

2010
Law Firms in Transition
An Altman Weil Flash Survey



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Contributing Authors

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Law Firms in Transition 2010

The Altman Weil Flash Survey, **Law Firms in Transition 2010** found a clear consensus emerging among US law firms regarding changes in the profession. Over 75% of firms surveyed indicate that they believe that more price competition, more non-hourly billing and the use of project management to improve efficiency of service delivery will be permanent changes in the legal landscape.

The primary impact on law firms of the recent recession will be a greater focus on efficiency and productivity driven by client demands for cost control. It's our observation that most firms are still in the early stages of determining how to successfully institutionalize those changes in their organizations.

The majority of law firms do not expect the changes to negatively affect their bottom line. In fact, only 27% of those surveyed believe that lower profits per partner will result.

Non-Hourly Billing

The survey reports that 94.5% of law firms offer some alternative fee arrangements (AFAs), and all firms with 150 or more lawyers do so. The majority of firms indicate that their use of AFAs is primarily in response to client requests, rather than as a proactive strategy. Additionally, half of all firms say their fee arrangements are either less profitable than matters billed hourly, or they're not sure how they compare.

When asked about tactics employed to implement AFA programs in their law firms, 80% report they require centralized approval for AFAs; 61% use cost analysis to determine fee structures, and 45% have AFA Committees. However, less than a third of firms track profitability outcomes, feature fee options in marketing communications, provide project management training, or set annual targets for AFAs.

We're seeing some systemization, especially in larger firms, but there is a long way to go before alternative fee programs are business-focused and profit-driven rather than being seen as concessions to clients.

Lawyer Staffing Structures

Partnership in US law firms is now harder to attain and will remain so according to the survey. Nearly 40% of firms made fewer partnership offers in 2009, and 50% indicated that they will or might do so in 2010. Over a quarter of all law firms reported de-equitizing partners in 2009 and 37% will or might do so this year. An additional 14% extended the partnership track last year and 20% will or might do so in 2010. The majority of firms expect each of these trends to be permanent going forward.

This is a key element in the changing equation of law firm finance. Firms will maintain their profits per partner, in large part, by managing the number of partners they admit.

The short term outlook for associates is not bright. Sixty four percent of firms reported shrinking their summer programs in 2009 and 54% anticipate doing the same in 2010. Just over half of all firms reduced or discontinued hiring first year associates last year, and 38% will do the same this year. Longer term, firms are uncertain of associates' fate. While 42% predict that smaller first year classes will be a permanent phenomenon, 45% expect the opposite. And only 32% predict that associate salary reductions will continue in future.

When asked about other staffing alternatives, firms expressed a growing enthusiasm for contract lawyers. In 2009, 39% of law firms reported using contract lawyers. In 2010, 53% will or might do so; and, 52% expect that contract lawyers will become a permanent part of their staffing plans.

By contrast, less than 10% of firms outsourced or offshored legal work in 2009 or plan to do so in 2010. Only 28% of law firms expect outsourcing of legal work to be permanently adopted in the future, and 22% expect the same for offshoring.

Despite the potential for cost savings, law firms remain highly skeptical of outsourcing and offshoring and will likely only adopt them when pushed by clients to do so. This is similar to the scenario we've seen with firms' adoption of alternative fees.

Workforce Reductions

Law firms cut personnel from the bottom up in 2009. Sixty-seven percent of law firms made cuts in support staff; 43% cut paralegals and 44% cut associates. By

contrast, only 25% cut equity partners and 26% cut non-equity partners from their ranks.

We have not seen the end of personnel cuts, according to the survey, but they will be more limited in 2010. Support staff is still a target, as are non-equity partners.

While making cuts, firms are also planning growth. Half of all firms indicated they will be more aggressive in increasing lawyer headcount in 2010. The overwhelming strategy of choice for growth is acquisition of laterals followed by the acquisition of groups.

Many firms see acquiring laterals as a way to buy new clients and increase the top line without raising rates. But our experience is that as many as half of all lateral acquisitions fail to fulfill expectations because they are not strategically planned or well executed.

Financial Performance

Despite the difficult economy, slightly more firms had revenue gains than losses in 2009. Forty-six percent of firms reported increases in gross revenue; 44% reported decreases; and 10% had no change from the prior year. Revenue per lawyer was also up in 47% of law firms in 2009. Profits per equity partner (PPEP) increased in 56% of firms.

PPEP increases were driven by cuts in overhead costs in 69% of law firms which were primarily cuts of personnel. Forty two percent of firms cut costs by more than 4% and an additional 27% cut costs by 1% to 4%.

Law firms raised their standard hourly billing rates in 2010. The median increase is 3% according to the survey, closely aligned with the 2010 US rate of inflation, currently reported at 2.2%

Conclusion

The final question of the **Law Firms in Transition** survey asked whether the events of 2009 were an anomaly, an accelerator of existing trends, or a game changer. A large majority of respondents chose 'accelerator' – and we agree.

The legal profession is – and remains even after the Great Recession – tremendously stable. It was certainly not immune to the recent economic upheaval, and 2009 saw the biggest staffing and overhead cuts ever made in US law firms.

But in most cases these cuts represented a rational business response to market conditions.

Going forward, law firms will deliver services using a more streamlined workforce, and will make other changes to billing and staffing structures that are responsive to client demands for cost control, predictability and value. And they will learn how to accomplish these changes while maintaining profitability.

The pace of change has accelerated, but it is still manageable for firms that have or learn adaptive skills. There will be a distinct competitive advantage for first adopters and 'fast followers' who pursue initiatives to make alternative fees consistently profitable, institutionalize project management training, right-size their partnership tiers, and deploy associates effectively.

For the bulk of firms in the middle of the pack, timing will be everything. Each individual firm will have a unique tipping point when external demands for change will significantly escalate based on their particular client and practice mix. Firms that proactively monitor their markets and pay close attention to client signals will be able to stay ahead of demand.

Firms that wait too long to incorporate market changes into their operations, may eventually find the gap between themselves and their more progressive competitors difficult to bridge. Although there may be risks to action, we believe there is greater risk in inaction.

Survey Methodology

Conducted in April and May of 2010, the survey polled Managing Partners and Chairs at 787 US law firms with 50 or more lawyers. Completed surveys were received from 218 firms (28%), including 38% of the 250 largest US law firms.

The full survey is available online to download at: www.altmanweil.com/LFiT2010. Special reports based on law firm size ranges are available exclusively to survey participants.

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About the Authors

Thomas S. Clay is a principal of Altman Weil, Inc. With 30 years experience consulting to the legal profession, he is an acknowledged expert on law firm management principles and is a trusted advisor to law firms throughout the United States. Mr. Clay heads complex consulting assignments in strategic planning, law firm management and organization and law firm mergers and acquisitions. He is a thought-leader on the key issue of law firm practice group strategy and leadership.

He is Fellow of the College of Law Practice Management (COLPM) and serves as a Judge for the College's InnovAction Awards which recognize outstanding innovation in the delivery of legal services worldwide. He is a member of the COLPM Futures Committee. In 2008, Mr Clay was named as one of the "100 Legal Consultants You Need to Know."

Eric A. Seeger is a Senior Consultant with Altman Weil, Inc. He works with large and small law firms in the areas of strategy formulation, practice group planning, merger search, merger assessment and organizational audit. Mr. Seeger directs Altman Weil's market research department. Over the years he has managed hundreds of strategic research projects for law firms and legal vendors.

Prior to joining Altman Weil, Mr. Seeger was an independent consultant to law firm and corporate executives. He served as strategic planning officer of an AmLaw 200 law firm for four years. Previously, he performed market analysis for a global manufacturer, holding leadership positions in the industry's trade association, and served in budgeting and planning capacities for a major university.

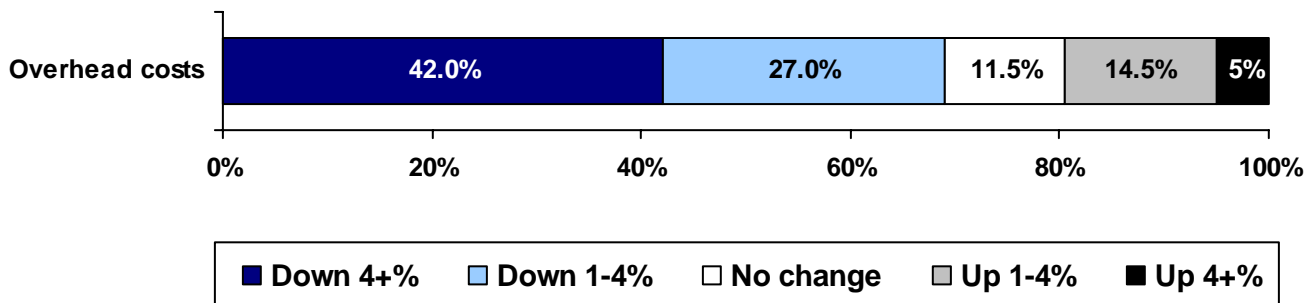
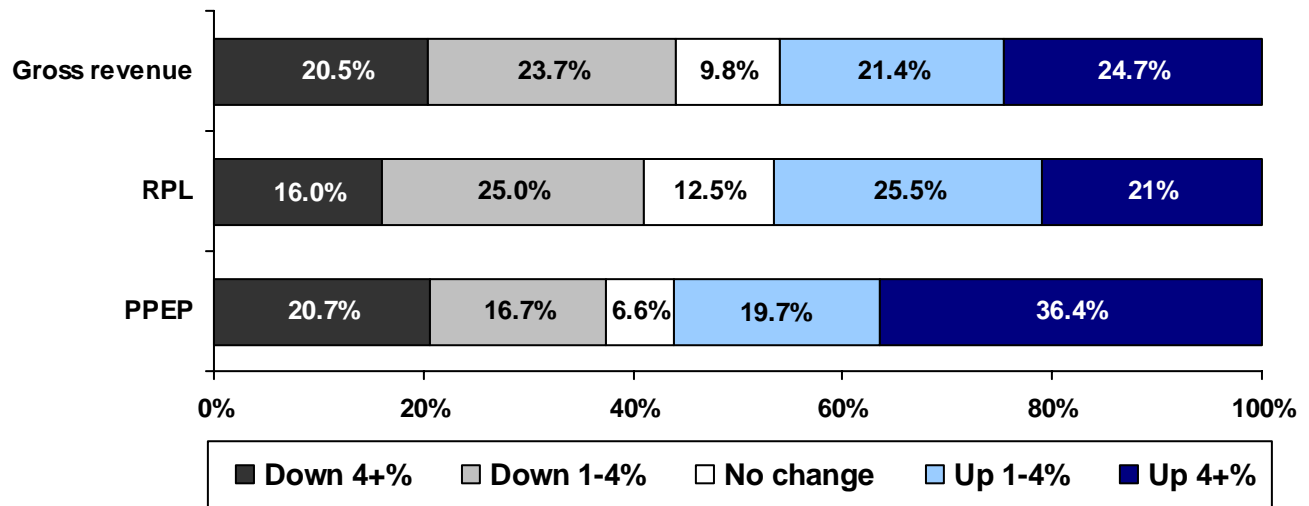
About Altman Weil, Inc.

Founded in 1970, Altman Weil, Inc. is dedicated exclusively to the legal profession. It provides management consulting services to law firms, law departments and legal vendors worldwide. The firm is independently owned by its professional consultants, who have backgrounds in law, industry, finance, marketing, administration and government. More information on Altman Weil can be found at www.altmanweil.com.

Financial Performance

How did your law firm perform in 2009 compared to 2008?

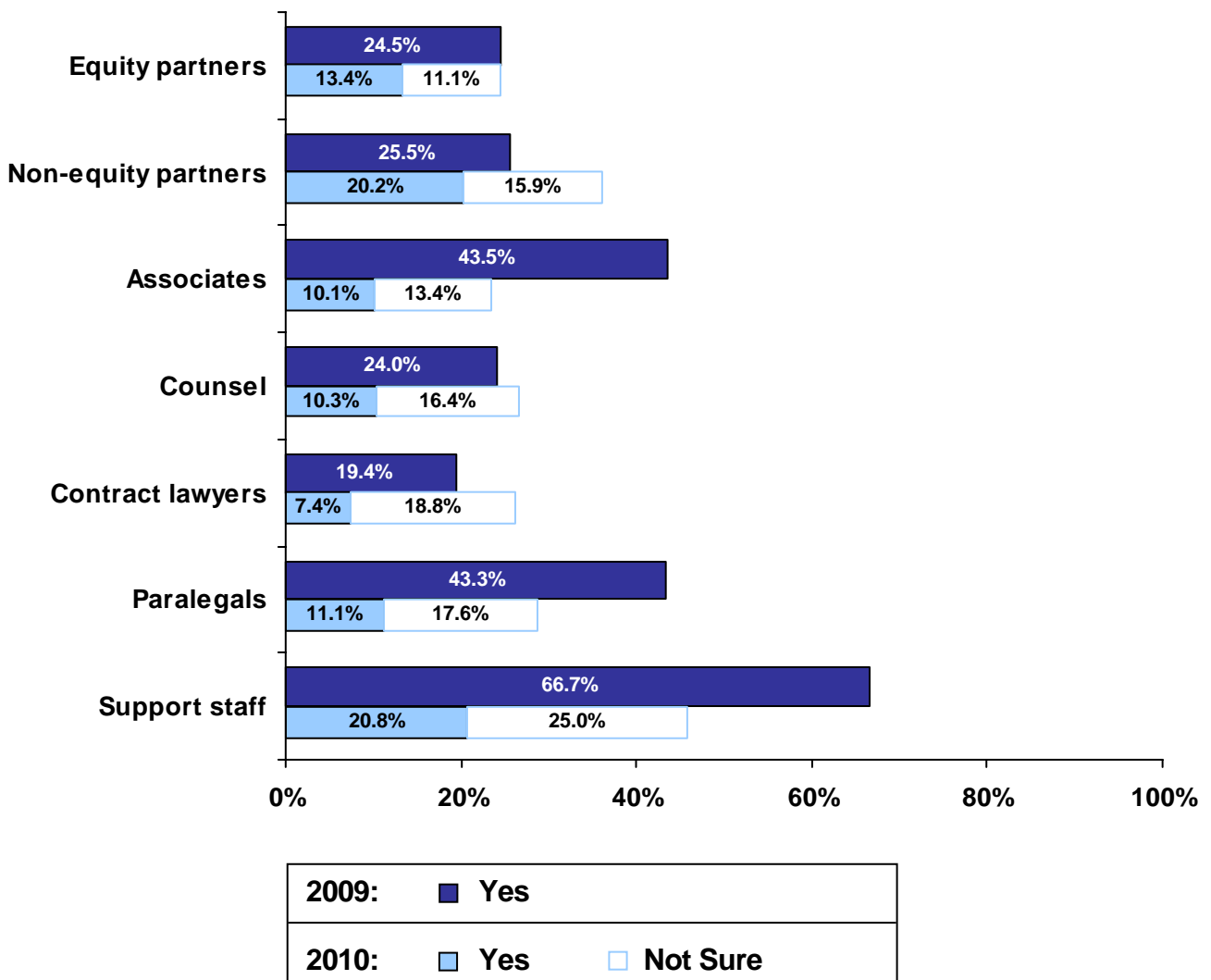
- Overall 2009 was not the disaster many predicted for law firms. More firms reported revenue gains than losses.
- Approximately 70% of firms reduced overhead which was a major factor in bolstering profits per equity partner.
- Across-the-board cuts reflected a market correction for firms that were overstaffed at a time of shrinking demand.
- Firms will continue to benefit in 2010 from 2009 cuts.
- It is likely that cuts may become permanent (firms are not rehiring staff), and that firms will simply be more productive.



Workforce Reductions

For each of the following timekeeper classes, did your law firm reduce its work force in 2009? Will you do so in 2010?

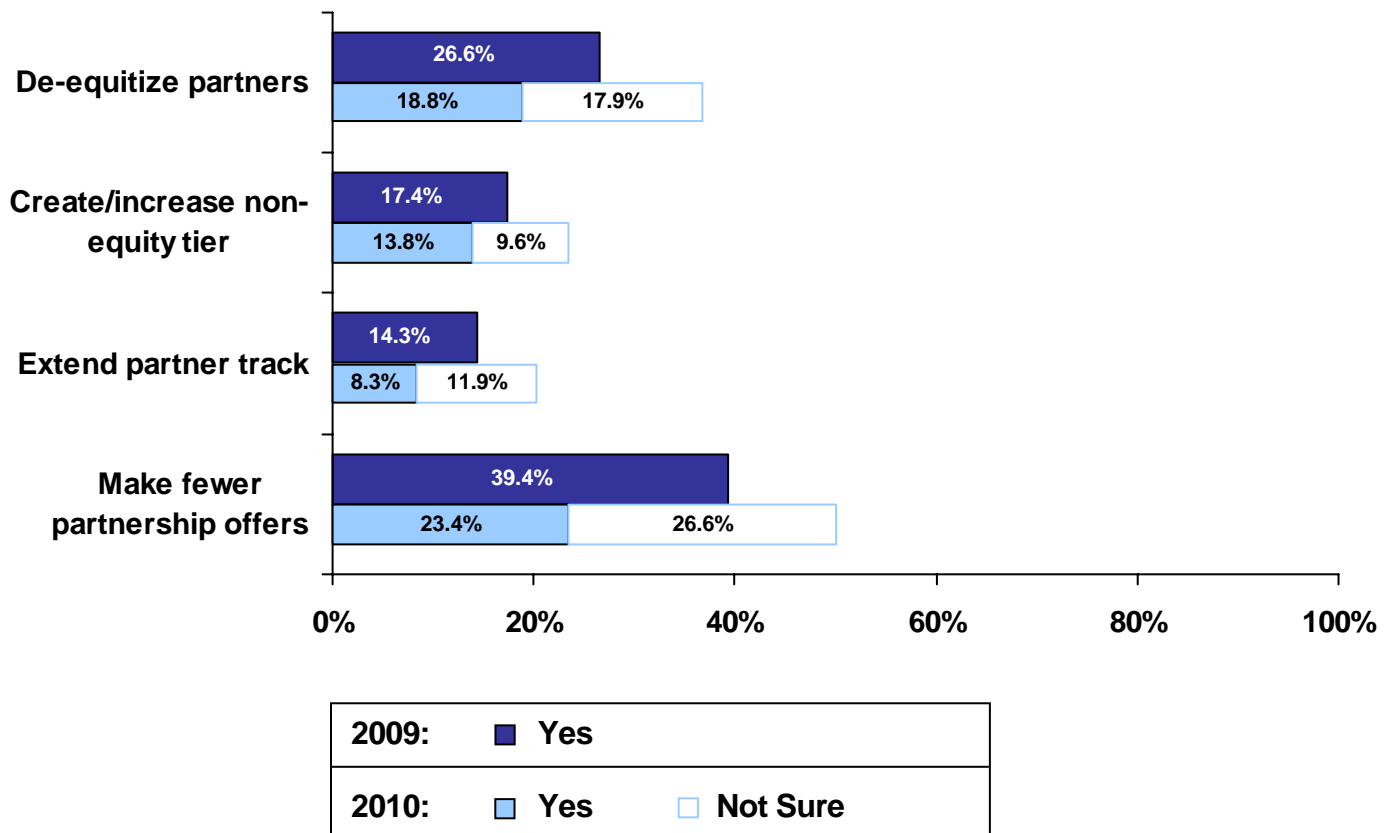
- Staff, paralegals and associates took the brunt of personnel cuts in 2009. Staff continue to be most at risk of being let go in 2010, although at much reduced levels.
- In general, smaller firms experienced less disruption in 2009 and are less likely to reduce staff and/or professionals in 2010.
- We are already seeing a focus on reductions of chronically unproductive partners and non-equity partners who are unable to contribute at a high level.
- We have not seen the end of personnel cuts, but they will be more selective in 2010.



Partnership Structure

Did your firm do any of the following in 2009? Will you do so in 2010?

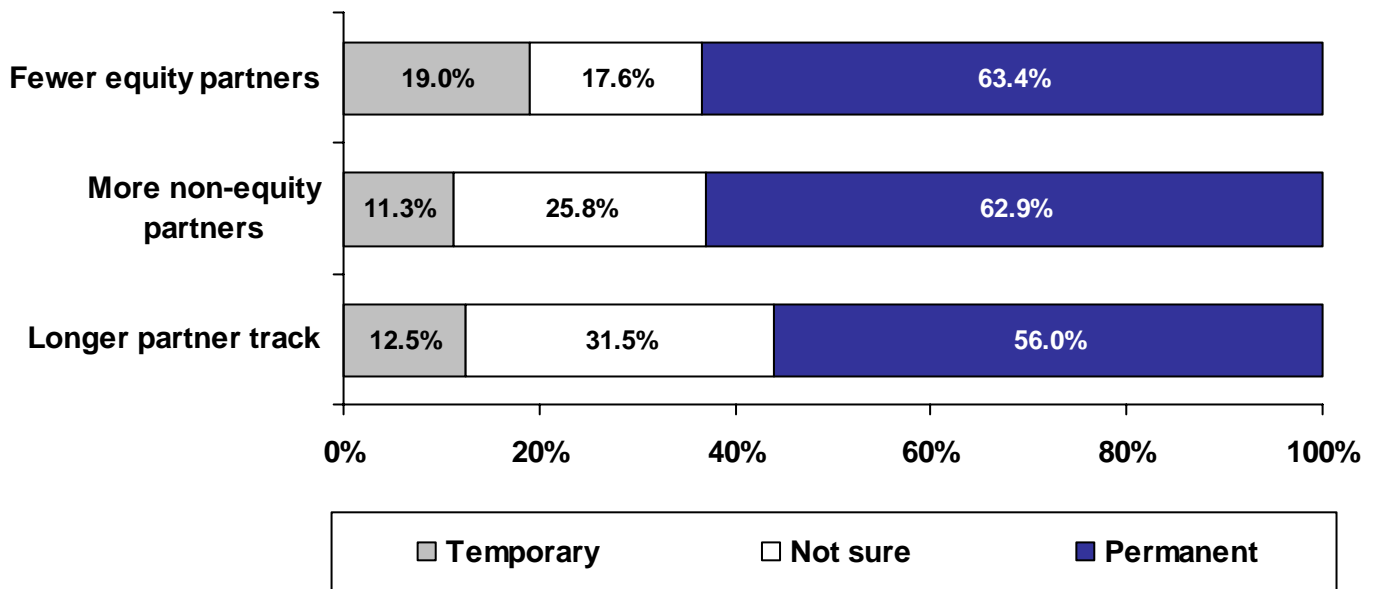
- Over one quarter of law firms de-equitized partners in 2009 and nearly 37% said they will or might de-equitize partners in 2010.
- Firms with 250 or more lawyers were twice as likely to de-equitize partners in 2009.
- The overall structure of law firm partnership does not appear to be changing radically, but it is harder to make partner and will remain so.



Partnership Trends

In light of the events of 2009, which of the following trends do you think are temporary and which will be adopted as standard by most firms going forward?

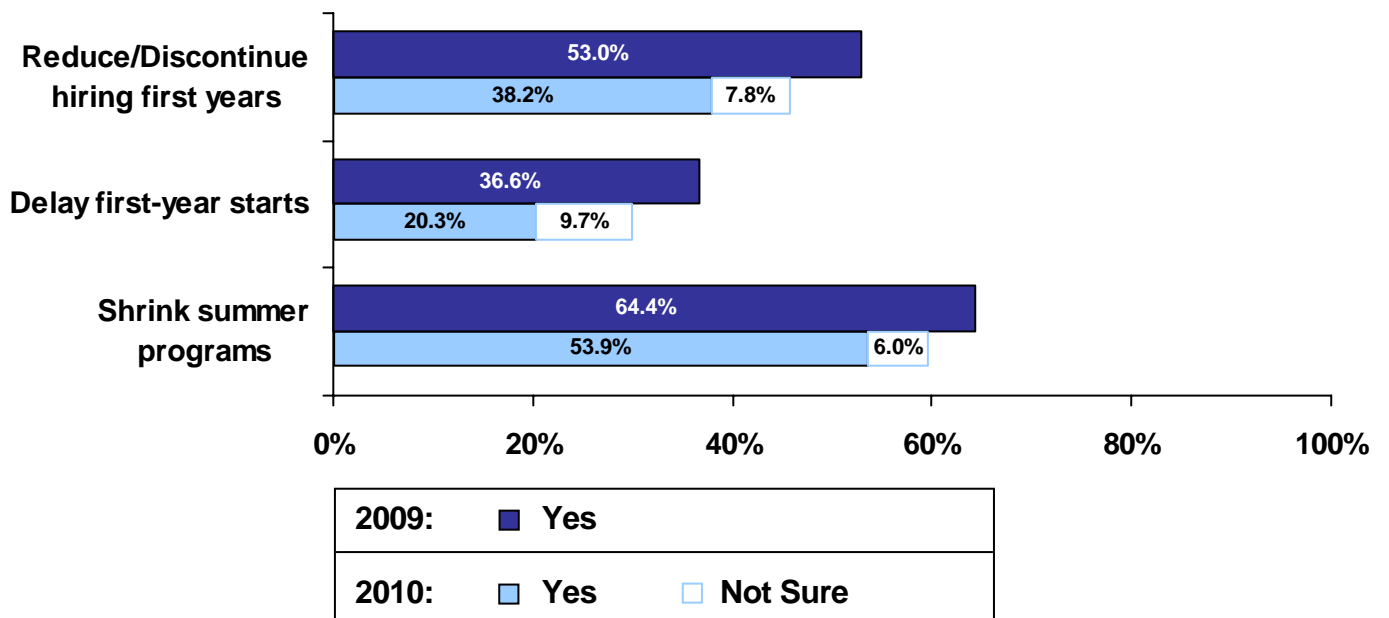
- Law firms will maintain profits per equity partner by managing the denominator – number of equity partners.
- Partnership in US law firms is now harder to attain and will remain so. Equity partners are no longer tenured for life. These trends were accelerated by the recession and are now well entrenched.



Associate Programs

Did your firm do any of the following in 2009? Will you do so in 2010?

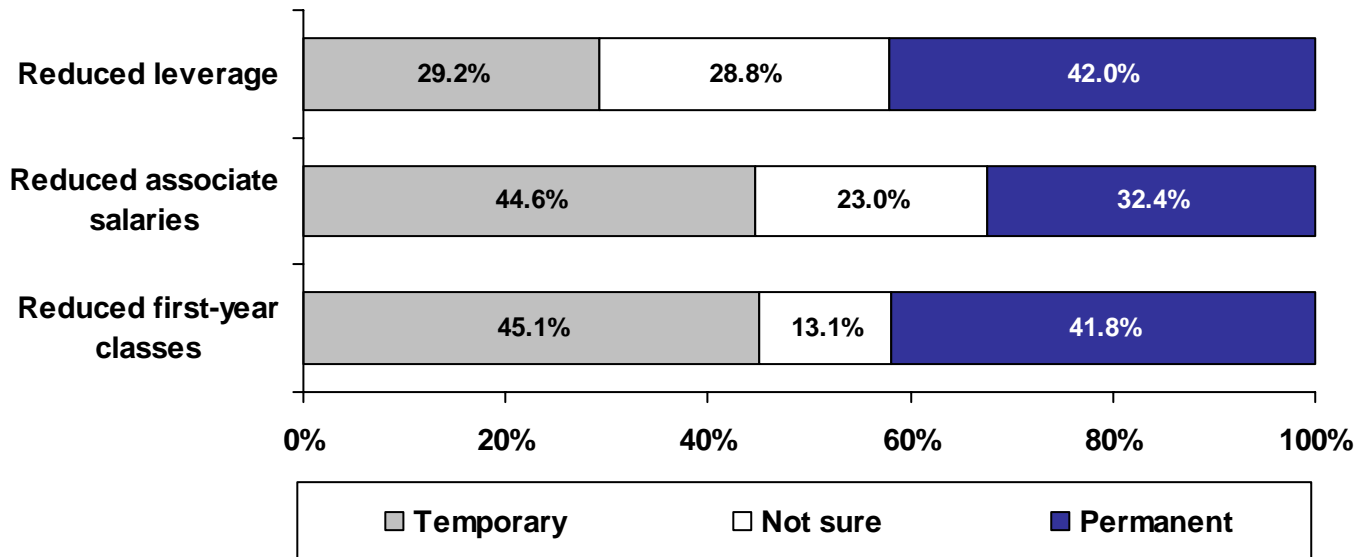
- Summer programs will continue to shrink in a majority of law firms. We are already seeing a movement toward less elaborate pay and structures in those programs.
- Many firms are continuing to be cautious and conservative in hiring. This will exacerbate the problem of new graduates being able to find positions in law firms.
- Overall the need for inexperienced associates has decreased and may never rebound.



Associate Trends

In light of the events of 2009, which of the following trends do you think are temporary and which will be adopted as standard by most firms going forward?

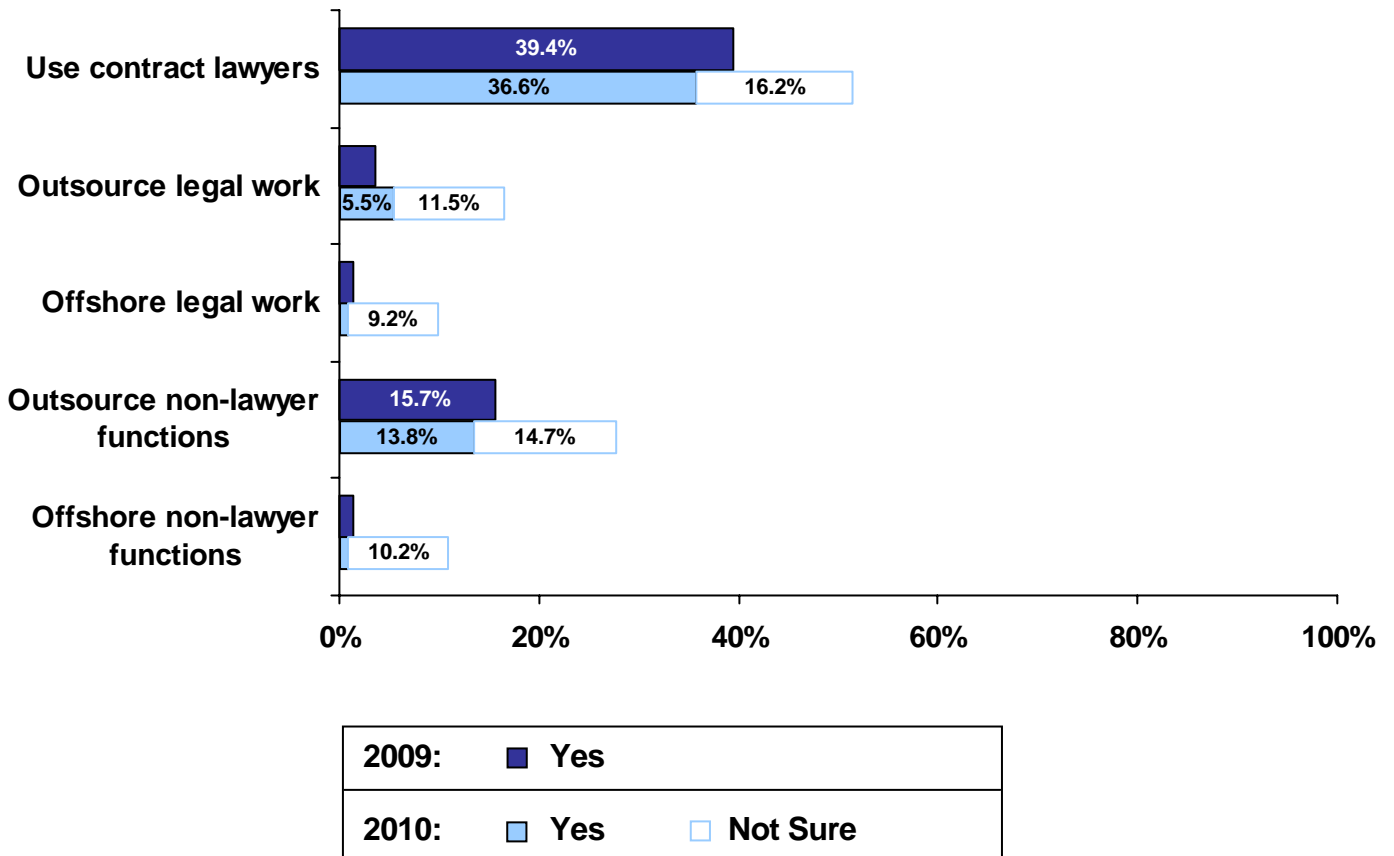
- How law firms will handle associate hiring and compensation remains highly uncertain.
- In 2010 there are some indications of a return to the status quo in associate compensation, reflecting firms' stronger economic position after staffing cuts in 2009. This may represent a missed opportunity to recalibrate associate compensation to be more consistent with client expectations and more in line with associates' economic contribution to their law firms.



Staffing Alternatives

Did your firm do any of the following in 2009? Will you do so in 2010?

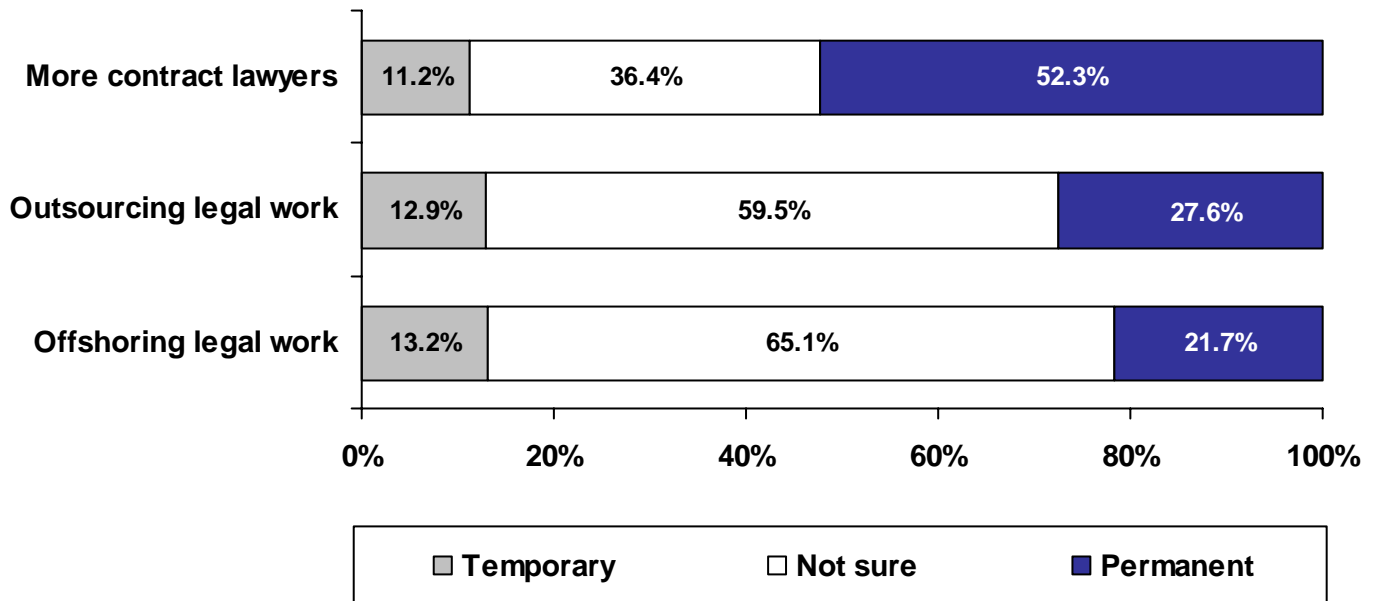
- A majority of firms indicated that in 2010 they will or might use contract lawyers, up from 39.4% in 2009. This staffing option is being pursued by law firms to achieve high quality, lower cost service that preserves flexibility.
- Very few firms will look to outsourcing or offshoring as a means by which to change the service delivery model. Firms that pursue these alternatives are mainly being pressed to do so by major clients.
- In general, we are not seeing much staffing innovation which could drive the increases in efficiency and value that clients are looking for. Clients, not law firms, are driving changes in this area



Staffing Trends

In light of the events of 2009, which of the following trends do you think are temporary and which will be adopted as standard by most firms going forward?

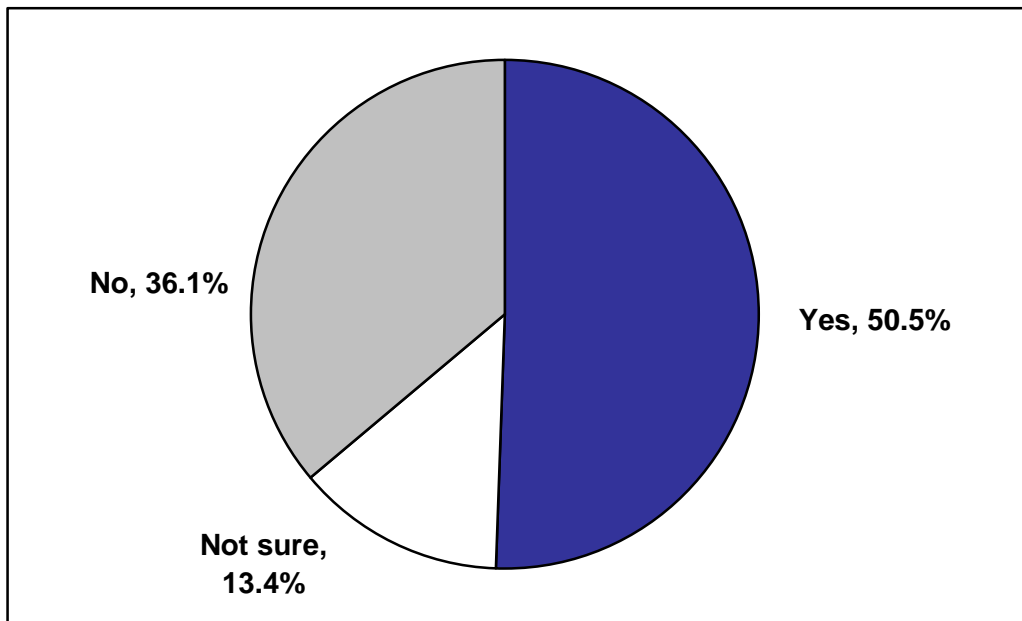
- Over half of all law firms, and a significant majority of larger firms, see contract lawyers as a permanent part of their staffing mix. This option provides a measure of flexibility for law firms and clients as well as lawyers who do not aspire to partnership or who have fallen off the partnership track.
- Despite the opportunities for cost savings, most law firms remain reluctant to consider outsourcing and offshoring options. As with AFAs, most law firms will only pursue these options when it becomes necessary.



Growth

Will your firm be more aggressive about increasing lawyer headcount in 2010 than it was in 2009?

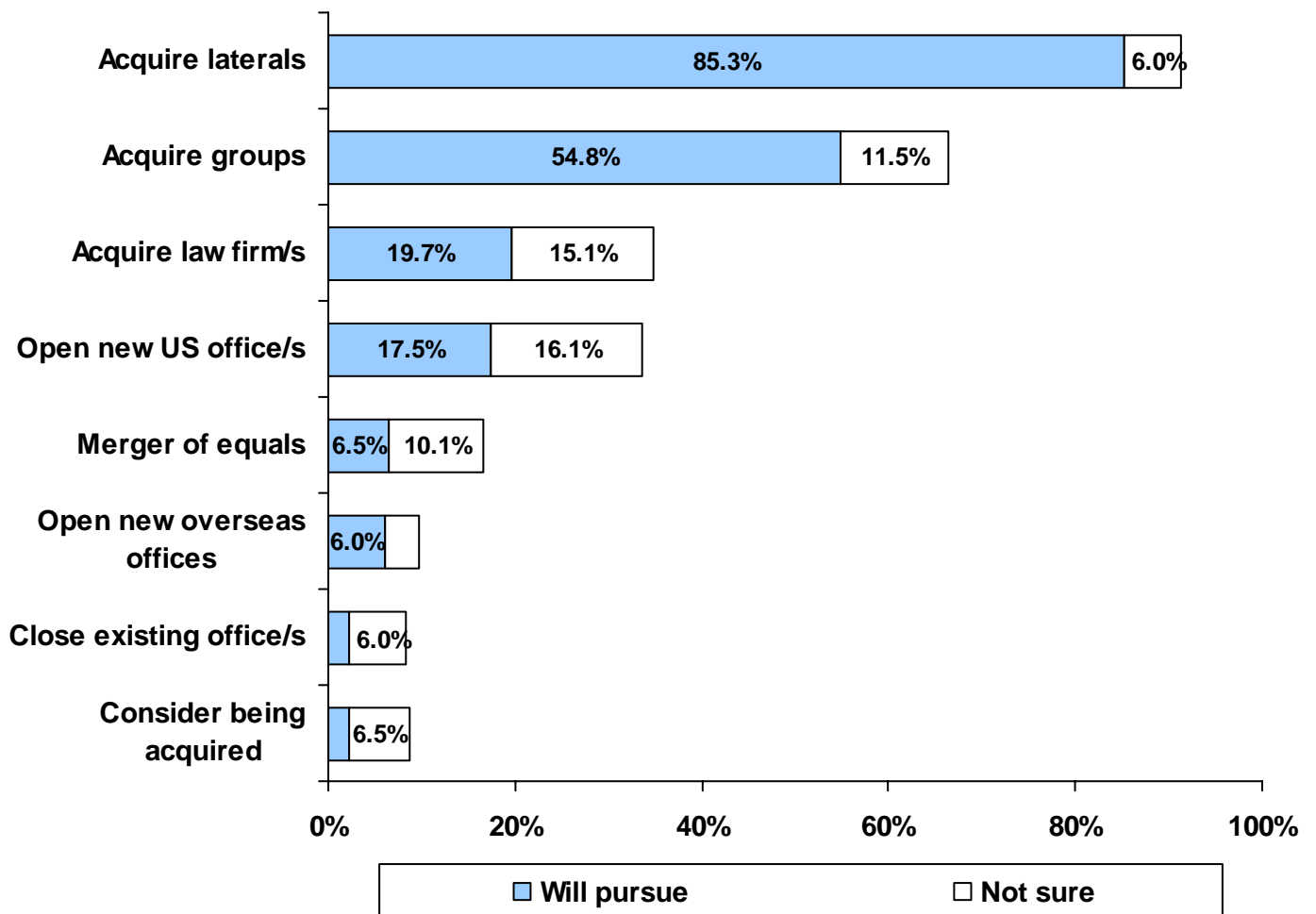
- 50.5% of law firms said they will be more aggressive in adding lawyers compared to 2009.



Growth

What growth options will your firm pursue in 2010?

- The overwhelming strategy of choice for growth is addition of laterals followed by acquisition of groups of lawyers.
- Firms believe that adding laterals is easier, less expensive, and less risky. The reality is that many laterals (some believe more than 50%) do not ever reach their stated objectives in terms of bringing clients and revenue to the firm.
- There are better and more useful ways to engage in lateral recruiting and firms will need to find ways to differentiate themselves in a market where everyone is pursuing the same strategy.

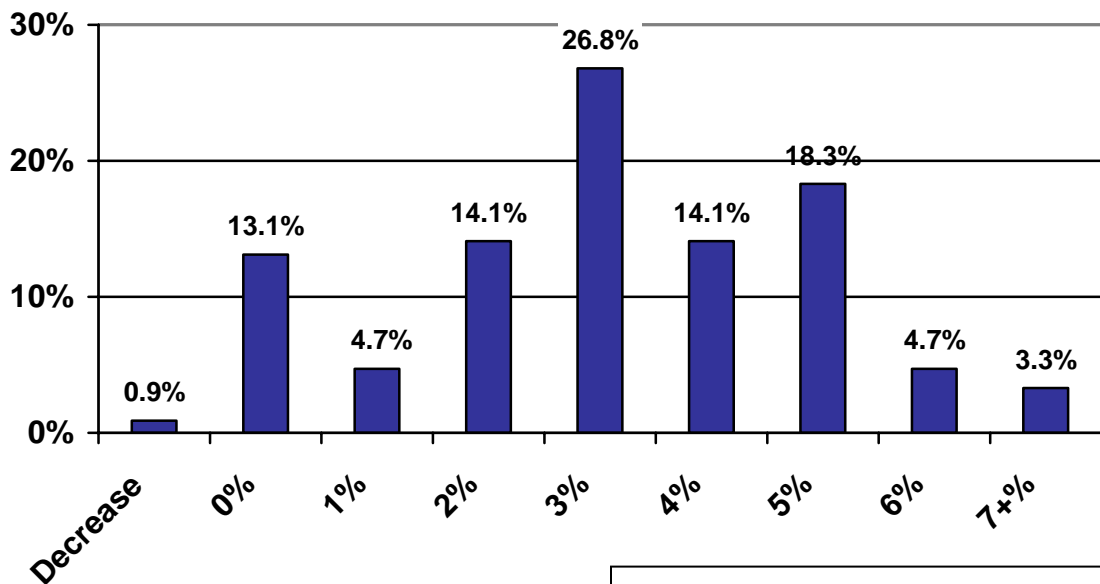


Billing Rates

What is your firm's overall change in standard hourly billing rates for 2010?

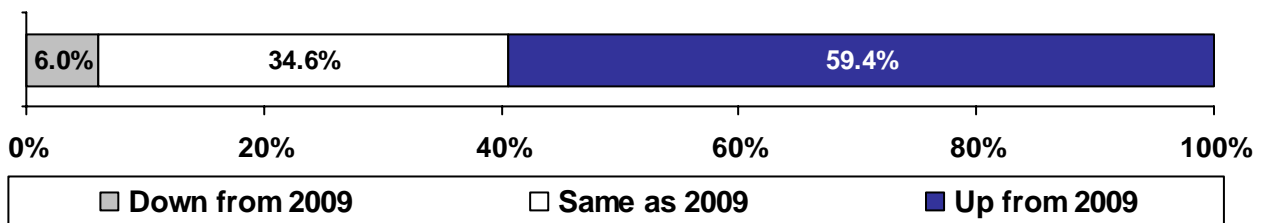
Overall do you expect your firm's effective (realized) rates for 2010 to be up or down?

- Overall standard billing rates are up 3.1% for all responding firms. For larger firms the increase is higher.
- Many firms refrained from rate increases in 2009 and gave discounts to many clients. Making up the lost ground will take years depending upon the depth of the discounts that were offered.
- It appears that the days of annual rate increases at twice the inflation rate are past.



Average rate change: 3.1%

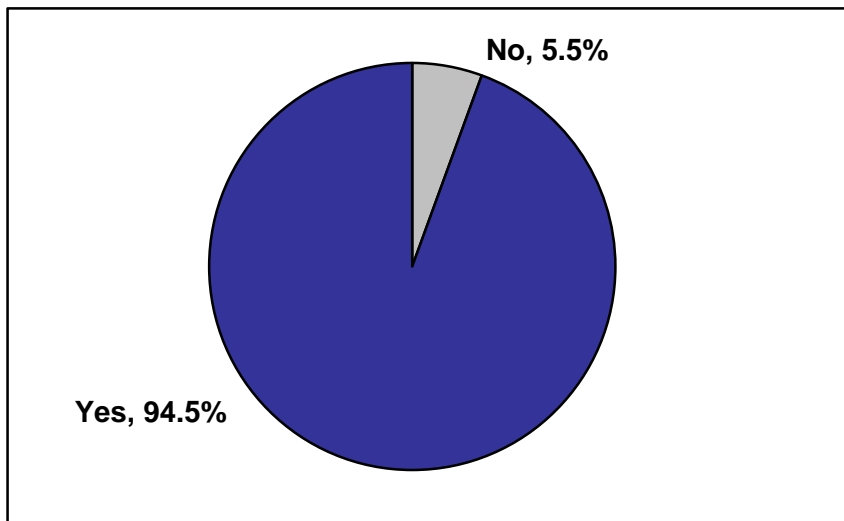
Median rate change: 3.0%



Alternative Fees

Does your firm use any non-hourly based billing?

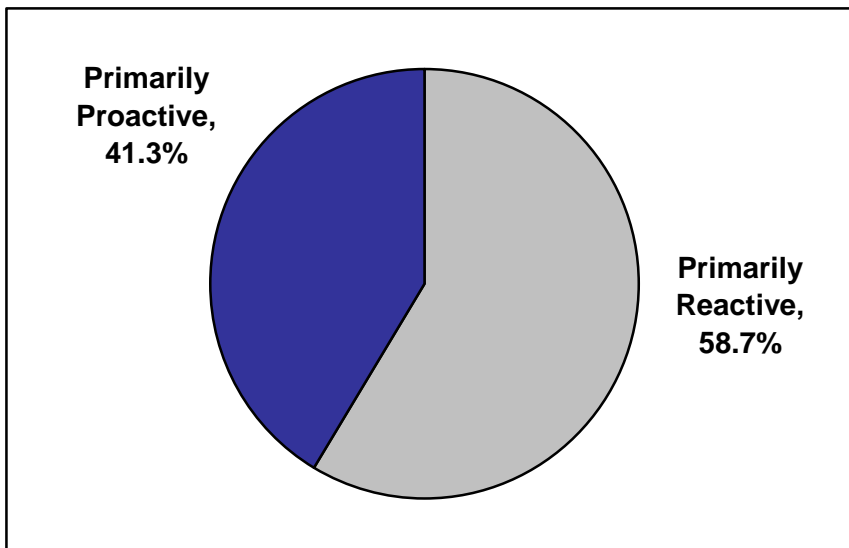
- Every firm with 150 or more lawyers reported using some non-hourly billing.
- More clients are expecting and demanding alternative fees, driven by cost control imperatives and their need for budgetary certainty.



Alternative Fees

If yes, is your firm's use of alternative fee arrangements primarily reactive (in response to client requests) or primarily proactive (arising from your belief in the competitive advantage of alternative fees)?

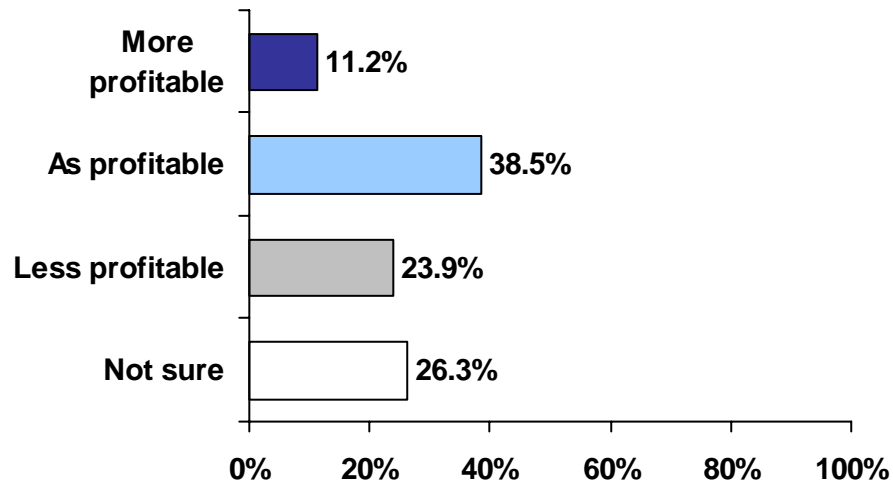
- Most law firms are reactive to the marketplace on alternative fee arrangements. We suspect this is because they believe that the pace of change will be slow and can be met with a measured response.
- The problem with this position is that installing and being successful with AFAs is an experiential learning process. Firms that have not started the process will find it difficult to catch up and will be less successful. Their relative lack of capability in this area will be evident to clients.



Alternative Fees

Overall, compared to projects billed at an hourly rate, are your firm's non-hourly projects more profitable or less profitable?

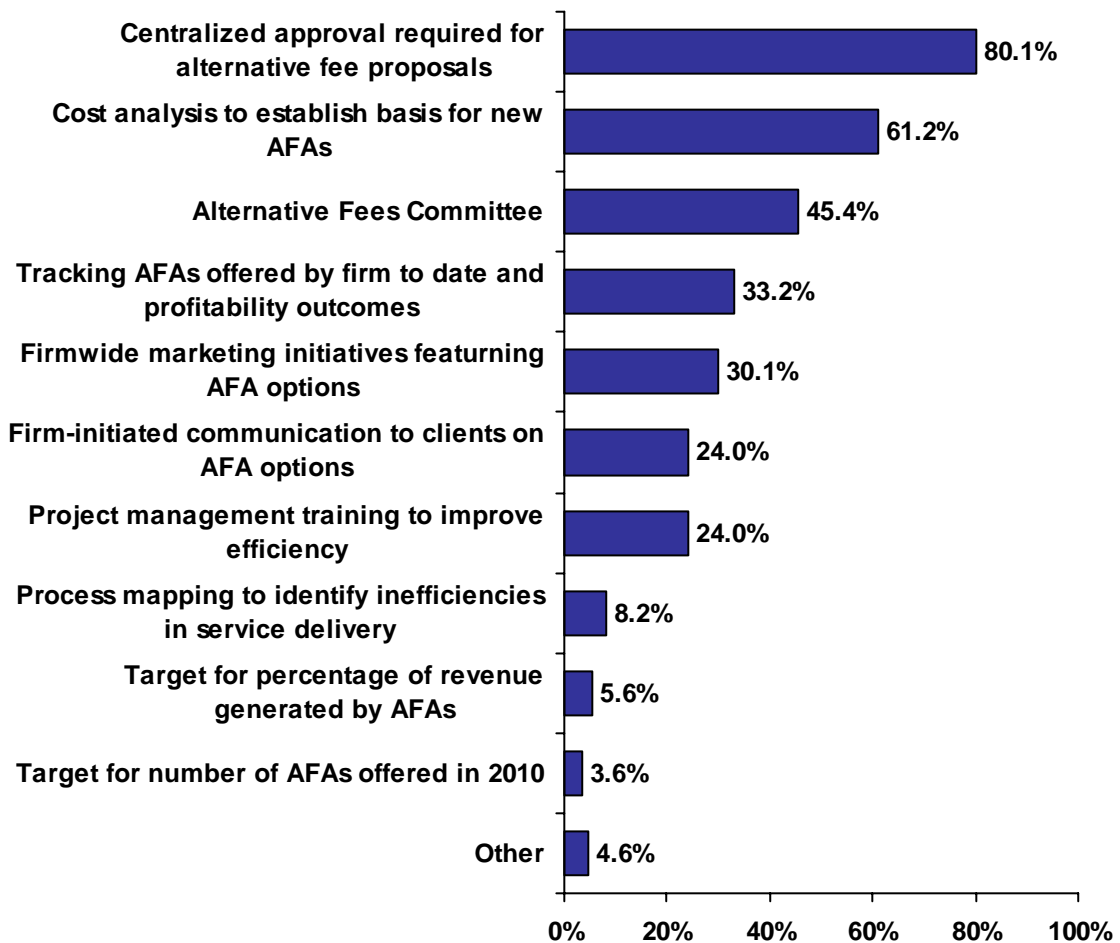
- Too many firms have indicated that their current fee arrangements are either less profitable than matters billed hourly or they're not sure how they compare. Neither position is acceptable and this will have to be rectified quickly if firms are to maintain margins and profits.
- Managed well, there is no reason why alternative fee arrangements cannot benefit both law firm and client.



Alternative Fees

If your firm uses non-hourly based billing, which of the following tactics has your firm implemented?

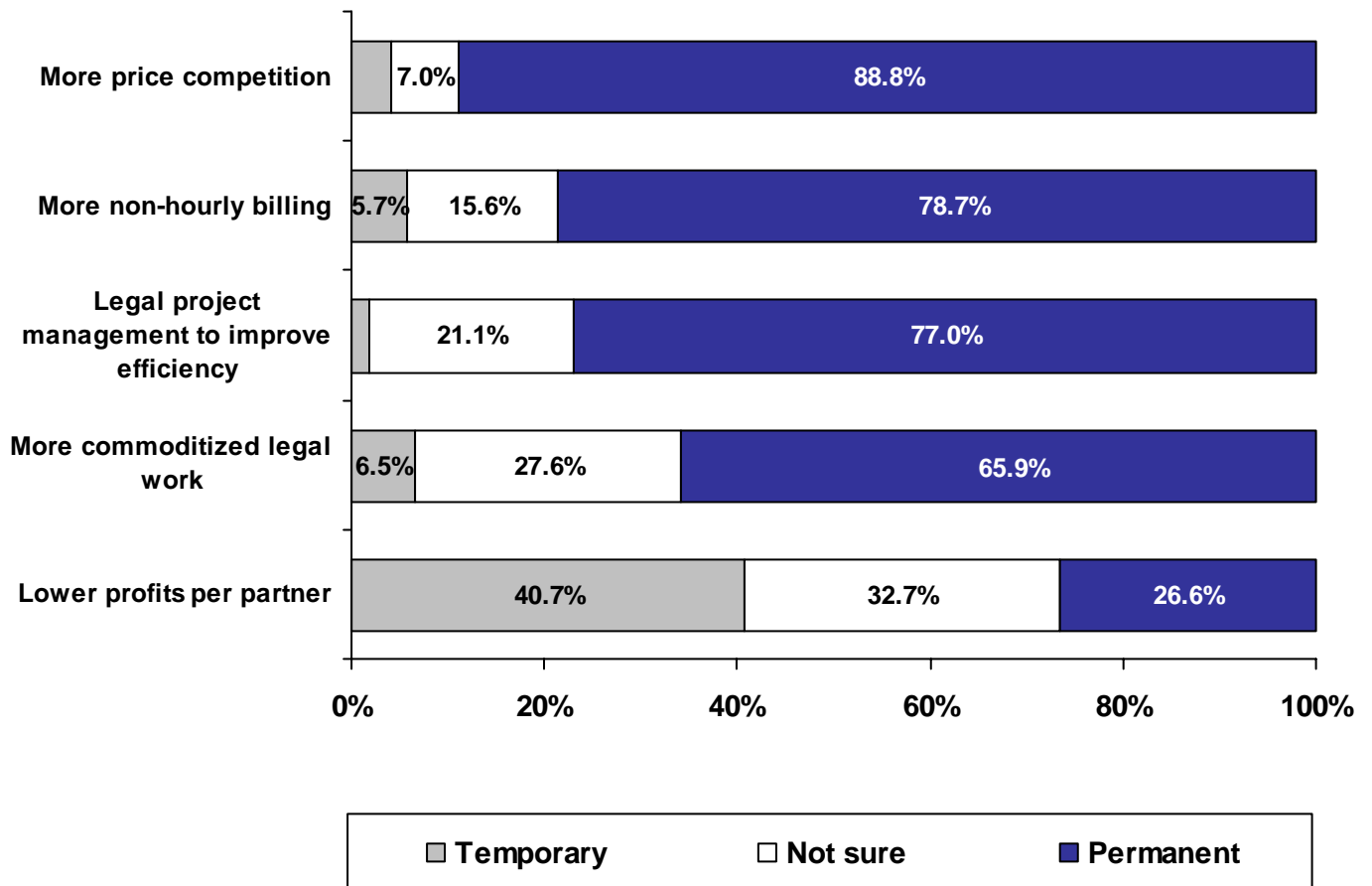
- Many firms are systematizing the AFA process, recognizing that alternative fees are here to stay.
- Larger firms are generally more rigorous in management of AFA programs.
- Most firms are not yet using AFAs as a competitive differentiator with clients or in marketing, and are thus foregoing a potential competitive advantage.



Economic Trends

In light of the events of 2009, which of the following trends do you think are temporary and which will be adopted as standard by most firms going forward?

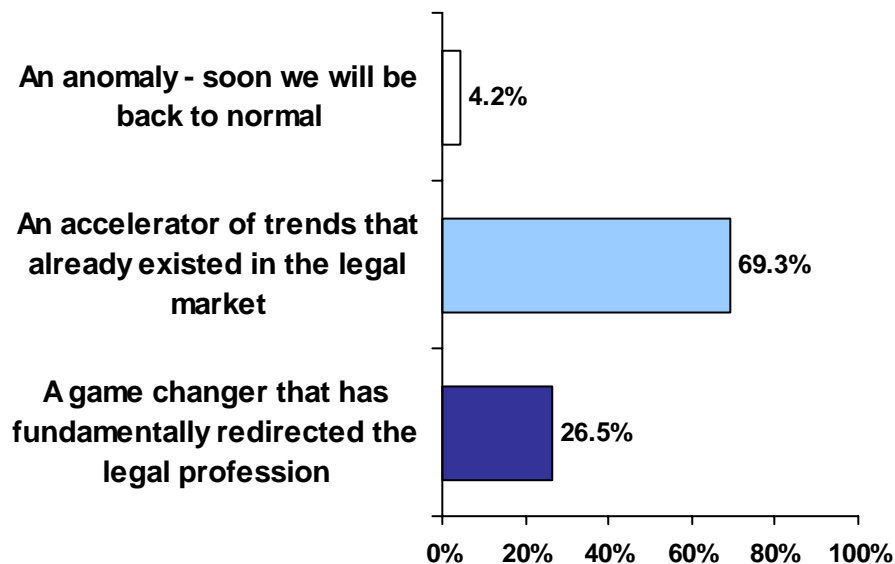
- Overwhelmingly firms see more price competition, more non-hourly billing, legal project management and commoditization as the top four permanent changes in the legal market.
- Yet only 27% of respondents believe these changes will permanently affect profits per partner.



Impact of 2009

Now that the dust has settled on the year 2009, do you see its events primarily as:

- Most firms of all sizes recognize that legal profession has changed in ways that were developing before the recession, but were accelerated by recent events.
- Only a few smaller firms expect things to be ‘back to normal’ soon, which may reflect their relative insulation from macro trends due to market, practice or geographic factors.



Demographics

In April and May 2010, Altman Weil surveyed Managing Partners and Chairs at 787 law firms with 50 or more lawyers. We received responses from 218 firms for a 28% response rate.

Firm Size	All US Law Firms	Survey Participants	% Response
1,000 +	19	5	26%
500 – 999	62	24	39%
250 – 499	83	37	46%
100 – 249	253	71	28%
50 – 99	370	81	22%
All	787	218	28%

The respondent group includes:

- 38% of 2009 NLJ 250 law firms
- 37% of 2010 AmLaw 200 law firms

* The exact number of lawyers in a law firm changes frequently. The universe of law firms surveyed is based on published directories and league tables available in spring 2010. Survey participants reported their own headcounts.

* Five firms invited to participate in the 50-100 lawyer category reported their size as under 50 at the time of the survey. We have included their responses in the 50-99 lawyer category.

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