million.



## 2. MacroView – The Larger EDD Market Space

Directionally, we prefer an econometric approach to market sizing. Given market demand for the delivery of some defined set of functionality, **what is the sum of goods and services in play?** We are not economists and we are not suggesting calculating incremental growth in desktop work stations resulting from an increase in EDD market size. However, **one area we believe should be included is the substitution value of law firm review time and charges.**

The cost of electronic discovery to litigants today consists not only of fees paid to EDD Suppliers, but a substantial cost is also incurred in professional fees litigants pay to law firms for both document review and overall process management. We mention this because any technology and process improvements by EDD Suppliers which effectively reduce fees paid to law firms is an opportunity not only for competitive market advantage, but more importantly, it is also an opportunity to price to value for the net cost reduction and therefore, increase the Supplier share of a (larger), total EDD market.

We have targeted sizing the cost of EDD-related legal review as an objective for our upcoming EDD research project focusing on law firms. Although we cannot reliably quantify this in dollars as a market size component today, we believe it represents a substantial pot of money and therefore, our \$1.3 billion EDD market size estimate is on the low side.

## C. FutureView -- Electronic Discovery circa 2010

In considering the direction of the electronic discovery marketplace, we are not only interested in projecting the dollar growth of EDD goods and services over time; we are equally **interested in understanding the nature of the changes taking place.**

We are interested in determining what's driving the growth and change – deconstructing change into its component vectors. A \$2 billion market dominated by two companies is qualitatively different from a \$2 billion marketplace characterized by robust competition among 15 firms. Global is different than local. And of course, we have seen entire markets enjoy brief Brigadoon-like moments, only to be decimated by environmental and/or technological innovation, which might have been foreseen if not for the irrational exuberance enveloping them. Short-term CAGR is an important thing ... just not the only thing that's important.

In this case, we think it's easier to walk the cat back from a vanishing point. So we begin out there ...

Here's *a view of the state of EDD six years hence.* To readers with mindsets or vested interests not particularly well-served by this vision, we acknowledge it will be easy to find one or more points of contention and then apply the false-in-one-false-in-all syllogism. We suggest a different approach. Stay at the 50,000 foot level, remove as much self-interest as possible and when done reading, ask yourself – “why not?”

- ▶ **Corporate.** Beyond a critical mass of perp walks and C-level heads impaled on sharp sticks, public companies finally get the governance/compliance/reporting message. Boards of directors and C-level suites are restructured into true systems of checks and balances. Supporting technology and systems are deployed. Private companies (more or less), emulate their public counterparts. Human nature hasn't changed -- there are still miscreants in the same proportion as today.
  - In the rare case where there is not a CCO (Chief Compliance Officer), the CIO, CLO and CFO share responsibility for compliance, reporting to the board's audit committee and assisted by the company's accounting firm and outside legal counsel.
  - Records management is a high-profile corporate initiative.
  - Document retention policies (DRPs) are put in place and actively managed. Documents are retained only as they relate to active projects, are needed to run the business or statutorily mandated.
  - Companies have gained a high-level of control over all their data, wherever resident: corporate server, off-network data, desktop, laptop, home office, PDA and/or phone.
  - Documents are automatically deleted and purged in accordance with corporate DRPs – wherever resident – and deletion logs are automatically maintained.
  - Active knowledge management systems scan, code and index all documents and communications, providing real-time problem detection and routing based on defined issue triggers. Privacy and security issues associated with communications review and interception have been resolved.
  - Data backup and archiving functions are largely outsourced to data utilities that support corporate KM systems, DRPs and litigation requirements.
  - Litigation “settings” on corporate data systems provide for automatic and selective suspension of DRPs to accommodate preservation orders. Target documents are automatically mirrored and routed to staging platforms for extranet hosting and access.

- ▶ **Litigation.** Electronic discovery, processing and management have become routinized. Moving parties still have the initiative, but not undue leverage.
  - Common rules and practice standards governing EDD have been adopted and implemented across jurisdictions.
  - EDD contention is focused on scope, relevance and compliance, not technology and process.
  - Judges, regulators and administrators focus on dispute resolution, adjudication and content/process management.
  - Extraordinary costs of EDD have been minimized and are born by the producing party.
- ▶ **Electronic Discovery Market.** For the most part, the functions, tools and operations of EDD Suppliers (circa 2004), have been absorbed into the products and services of adjacent industries. What had been the extraordinary *event* costs of electronic discovery are subsumed in other corporate operating costs. Residual specialties remain, addressing forensics and data wrangling market needs. And of course, paper has not disappeared.
  - **Forensics and Restoration.** Forensics is largely concerned with identifying and extracting data which is deemed inaccessible due to malfeasance, human error and gross negligence. Restoration is an automated process provided either by corporate IT or external archivists.
  - **Collection and Extraction.** Against a negotiated and agreed upon scope, corporations and their data archivists can readily isolate and aggregate a target dataset – wherever resident – housed in native form by archivists as a litigation service.
  - **Culling and Review.** Culling the target data set is a straightforward process using standardized search and filtration methodologies. Improvements in scoring schemes effectively reduce the target data set to a target response set within 10% of the final production set. Automated sampling speeds human QA. Human review is still required, but dramatically reduced. More review time is spent on content impact assessment than on responsiveness and privilege assertion (much of which has been pre-coded and indexed by the corporate KM application). Litigation support software provides the primary interface to, and is interoperable with, target datasets hosted by archivists.
  - **Production.** Consistent with the standards for production in electronic format, both courts and opposing parties accept the responsive dataset in native file format.

The glass half-empty crowd will tell you we just predicted the annihilation of the EDD marketplace. We did not. We extrapolated current developments and trends forward to arrive at a future view. There is not a single technology, application or practice referenced above that does not exist today, some already deployed as described, others in near-commercial state, still others waiting for critical mass market demand to emerge.

Importantly, we believe this particular future view holds significant business opportunities for any EDD StakeHolder smart enough and skilled enough to lead the way into tomorrow's landscape, as opposed to being swept along with the tide ....

To explain how we arrived at this FutureView, we return to the present tense. First, examining the fabric of the EDD market more closely, then moving on to a discussion of the trends from which the future view was extrapolated.

## D. EDD is a market, not a standalone industry

With over 200 companies claiming EDD expertise chasing after a rapidly expanding \$1+ billion marketplace, it is easy to mistake the market for electronic discovery products and services as a nascent industry or micro-industry.

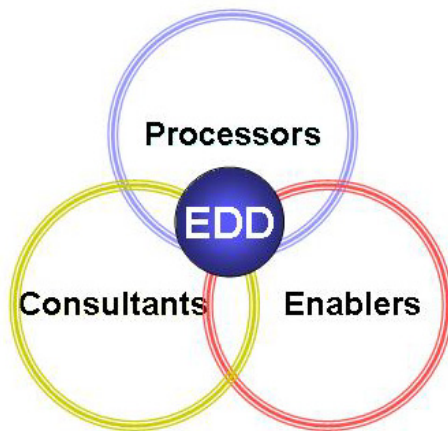
We believe EDD is not a standalone industry. Rather, **we view electronic discovery as a vertical application market which has been, is and will be supplied by vendors in other industries for which EDD is a line extension and/or a piece of a larger product/service framework.**

There are only a handful of *pure play* EDD Suppliers – companies whose sole focus is electronic discovery. For the most part, EDD products and services have evolved as a veritable patchwork of innovation and best practices originated in other, adjacent market spaces and adapted/leveraged to provide solutions to the challenges posed by electronic discovery. From our interviews, it is clear that even the pure play firms are looking to line-extend into other adjacent markets.

In our own Rorschach-inspired version of EDD history, two developments converged that made it both possible and desirable to manipulate and process documents electronically: (i) scanning and coding technology and applications enabled conversion of paper documents to electronic form for more effective and efficient processing and (ii) documents increasingly originated in electronic form.

Initially, this new market opportunity gained the attention of litigation support vendors who had been providing processing and reproduction of paper documents sets for law firms responding to discovery requests and they extended their services to include scanning and coding. Rather quickly, it became apparent that meeting the legal market's rapidly expanding needs required new (or re-purposed) tools, (enter developers and software vendors), as well as new (or re-purposed) people to apply the tools, (enter professional services firms). In other words, electronic discovery ink-blotted across industry boundaries. Custom software development was productized, specialized processes became service-based practices and products and services morphed into lines of business.

With all the risks attendant to reductionist abstraction, **our conceptual framework divides the landscape into three principal Supplier types based on principal focus, strategic drivers, leveragability of assets and corporate culture.** As the Venn diagram on the following page suggests, successful execution of complex electronic discovery involves skills, capabilities and experiences derived from all three types, in proportions that tend to be matter related.



## Principal Types Of EDD Suppliers

### 1. Processors

We use the term Processors to describe EDD firms whose principal activities are volume-driven and measured by the cost per unit of delivery. Generally, the leverage points are plant and equipment, processes and people. Key metrics include return on invested capital and plant utilization. Beyond breakeven volume, these operations scale fairly linearly.

### 2. Enablers

Primarily software solution companies, these adjacencies feature numerous points of entry into, and overlap with, electronic discovery. The primary driver for these companies is leverage of intellectual property. Post-amortization of development costs, these businesses can scale in hockey stick fashion, given solid market share and a sufficiently long product life cycle.

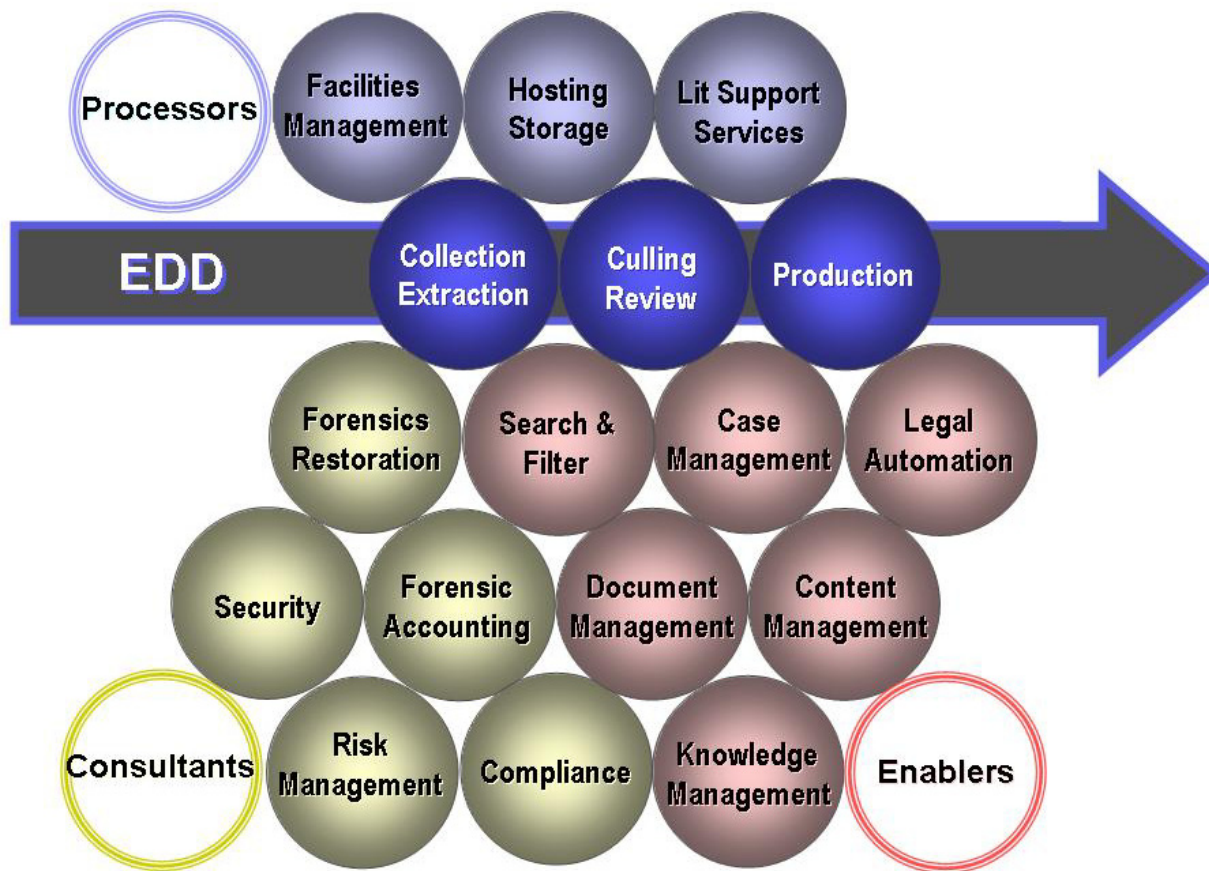
### 3. Consultants

This segment is largely comprised of professional services (PS), firms whose key metrics are staff utilization and billing rate. Absent significant upfront investment, PS firms get profitable quickly, are seldom unprofitable, but scale in a totally linear fashion unless they are able to integrate and leverage proprietary intellectual property.

## 4. EDD Market Composition and Adjacencies

The diagram builds out our view of the Supplier landscape by depicting the constituent product/service types within each of the three primary market segments. We refer to these business lines as adjacent market spaces and we view them as overlapping, as well as being tangential to, electronic discovery operations.

Contrary to what you see displayed in this two-dimensional graphic, in real life, the business lines identified are far less discrete than pictured and have myriad points of intersection and overlap – up, down, side-to-side, across-type, etc.



## E. Current Market Dynamics

We arrived at our FutureView by extrapolating forward what we view as the critical current market trends. Let's see if we can connect the dots ...

### 1. Market is growing broader and deeper

It's hard not to know that the market for EDD services is rapidly expanding. Electronic discovery gets significant coverage in the legal trade press and has figured prominently in a slew of high-profile corporate malfeasance cases feeding the front pages of general business press over the past several years. At the moment, we are less interested in gauging the rate of growth than in identifying the factors fueling that growth.<sup>6</sup>

We view the EDD market as growing simultaneously *broader* (i.e., the universe of organizations directly affected by electronic discovery is increasing), and *deeper* (i.e., the number of operational points EDD touches within each organization is multiplying).

When defined in terms of the number of total matters involving electronic discovery and/or the total number of documents to be discovered and/or processed, we foresee steady, straight-line growth, ad infinitum.

#### a) Factors broadening the market

- ▶ **Substitution of electronic documents for paper-based.** There is more and more to be discovered electronically, exponentially so. The number of electronic documents in the world is expected to double every minute for the next 10 years<sup>7</sup> and the impact on litigation has been palpable. Today's mega cases can involve anywhere from 500,000 to more than 500,000,000 pages of documents.<sup>8</sup>
- ▶ **Toward ubiquity of electronic discovery.** The pioneering of law, technology and processes in larger cases have paved the way for explosion of EDD in smaller matter cases. Large, complex litigation with significant dollars in controversy, have subsidized the development of EDD technology and processes, as well as established electronic discovery case law. There is now a marketplace and infrastructure in place for handling electronic discovery – EDD tools have been built, processes have been established and resources have been assembled (lowering the costs of EDD generally), and there are clearer legal guidelines covering practice.
- ▶ **Broader base of EDD practitioners.** The growth in the volume of matters requiring electronic discovery has been accompanied by corresponding growth in both the number of EDD Suppliers and the scale of operations of established Suppliers.

#### b) Factors deepening the market

- ▶ **Proliferation of electronic communication forms.** It's not only e-mail and office applications replacing their paper predecessors fueling EDD market expansion, new electronic communications devices, applications and formats are significant growth drivers, as well (e.g., laptops, tablets, PDAs, Blackberry, GPS, instant messaging, digital audio voice mail and call center recording).
- ▶ **Broadening the definition of document.** Although the law struggles to keep up with emerging technologies, it always seems to get there. The expanding definition of *corporate records* and discoverable *documents* has paralleled the explosion of digital communications forms, albeit at a discreet distance. Today, documents arguably consist in any medium (paper or electronic), created by any party, including not only formatted documents, but myriad forms of communications and transactional records, as well as all of the metadata relating thereto.
- ▶ **Legislation and Regulation.** Whether you are a commercial, nonprofit or public entity, laws and regulations governing recordkeeping and compliance reporting are proliferating. Sarbanes-Oxley and

HIPAA are just two current examples of new mandates creating new, discoverable records and reporting requirements.

## 2. EDD Suppliers are Healthy ... for Now

A rising tide raises all boats, or so the saying goes. As a class, EDD Suppliers are experiencing excellent revenue growth while maintaining, and in most cases, simultaneously growing net contribution to overhead and profit (i.e., net margin before reinvestment).

The market broadening and deepening factors described in the preceding section are driving topline revenue growth. As a matter of fact, the growth is so substantial that market opportunities have attracted a large number of new EDD operators into the marketplace.<sup>9</sup>

Thanks to the largely non-competitive market environment described below, for the time being, the rate of total market expansion has provided healthy bottom-line growth for virtually all existing Suppliers, enabling them to reinvest in enhanced products and expanded operations.

## 3. The Competitive Landscape ... Not!

With respect to margin growth, **although the EDD marketplace can boast a large number of competitors, it is not what we would term an especially competitive market**, at this point in time ...

- ▶ **A few EDD Suppliers control the marketplace.** In our estimates of market size and share at the beginning of this chapter, we estimated 14 firms account for over 90% of the total market with the remaining 10% split among as many as 200 specialist and local market operators.
- ▶ **Market-controlling Suppliers are not always directly competitive.** Variances in the requirements of specific litigation play to the varying strengths of different suppliers. Not every instance of electronic discovery has a heavy forensic accounting need or print production need or data forensics need. To this point in time, the rapid expansion of the market demand combined with diversity in requirements has enabled the larger Suppliers to avoid one another.
- ▶ **The process of EDD Supplier selection is not particularly competitive.** For any given matter with electronic discovery requirements, the locus of Supplier selection, the methods used and the criteria applied do not promote active competition among Suppliers.
  - **Direct, formal competition is not the norm.** As reported in Chapter V, our research indicated Suppliers encounter direct competition only 45% of the time and formal proposal-bidding processes less than 20% of the time. Additionally, we have shown there is considerable continuity in relationships between EDD Suppliers and the law firms that select them for EDD engagements.
  - **Price does not drive selection of EDD Supplier selection.** As we saw in Chapter VI, in assessing the various criteria used to determine which Supplier to use for any particular electronic discovery engagement, Price was seen as accounting for only 21%. The combination of Reputation and Relationships account for twice the impact of Price.
  - **Suppliers have historically been selected by the law firm** (which does not have to foot the bill and 75% of which EDD Suppliers in our research adjudged not competent to handle a complex electronic discovery matter anyway). Earlier, we documented the Supplier view of the selection process; i.e., the litigating law firm exercises twice as much influence in vendor selection as does the end client litigant (60:30%).

We see developments on the horizon – too early to term trends – which we believe will alter the fundamental dynamics of the EDD marketplace, creating a more competitive environment in the near-term (3-5 years) and changing the basis for competition over the longer term (5-10 years).

## F. Near-Term Market Rationalization

Over the next five years, we see the EDD marketplace evolving toward a more robust and competitive landscape. Here are the factors we believe will drive near-term developments.

### 1. Toward Feature/Function Parity at the Top

We do not view electronic discovery as a market where it is possible to establish any true sustainable competitive advantage in the feature/function arena, apart from brand franchise.

As the market matures, we do not believe the early feature/function differentiators are protectable. While there have been, are and will continue to be real barriers to competition, **none of these are of a nature that cannot be surmounted by a focused competitor with time, money, skill and market execution.**

In the market's current competitive stratification, we see the effects of first-mover advantage, the long-term strategic value of which is totally dependent on how effectively it is leveraged in the market; i.e., what is built on top of that head start platform.

Looking at the top 15-20 Suppliers, today's principal feature/function differentiators include ...

- ▶ **Breadth of Feature/Function.** There are only a handful of Suppliers offering one-stop shopping, directly providing the full range of electronic discovery functions required for any given matter. Growing out of the core identities we previously discussed – processors, enablers, consultants – some firms subcontract forensics, others subcontract production, etc.
- ▶ **Depth of Feature/Function.** At the risk of glib overstatement, we view Collection, Restoration, Extraction and Production as relatively straightforward functional executions, already at (or very near), parity among the top tier Suppliers. We set aside Forensics, because we believe it is severable as a distinct area of specialization, easily and transparently outsourced. That brings us to the functional areas of Culling and Review, which is where we see today's best-of-breed competition being played out.  
  
How Culling and Review functions are approached and performed can profoundly affect the timing, cost and end result of an electronic discovery engagement. Among the top tier Suppliers, there are significant differences in approach, tools and performance.
- ▶ **Scale of Operations and Throughput.** Depending on the size of the electronic discovery task and the timeframe within which it must be completed, the magnitude of a Supplier's available resources can be an important factor in Supplier selection.

With respect to feature/function breadth, it is not clear to us that one-stop shopping cannot be successfully implemented using a best-of-breed and outsourcing approach. The critical success factors are coordination, performance, cost and transparency. Clearly this *integrator* approach has a few more moving parts over which the vendor does not exercise complete control, but it is a well-established business model in, for example, large-scale enterprise systems and software deployments.

Regarding feature/function depth and looking solely at the Culling and Review functions, the best-of-breed performers today have an estimated 12 to 18 month advantage over their competitors, who we believe could integrate off-the-shelf, third-party vendor component solutions, from a standing stop in that same time frame.

It is important to point out that in the total scheme of Supplier selection criteria, our sample of EDD execs thought “Technology” (which we would substitute for feature/function), accounted for only 13% as a selection weighting factor. Almost half of the vendor selection weight (46%), was attributed to Relationships and Reputation, which speaks to competition for distribution and brand franchise.

## 2. Changes in How EDD Suppliers are Selected

**Over the next five years, we predict a shift in both the locus of Supplier selection decision making and in the methods of selection. We see greater end client litigant influence in the decision making process and a more competitive process.** Here are some of the factors leading us to those conclusions ...

- ▶ **The costs of electronic discovery are significant for the end client litigant.** Six, seven and eight-figure contracts are not amounts that corporations are wont to leave unmanaged.

Historically, procurement is not a litigation firm strength, nor as we mentioned before, are law firms particularly motivated to aggressively manage third-party EDD Supplier costs. Assuming relative parity among some group of Suppliers, it is difficult to imagine any law firm falling on their sword to maintain control over vendor selection, though we would expect them to remain involved in the selection process and provide active management during the engagement.

Under corporate control, we would expect to see procurement processes that are more thorough, formal and less fraternal.

- ▶ **As clients gain greater control over their data, they will be better positioned to participate in the electronic discovery process – and they will.** The new and visible arrival of compliance and reporting as a critical and permanent corporate initiative means formal systems and structures for active management of corporate records (documents). Ideally, this suggests a smaller scope, electronic discovery task. We would additionally posit that, with no disrespect to CIO luminaries the world over, the Chief Compliance Officer will stand in a different relationship to litigation counsel.

## G. Rapid Growth at the Bottom

**The next five years will see the growth of a large submarket of small matter electronic discovery projects.** EDD is marching toward ubiquity at virtually every level of civil litigation. Whereas large complex litigation has proven to be relatively price-insensitive for EDD, proportionality dictates that cannot possibly appertain at the small matter level.

While we are registered disciples of Moore’s Law, **we do not believe the business models, products and services of the top tier EDD Suppliers scale downward particularly well.** Requisite service levels are generally achieved using a relatively high level of skilled practitioners. Experience tells us this formulation does not scale downward easily either in terms of matter size or geography. For example, it is difficult for us to imagine a Supplier successfully extending direct EDD operations in the US below the top 25 metropolitan markets, (excepting co-location of CSR personnel at/near a major corporate client headquartered in a smaller market or the implementation of a franchise-like model where affiliate spokes gather and feed processing volume to a corporate hub).

We believe that what will be required to meet the needs of the small matter marketplace is a homogenized set of accepted practice standards, plus self-contained, turnkey solution sets to enable mid-to-small sized law firms to execute EDD projects with the assistance of local market consultants. We think the critical components of the solution are software, hosting and training (which may also be software-based).

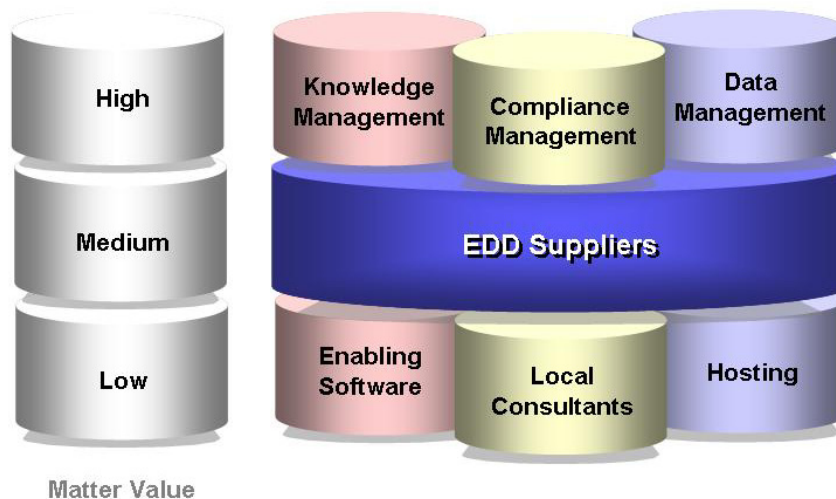
Following the corporate systems and software deployment model we referenced earlier, we can envision a Supplier-branded and certified local market affiliate structure working very well here as a midterm market solution, but we do not see many of the top tier Suppliers aggressively moving in this direction at this time. Alternatively, we can also envision extensions of litigation support software evolved to the point of bridging the gap for local market EDD practitioners.

## H. Long-Term Market Rationalization

In spite of continued and significant growth in market demand for EDD products and services, we do not envision electronic discovery evolving into a long-term, standalone industry. Rather with the sum of EDD goods and services comfortably over \$1 billion and rapidly growing, **we are looking for the already present trend toward horizontal consolidation – absorption of EDD operations into market adjacencies – to accelerate.** The dollars are now too large to ignore. Additionally, changes in regulation and legislation (particularly, Sarbanes-Oxley), have made many of the EDD operations, tools and people strategically attractive to larger enterprises with operations in adjacent market spaces.

There are several prominent examples of horizontal consolidation already in the marketplace today – LexisNexis (an information company), acquired Applied Discovery; EMC (a storage management company), acquired Legato and Documentum; Marsh McClellan (a financial services and risk management company), acquired Kroll. **In each case, the acquirer, sitting in a larger adjacent market space, envisioned a strategic fit of the target company’s electronic discovery operations with the acquirer’s much broader array of products and services. In other words, an opportunity to leverage their existing customer relationships into broader, deeper and more profitable relationships.**

The continuation of this trend has significant implications for the EDD Supplier landscape. Taken to its logical conclusion, **we may well be looking at a future marketplace dominated at the large matter end by subsidiaries of very large, diversified corporations. Five to seven standalone EDD Suppliers will compete for mid-sized matter engagements. And a very broad small matter marketplace will be serviced by several hundred modest consulting firms.**



Importantly, this projected **realignment of players will also change the basis of competition**, certainly at the high matter end of the spectrum, which is one reason we don't foresee any standalone EDD Suppliers competing at that end.

**For the diversified enterprise owners, electronic discovery represents the opportunity to ...**

- ▶ **Offer the marketplace a fully integrated set of related services.**
  - If you are providing enterprise risk management and compliance management services, EDD is a logical extension which leverages domain knowledge, operations and distribution channels.
  - If you are providing data management services, you already have the data and there are a number of electronic discovery services that can be provided as a margin-laden, value-add.
  - If you are providing knowledge management services, you have already participated in pre-collection and pre-culling the data. Creating the structures to finish the job should not be all that difficult and are potentially very profitable.
  - If you are an information content company (and frankly, we never quite got that one), it is a channel leverage strategy, although the channel in question is about to be disintermediated from the decision making process, at least at the high end of the market.
- ▶ **Establish relationships with large target client companies.** Just like every other product in the portfolio, EDD can be used as an opportunistic wedge to open the door to growing broader, deeper, and more profitable relationships.
- ▶ **Deepen existing corporate client relationships and derive the type of high margin revenues characteristic of cross-selling, absent real competition.**

With the exception of the use of EDD as a wedge into a new client relationship, EDD at the high-value-matter end is largely devoid of direct competitive pressures for individual assignments. Rather, the competitive frame migrates toward image, mindshare, market leadership, reputation and execution for which competition, we hasten to add, can be every bit as brutal as hand-to-hand combat over a single piece of business.

Another important change in the basis for competition grows out of the type of market realignment we have described – another change in where and how EDD services are procured. Within the corporate client, data management services are the province of the CIO; for risk management services, the buyer can be the CLO or CFO; compliance management services purchase decisions will be made by the new CCO; and at the end of the day, the CLO is the internal field general regarding all things litigation. This suggests a very different type of competition than the standard three bid, direct shootout among qualified, standalone EDD Suppliers; each trying to convince a litigation firm that theirs is the best solution.