

An Altman Weil Special Report

2019

Law Firms in Transition



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.

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Law Firms in Transition 2019

The 2019 edition of Altman Weil's *Law Firms in Transition Survey* – our annual assessment of the profession's most compelling trends and opportunities – finds more US law firms enjoying improved financial performance and reports greater confidence among law firm leaders. A clearer picture of 'what works' is taking shape as we continue to explore what firms are doing and how successful they've been in the critical areas of pricing, staffing, efficiency, profitability, practice group leadership, leading change and long-term sustainability.

Financial Gains Posted by Most Firms

Of the 362 firms participating in this year's survey, more than 78% reported higher gross revenue in 2018 compared to 2017, up sharply from 68% the previous year. Similarly, 77% of firms reported increased revenue per lawyer (up from 66% the prior year) and 72% of firms reported gains in profit per equity partner (up from 61% the prior year). Financially, it was a good year overall for law firms and a dramatic improvement over the previous six years when the number of firms reporting revenue gains varied between 59% and 69%.

Forty-nine percent of firms reported demand for their services was up in each of the last three years, compared to only 40% a year ago. Lawyers are busier. Firms raised their rates more aggressively than in previous years and clients paid the increases.

Buoyed by positive financial results, many law firm leaders scaled back their skepticism regarding the long-term outlook for legal services. This year's survey saw an unprecedented decline in the number of firm leaders who expect to see persistent ongoing commoditization of legal work (down 5 percentage points from last year), the erosion of demand for law firm services (down 7 points), decreased realization rates (down 11 points), smaller annual billing rate increases (down 5 points) and slowdown in profit per partner growth (down 7 points).

Law firm leaders have long recognized a host of permanent trends that have reshaped the legal landscape. There has been near-universal agreement in our past surveys that the pace of change will remain high or even accelerate. Yet only 54% of managing partners said their firms' urgency to change is higher now than it was two years ago. Success can bring about a tendency to relax.

Topping the list of managing partners' concerns in 2019 is the prospect of a broad economic recession – although they rated it only at a 6.0 on a scale of 0 (not at all concerned) to 10 (existential threat). Three things are certain about the next recession. First, there will be one. Second, no one knows for sure when it will occur or how disruptive it will be. Third, some firms will fare better than others. It behooves law firms to take steps now to put themselves on the best possible footing to withstand a downturn and be in position to capture more work from unsettled clients.

Law Firms in Transition and the Law Firm Business Model

Our intent this year, as always, is to make the survey data a helpful tool for decision makers at all levels of leadership and management in law firms. To that end, we think it's useful to consider the data in terms of the four elements of a law firm business model: client value propositions, the profit model, key resources and key processes. All four areas must be managed, and their interdependency taken into account, when making decisions regarding strategy, policy and operational effectiveness.

1. Client Value Propositions

Peter Drucker famously asked, “*What does the customer want?*” Any business must determine what its customers or clients want and work hard to consistently deliver it. What do law firm clients want? In general, they want relevant expertise, professional service, good communication, an efficient process and desired outcomes at a reasonable price. However, specific answers reside with each individual client. “Quality service,” “high-value outcomes” and “cost-effectiveness” must be defined by your clients, understood by your lawyers and practiced daily. For a law firm, practice group or lawyer to be successful, they must sell what clients want to buy and consistently deliver on promises and expectations.

Professionals, unlike widget makers, have always traded on specialized expertise. Clients are willing to pay for skills and knowhow, years of experience, informed judgment, knowledge of the client's business and industry, a proven track record, perceived excellence in advocacy and counseling, and the like. But increasingly, law firm clients are unwilling to pay high hourly rates for what they deem to be lower-value, commoditized services such as routine due diligence, research and document review.

Clients are continually seeking “better, faster, cheaper” ways to meet their business objectives – it’s just the way of free-market competition. Law firm leaders agree almost unanimously (96%) that a focus on improved practice efficiency is a permanent trend in the profession. Therefore, we would hope to see more firms successfully differentiating on efficiency, staffing, pricing, technology utilization and the like. We continue to believe that the pace of change in these areas needs to be accelerated within many firms to enhance long-term sustainability.

Clients have choices, so it’s important for a law practice to be able to distinguish itself from other law firms and alternative service providers in meaningful ways. A majority of firms think they are significantly ahead of competitors in terms of their personal relationships with clients (61% of managing partners think so) and client service (53% think so). We note that it is mathematically impossible and logically inconsistent for most firms to lead the pack on these or any other factors. If everyone’s ahead, there’s no pack to lead. Your clients can tell you how you’re doing and how you compare in these areas – if you ask.

Although almost all firms were able to point out one or more areas – from experience to pricing to geography – in which they excel, only about half (53%) of firm leaders think their firm is clearly and specifically differentiated from competitors. That means almost half the firms in America cannot point to a compelling differentiator that would significantly elevate them above other firms in clients’ eyes. Establishing some credible means of differentiation should be a key area of attention for all firms and each group within a firm. “Good lawyers who do good work” isn’t enough. “We’re just as good as them and cheaper” might work – or might indicate a race to the bottom. We strongly recommend asking key clients what they value and measure, making sure your firm is demonstrably strong in those ways and not making unnecessary concessions. Again, an ongoing dialogue with clients is essential.

2. Profit Model

Firms successfully pulled many of the levers that led to improved profitability in 2018. Billing rates were increased more aggressively than in past years. Realization held steady or even increased in 86% of firms. Staffing levels continue to be adjusted to reduce overcapacity. Firms used profitability data to assess and reward both efficiency and effectiveness.

Rate increases

Most firms (61%) increased their billing rates more aggressively in the last few years to improve profitability – and it worked, with 81% of those firms reporting a significant corresponding improvement in firm performance. Generous price increases on moderate increases in demand led to substantial performance gains in many firms. We recommend that firms pursue rate increases wherever they can get them – and be ready to justify the reason for the rate increase. Your lawyers must be able to demonstrate increased value to justify a price increase, not just point to increased costs or to other firms that raised their rates too. Rate increases should be tied to demonstrable improvements in service delivery and value delivered, in ways that clients can directly experience and measure.

During the post-recessionary period, many firms became afraid of losing their clients. Lawyers sought to “buy clients” or hold on to at-risk relationships by offering margin-killing discounts, sometimes as deep as 25%. Instead, we recommend collaborative discussions about pricing that encompass goals, staffing, pricing alternatives, budgets, matter management and metrics/reporting. Clients are looking for greater transparency and accountability in this area – not necessarily the lowest possible price.

Cost of services sold

Most firms (52%) have invested in developing data on their cost of services sold, but so far, only about a third of those firms are reporting clear corresponding improvements in firm performance. We continue to assert that real achievements can and must be made in using cost data and project management techniques to improve matter profitability, with or without the purchase of expensive, custom-tailored technology solutions. To have intelligent conversations with clients about scope, responsibilities, methodology and price, and to manage projects within agreed parameters, firms have to know their costs and have the tools and skills required to manage processes, staffing and costs within a budget.

More firms are generating profitability data for review by firm management. What are they doing with the information? Nearly four in five firms (77%) use profitability data to assess partner performance. About 60% use it to analyze the profitability of individual clients. Only 55% of firms use profitability data to manage practice groups. We would like to see all three numbers increase. Firms of any size can and should be analyzing their internal data to inform decision making at all levels.

It's been said that you'll get more of what you reward. Forty-eight percent of firms are rewarding efficiency and profitability in compensation decisions and of those, 62% said it has resulted in a significant improvement in firm performance. We recommend more of the same.

Increased volume of legal work

Six in ten firms (60%) met or exceeded their total billable hours budget in 2018, up from 51% in last year's survey. Moderate increases in demand, coupled with slow hiring over the last several years, combined to generate greater overall productivity.

Demand for law firms' services had been relatively flat for years. In a low-growth environment, firms invested heavily in business development, in hopes that more lawyers would step up their client acquisition efforts. Obviously, the continual acquisition of new clients is essential to long-term sustainability.

Unfortunately – but in our experience, predictably – widespread attention (through planning efforts and firm incentives) and new investments (by hiring more business development managers, coaches and trainers, for example) have so far failed to deliver the hoped-for gains. Nearly two-thirds of firms (64%) have spent more on business development, but to date, only 42% of those firms have seen the investments pay off in any meaningful way. Rather than spreading resources across your firm's entire lawyer population, where much of it will be wasted, we recommend directing budget and resources to proven originators and those lawyers who have shown the aptitude and will to generate new business. In other words, make selective investments in cohorts of lawyers who know or can learn what to do and who have a high likelihood of success.

Most of the 78% of firms that have created a more collaborative culture say that improved collaboration has resulted in improved firm performance. We recommend that firms push hard in this direction and align their compensation systems to reward rather than deter collaborative business development and client service.

Firms continue to pursue laterals, groups of laterals and small firm acquisitions as a means of buying market share, with mixed results. We emphasize the need for well-coordinated recruiting processes, driven by clearly articulated needs as well as opportunistic flexibility. In our experience, vetting of candidates and speed of

decision making has improved in many firms; better on-boarding and integration is still necessary to improve the overall success rate.

Lower overhead costs

Historically in law firms, about 80% of every fee dollar has gone to pay people, with the second most significant expense being rent/lease/occupancy expense. Firms have made great strides in cutting expenses in the two main expense categories. Most firms (55%) have reduced staff and many have closed underperforming offices or moved into cheaper space. All of those moves have generated improved financial performance in a majority of firms that have made them.

Of course, the opportunity to move an office or renegotiate a lease only comes around so often. Ongoing investments can and should be made to substitute technology for support staff, thereby improving lawyer-to-staff ratios as well as lawyer support and client service. Forward-looking firms will continue to redefine legal support functions in terms of what technology to buy, what kind of people to hire and where to put them.

3. Key Resources

Key resources in a law firm include people, brand, technology, information / knowledge and capital. We have been reporting for years that US law firms employed too many lawyers – more than were required to handle the total amount of work being performed. Although 84% of firms still say they have chronically underperforming lawyers and 56% report that overcapacity is hindering overall profitability (74% of large firms), the overall picture is markedly improved. Most firms (71%) have taken measures to hold their lawyers accountable for achieving certain performance standards; two-thirds of firms (67%) have reduced their number of underperformers; and, nearly half (45%) have successfully removed most or all underperformers from the payroll.

Of all the tactics law firm leadership teams have pursued in recent years to improve performance, almost nothing has succeeded like removing chronic underperformers from their firms. Of those firms that removed underperformers, 82% reported significant associated improvements in firm performance.

Forty-one percent of firms think their brand or reputation gives them a significant advantage over competitors. We suggest that as firms continue to define, promote,

require and demonstrate excellence from top to bottom – meaning all their lawyers, all the time – their reputations will only improve.

4. Key Processes

Carefully designed processes help a firm manage its resources effectively. Especially in lower-rate practice areas, professional process management can be the key driver of margins.

Most firms have gotten the message that work should be performed at the lowest capable level to improve margins without compromising work product or service quality. Many firms are using staff lawyers (42% of firms), contract lawyers (48%), part-time lawyers (57%) or a combination of these. Forty percent have shifted some work from lawyers to paraprofessionals. At least half of all firms using each of those tactics have reported significant improvements in firm performance as a result.

Fixing underperformance means more than just dealing with underperforming lawyers, although that is necessary. It also means not taking on unprofitable work, firing unprofitable clients, ramping up collection efforts and the like. We have seen firms realize substantial improvements in firm performance, even on flat revenues, by earnestly managing intake and financial hygiene. Rigorous oversight from matter acceptance through collection of the final bill is an absolute must.

About half of the survey respondents (48%) reported using technology tools to replace human resources in order to increase efficiency of legal service delivery. We think technology and staff can be used more effectively in most firms to improve service and throughput with greater transparency and lower cost. Only 15% of firms have created a low-cost service center for back-office functions, for example, but most of them have seen significant performance improvements as a result.

Most firms (62%) that have moved toward rewarding efficiency and profitability (not just absolute revenue) in partner compensation decisions have seen consequent improvements in performance. However, few firms have made serious attempts to systematically reengineer work processes (22%) or implement formal knowledge management programs (28%). We recommend working with willing volunteers to demonstrate proof of concept in these areas, then rolling out proven formulas to other cooperative lawyers and groups.

Pricing continues to evolve and take on greater importance. Most firms (64%) say they are collaborating with clients on creative alternative fee options. Forty-two percent have trained their lawyers to talk with clients about pricing. Three in ten (30%) have added a pricing director or assigned pricing support responsibilities to a staff member. Larger firms are way ahead of smaller firms in all aspects of pricing innovation.

Practice Group Leadership

As we have counseled firms for many years, it is necessary to be a firm of leaders, not just with a leader. In our experience, a firm can never have too many leaders and rare is the firm that has enough good ones. In particular, we believe that improved leadership of firms' practice groups and industry teams is absolutely essential to achieving real improvements in all the areas addressed in this year's survey.

A majority of firms appear to be doing the right things in this regard. Sixty-four percent of firms are appointing practice leaders based on their leadership capability (rather than on seniority, popularity, ego or book of business) and 61% require a significant time investment by practice leaders. We endorse both of these tactics, and both are rated highly in effectiveness.

Most firms have developed clear job descriptions for practice leaders (56%), are providing leadership training to practice group heads (56%), and require business plans at the practice/industry group level (64%). We recommend doing all of these things.

Implementation of practice group goals can be improved by agreeing on a few highly important goals or priorities, with a designated champion for each, translating each goal immediately into action steps with specifically assigned responsibilities and deadlines, tracking whether the assigned actions are actually taking place and scheduling brief check-in meetings to discuss progress and next steps. When groups go off track it is often because their plans are too long or overly ambitious, they lack shared urgency and importance around the goals to be achieved, or there is insufficient accountability.

Each of these principles of effective practice group leadership is applicable at all levels of law firm leadership.

Leading Change

A leader's job is to move the firm forward and make it better. This usually requires a certain sense of urgency, which can be driven by internal factors like declines in performance or the loss of key clients or partners, or by external threats of competition, market change or economic uncertainty. However, after a few good years in a row, firms and their leaders can easily become a little complacent.

How worried are law firm leaders right now? Not very, according to the survey. On a scale of 0 (not at all concerned) to 10 (existential threat), no potential threat rated higher than 6 on average. Few law firm leaders see any existential threats at all. The threat of competition from larger firms with more resources averaged only 5.6. The threat from differentiated firms with seemingly more to offer averaged only 5.3. The threat of losing key partners barely registered. On a 0 to 10 scale, the level of seriousness among law firms to change their legal service delivery model remained constant at a median rating of 5 for the seventh year in a row.

Fear can be a useful driver of change. Without it, leaders have to find other ways to motivate their partners to embrace new policies, procedures, systems and behaviors to improve efficiency, service quality and pricing to meet client expectations and demands.

In a new question in the 2019 survey, we asked firm leaders what they've done to effectively lead change in their firms. The two most effective tactics reported were to create a culture of collaboration at all levels in the firm and to put forward-looking leaders in key roles. Another top response was to actively solicit ideas for process and service improvements – which in our experience will often come from paralegals and staff, not from lawyers. Each of these tactics can be implemented by firms of any size or level of sophistication.

A tactic that is less often used but shows potential for effectiveness is to actively collaborate with clients on change efforts. Whenever you can bring your key clients into the conversation about change, you will not only learn more about what they value but also solidify those relationships and strengthen your firm.

We know that law firm leaders can encounter stiff resistance when trying to lead change in their organizations. In 69% of firms, partners' resistance to change is an

embedded drag on progress, and recent economic successes may obscure any clouds on the horizon – at least for the short-sighted.

However, it is the leader's job to make the case for change and set the firm's sights on a longer-term horizon, weighing each threat and finding the right opportunities. Are your firm and its practices clearly differentiated in clients' eyes based on useful strengths – and are those strengths sustainable? Are you well positioned to withstand the next economic downturn? Do you have work to do to assure your firm's long-term viability? Marshall the facts and make your case.

Conclusion

The 2019 *Law Firms in Transition Survey* shows that many firms have adapted reasonably well to the post-recession decade of intense competitive pressures and clients' changing expectations. Most firms reported financial performance gains in a strong 2018 economy. We commend their efforts.

Firms are increasingly recognizing the benefits of having capable leaders and a high level of collaboration within the firm and with clients. We believe continued focus on leadership development and on collaboration (not only in serving clients but in all facets of firm operations) will yield positive results and contribute to law firms' sustainability.

Looking ahead, clients' calls for increased value and lower cost will continue, requiring attention by law firms to improvements in pricing, staffing, technology utilization, project management, efficiency of service delivery, knowledge management, communication, and the like.

As has been the case for years, law firms' success will be driven by their ability to meet the changing requirements of the marketplace. Firms that can craft smart, client-focused strategies and execute on them rapidly are likely to achieve competitive advantages. Moreover, firms that can build flexibility, scalability and resilience into their business models will create sustainable advantages for the long-term.

About the Authors

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The 2019 Law Firms in Transition Survey

Conducted in March and April 2019, the *Law Firms in Transition Survey* polled Managing Partners and Chairs at 810 US law firms with 50 or more lawyers. Completed surveys were received from 362 firms (45%), including 49% of the 500 largest US law firms and 46% of the AmLaw 200.

A copy of the survey can be downloaded at: www.altmanweil.com/LFiT2019.

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