# 2014: LAW FIRMS IN TRANSITION

**BY ERIC A. SEEGER**

# PARSING A SURVEY OF MIDSIZED AND LARGE FIRMS.

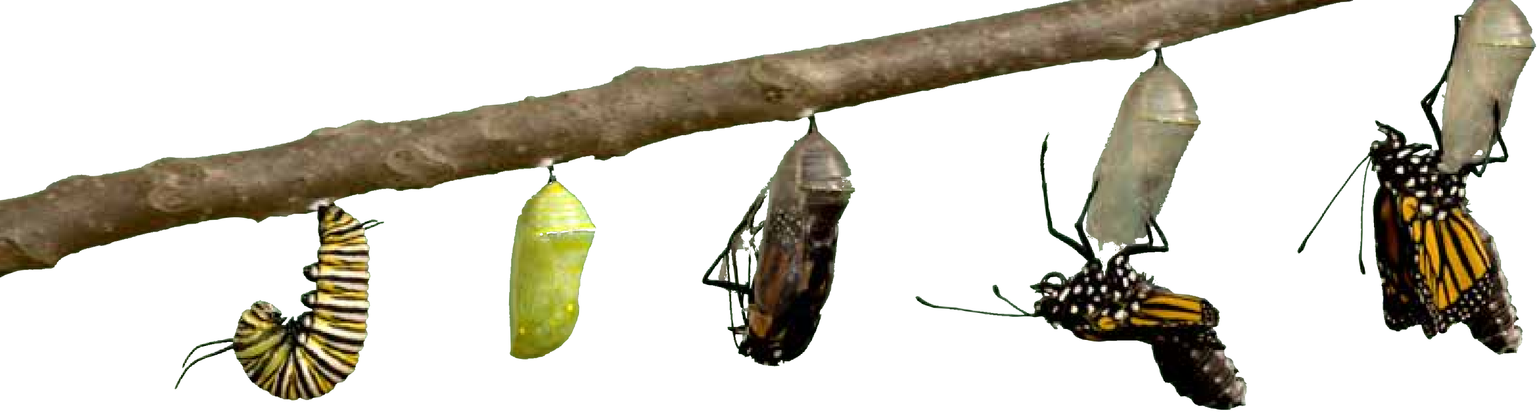
**WHEN ALTMAN WEIL INC.** created the *Law Firms in Transition Survey* in 2009, there was a lot of hyperbolic commentary in the marketplace about the end of the billable hour, a coming wave of law firm collapses and the like. We wanted to know what law firm leaders were actually doing, analyze the most important trends as they took shape over time, inform law firms and industry observers as to the nature and pace of change in the profession and give practical advice on how law firms could compete more effectively in a challenging environment. To do this, we polled the chairs and managing partners of U.S. law firms with 50 or more lawyers, and we have continued to do so annually.

Now in its sixth year, the survey has largely achieved its original mission. Looking at six years of trend data, certain developments could not be clearer. The combined forces of intense competition, technological advances, commoditization of services, flat demand and more demanding buyers have created a legal marketplace that few law firm leaders now expect to return to the good old days of 6 to 8 percent annual rate increases, ever-rising law firm profitability and plenty of work for everybody. Those days have passed.

Rather, today's leaders recognize that the legal economy will continue to be characterized by pervasive price competition, more commoditized legal work, technology replacing human resources, competition from nontraditional providers and more nonhourly billing, resulting in smaller annual billing rate increases, fewer equity partners, increased lateral movement, more contract lawyers, more part-time lawyers, reduced leverage, smaller first-year classes, fewer support staff, slower growth in profits per partner and a clear need for improved practice efficiency.

For better or worse, the playing field has become permanently redefined. Size, brand and client loyalties no longer always carry the day. As with any market disruption, there will be winners and losers. However, firms can pursue clear strategies to be among the winners.

It's neither useful nor appropriate to scold law firms for inaction. On the contrary, our survey data confirm our consulting experience that law firm leaders understand the current landscape quite well and have taken some appropriate steps in response. Managing partners understand the need for greater flexibility and new thinking in the areas of efficiency, staffing and pricing. What is needed now is faster action, and more of it.



## MORE CHANGE, AND FASTER, IS NEEDED

Are law firms in transition? Some are—and the rest should be.

Many law firm leaders admit they are not doing much in their firms to seriously rethink or restructure their delivery of legal services to increase value to clients—something they say they know is necessary. Their own assessment of how serious they are about changing the law firm business model hasn't changed in the three years we've asked the question. Overall, firm leaders give themselves a mediocre median rating of 5 on a 10-point scale. (Clients have been even less charitable in response to our Chief Legal Officer Surveys; they have given law firms a median rating of 3 on the same 10-point scale.) The lack of seriousness to adapt to clients' needs and expectations creates opportunities for firms that show up with new ideas and good listening skills.

Managing partners can't change their firms' habits by themselves. They need buy-in and cooperation from their partners, and in many firms they are having a hard time getting it. Despite general consensus on the need for greater efficiency, leaner staffing and more flexible pricing strategies—all to better serve client needs—the survey showed most law firm partners to be less than willing to do things differently.

The fact that law firms and lawyers are slow to embrace and even slower to implement change is not an insurmountable hurdle and cannot be an excuse for inaction. Leaders who spend the time to educate their partners and embark on practical, manageable change efforts will reap the rewards and continue to separate from the pack.

## PRICING FOR SUCCESS

Clients have declared that they want greater predictability in their legal spending, more transparency and input into how pricing is determined and more initiative shown by outside counsel in achieving these goals to mutual benefit.

Alternative fee arrangements (AFAs) are part of the answer. While the billable hour is decidedly not dead, the use of AFAs is increasing as a percentage of law firm revenues. Law firms that are proactive in their approach to AFAs are more than three times more likely to say their nonhourly work is more profitable than their hourly work. Yet despite clear benefits, the proportion of firms that are proactive in their approach to AFAs has dropped in each of the past two years.

The savviest firms are developing data on the cost of services sold, training their lawyers to talk with clients about pricing, identifying each client's specific pricing preferences, incorporating pricing into their planning and marketing efforts and setting margin goals in firm and practice group plans. It was reported in the press recently that law firms have hired more than 300 pricing managers over the last few years. More are on the way. Firms simply must get smarter about calculating costs and margins, and working with clients to construct mutually beneficial pricing packages.

## STAFFING FOR SUCCESS

The call for greater efficiency requires more flexible approaches to staffing. Increasingly, law firms have answered the call by employing labor arbitrage strategies and alternative staffing solutions—trading higher-priced human resources for lower-priced resources such as contract lawyers, part-time lawyers and nonpartnership-track associates. Continued movement in this direction is assured, and every firm should continue to assess opportunities and needs. Firms would also be wise to rethink their physical space requirements as they rethink their workforce and continue to look for ways to cut costs.

The 2014 survey showed significant disconnects between what firms are saying and what they are doing with regard to lateral hiring and nonequity partners. Lateral hiring continues to be law firms' growth strategy of choice, employed by nearly all firms, yet lateral hiring effectiveness continues to be mixed at best. When asked, "Would you hire them again today?" only one-third of firms report a success rate of better than three in four lateral hires.

Nearly half of all firms think they have too many nonequity partners and most nonequity partners across the profession do not have a realistic shot of becoming equity partners, but only 2 percent of firms have up-or-out policies for their nonequity partners. Meanwhile, "nonequity partner" was the category of lawyer the largest number of firms reported growing in 2013, and a majority of firms expect to have more nonequity partners five years from now than they have today.

Firms should develop clear standards and metrics for hiring, developing, evaluating and promoting lawyers at all levels—most notably the nonequity partner tier. Standards for entry

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into and exit from each category should be clearly communicated and rigorously upheld.

### THE LEADERSHIP CHALLENGE

Law firms are not known for their eagerness to change, but the drive to succeed is sufficient in nearly every firm to embrace, implement and survive necessary changes in attitudes, behaviors and habits.

Larger firms tend to be out front, leading the pack on change initiatives. We see evidence that they are doing more of the right things, and faster. Why? Part of the difference can be attributed to the nature of large-firm leadership:

- Leaders tend to have more authority and are expected to make decisions and take action on behalf of the firm.
- Because larger firms tend to serve larger clients, they may experience more direct pressure from clients to change.
- Big firms often have more resources available to dedicate to strategic improvement projects.
- Leaders in large firms tend to spend more time in the leadership role. Many are full-time CEOs. This frequently translates into better strategic planning and more effective execution.
- Large-firm leaders may have an inherently greater bias for action. Big firms get big on purpose, driven by ambition and a bias for action.

Larger firms are also more likely to identify external rather than internal pressures as the main driver of change in their firms. This suggests they are listening more closely to clients, responding to what they hear and working with clients to get it right. These are sound disciplines in any market, and all the more so in an environment where clients have found their voice and are demanding to be heard.

The times call for steady, fearless leadership, but still too many law firm leaders see change as something imposed upon them from outside. Most firms are not making current investments in a future they acknowledge will be different from the past in predictable ways. We hope to see more leaders taking control of change and deliberately outpacing their competitors in the areas of pricing, staffing and efficiency.

### REDEFINING SUCCESS

This year's survey showed that less than half of law firm leaders think growth in lawyer headcount is essential for their firms' continued success. Revenue growth is out; margins and profitability growth are in. Ever-higher leverage is out; flexible, efficient staffing is in. Large annual rate increases are out; predictable pricing is in. Fat and happy is out; lean and hungry is in. It's no longer about growing to get stronger but rather changing to get stronger.

Many opportunities are available to firms that rigorously pursue rational, client-friendly strategies in a persistent, disciplined manner. For every problem there are solutions that do not require more change than your firm can handle. Proactive firms can secure advantages by adapting more quickly than competitors.

On the whole, the profession has weathered the storm quite well. Although one can still expect the occasional law firm implosion, new external and internal pressures have not caused widespread destabilization of law firm partnerships. That does not mean the toughest times have passed. Nonetheless, law firm leaders and leadership teams that take appropriate business actions to educate their partners and work with clients to improve service, value and profitability should continue to enjoy strong support in their firms and excel in their markets. **LP**

**SUGGESTED READINGS**

Conducted in March and April of 2014, the *Law Firms in Transition Survey* polled managing partners and chairs at 803 U.S. law firms with 50 or more lawyers. Completed surveys were received from 304 firms. The survey and its findings may be downloaded at www.altmanweil.com/LFiT2014.

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