

# The Passing of the Baton

By James D. Cotterman

**S**ociety is about to embark on a journey to a new America. No, this is not the opening line of a political speech. This is about the graying of America – that vast cohort group in America known as the baby-boomers. This large segment of our population begins to retire in 2011 and continues until 2031. This is important because it suggests strong economic pressures that will likely affect tax policy, federal deficits, national debt, interest rates and standards of living. It also represents the passing of much experience and skill from America's work force and challenges the adequacy of future labor markets.

The legal profession will face these same demographic issues as the number of lawyers leaving the profession catch up to and equal the number of lawyers entering the profession. Consider the following U.S. Census Bureau projections (population shown in millions):

Population	2000	2010	2030	2050
Under 20 years	80.5	83.2	95.1	109.1
20–64 years	166.5	185.5	197.0	224.0
65–84 years	30.8	34.1	61.9	65.8
85 and older	4.3	6.1	9.6	20.9

These changes are the culmination of the post-WWII population surge, declining fertility rates and increasing life expectancy. (See sidebar on page 7 for more detail.)

In 2001 the Employment Policy Foundation (EPF) warned that the U.S. will likely face future labor and skill shortages. Projections using data from the U.S. Census, Bureau of Labor Statistics (BLS) and the Bureau of Economic Analysis (BEA) show a shortage of labor available to fill positions beginning around 2010 and increasing each year through 2030, with 35 million jobs potentially unfilled in that year. EPF goes on to warn that, "The future shortage will be felt most acutely in fields that require the highest levels of skills and education." Many of the previously

mentioned variables coupled with productivity gains, immigration and off-shoring of jobs will weigh in on what the final shortfall may be.

Businesses would be wise to begin to consider the challenges that lie ahead. Where strategic planning has historically focused on markets and much less on labor supply, the next several decades may require a more balanced effort. Relationships that have been key to business success will need to be replaced. And the replacements will be fewer in number. This has implications to all businesses, not just the legal profession. For businesses generally, it means grappling with a massive series of changes in the demographics of the workforce.

For lawyers, it means that the number of lawyers leaving the profession each year will catch the number of newly minted lawyers entering the profession. The 1995 American Bar Foundation *Lawyer Statistical Report* indicates that since 1977 the number of bar admissions has been consistently around 30,000 each year. Further, the number of lawyers by age reached 30,000 for lawyers under 50. Those lawyers in 1995 who were in their late 40s will be reaching retirement age between 2010 and 2015. The problem is that the likely continued growth in legal jobs will collide with a lawyer labor market that is not growing.

## Transitioning Relationships

Currently, law firms have a growing population of lawyers in their 50s and 60s for whom retirement or a reduction in hours and the pursuit of other interests have become more important. Therefore, law firms must focus on strategies that preserve the business those lawyers are responsible for and capture and transfer their skills, experience and market presence. Except for a very few firms, the existence of truly institutional clients is rare. The key to holding client business is and will continue to be found in individual relationships. How a firm maintains those client relationships as key senior lawyers retire will be critical.

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Deeper and broader relationships employing multiple lawyers at the firm and multiple members of a client organization will strengthen a firm's grip on a client. Efforts should focus on creating both lateral and vertical relationships. Of particular importance for passing the baton are the vertical relationships. The younger lawyers in a firm are not going to hold a client unless the future decision-makers in the client organization know and trust them. And trust is not earned overnight.

### **Performance and Productivity**

One challenge to transitioning relationships is the law firm performance measurement model. The legal profession, at least in the U.S., is heavily invested in merit-based pay concepts. The top factors law firms use to make pay decisions are productivity as a working lawyer and productivity as a business generator (both measured on a collected fee basis).<sup>1</sup> Add to that the fundamental requirement for law firms to maintain a highly productive complement of fee earners. That metric (revenues per fee earner) signals more than any other whether a law firm is profitable. Clearly productivity is on the minds of law firm management and its timekeepers.

How then does a law firm pry productivity – in terms of working lawyer and business relationships – from aging partners in a way that meets the interests of all stakeholders? The leverage a partner has is her book of business. The retention of relationships up to the moment of retirement is important to status, ego, annual pay and one's ability to negotiate future income into the early retirement years. High individual working productivity is a matter of pride, if not a source of status. Both personal productivity and business relationships, however, are likely to decline as one approaches retirement.

Yet, productivity, relationship development and succession planning are precisely what must be done. The firm must acknowledge the importance of client relationship succession, must accept the time and the "off-the-clock" effort transitioning requires, must recognize those efforts when attempted and must not penalize those who are active in pursuing them. Concurrently, the firm must balance these ideals with the necessity of productive timekeepers to ensure a profitable law firm.

### **Personalities and Practices**

Management must grapple with the diverse personalities of its lawyers. Some practitioners will undertake to be benefactors, introducing team members to their clients, encouraging and orchestrating opportunities for new relationships to be established. They do it because they understand that it is in the best interests of the firm and that it allows them to grow their practice even larger. Some practitioners will be less generous, not actually impeding transitions, but certainly not taking the lead to ensure they occur. And finally there will be those who hold the client relationship close, allowing only the most superficial contact with others in the firm.

Likewise, among the beneficiaries, we find those who instinctively understand the importance of relationships and actively build them within client organizations. Others wait their turn, looking to inherit the client when the senior partner retires. And still others prefer to simply sit at their desks and solve legal problems, possibly thinking they would be much happier if the clients would simply post the work in their inboxes so the time and effort of building relationships could be avoided.

Consider also unique practice characteristics that are likely to shape succession opportunities and challenges. Some practices require the partner to be heavily involved in the

delivery of the legal services. This is true for practices that specialize in senior-level advice and counseling where it is the experience and expertise of the individual that is so critical. Succession in these areas will be quite difficult. Other practices may be more amenable to leveraging major aspects of the work and offer multiple opportunities to develop additional relationships.

Finally, some practices are transactional, while others are more ongoing. Different opportunities and challenges will exist with each.

### **Reward Systems**

Reward systems must be reviewed so that they do not impede what management is trying to encourage. These systems must support the firm's efforts, but they will not cause them to occur. We are often asked to assist firms in designing incentives to motivate partners to do these (and other) things. But we have found that compensation makes for a remarkably poor stick and only a marginally effective carrot.

One cannot use money to extract results if the skills don't exist and the personalities are ill-suited to the task. Further, compensation systems are grossly inadequate at turning performance around simply through the reduction of pay or the promise of increases. The compensation process *supports* management's efforts, it does not replace them, nor does it drive behavioral change.

Compensation decision-makers need some degree of flexibility in how they assess performance. Because most firms will have a mix of the partner attributes and practice characteristics mentioned earlier, one single approach is unlikely to provide a good outcome. So the compensation system needs a certain amount of flexibility if decisions regarding pay are going to support management's efforts to obtain the desired results.

Consider a typical compensation program that recognizes working-, responsible-, and originating-lawyer fee collections – the basic production-oriented system. The management message it supports is to work hard, develop clients, and manage the client and the work. The message to invest time off-line to transfer relationships, either as benefactor or beneficiary, is not supported. The older practitioner may view splitting credits for origination and responsibility, while logical, as a sure path to lower compensation. And the younger practitioner sees only his or her independently produced book of business as the Holy Grail. Neither is completely right or wrong. It requires a blend of independent and collaborative efforts.

The legal market continues to retain unfunded deferred compensation arrangements as part of its with-

drawal provisions. Much has been done since the late 1980s to eliminate, reduce or manage the projected costs of such plans. One newly developed change might actually revitalize those programs. If a departed partner is to be paid in excess of his/her capital account, it should be to recognize value that partner has left in the firm. The clearest and most tangible expression of value is the clients that remain with the firm or, essentially, the future fee receipts that the firm will earn from those clients.

This is tricky to measure, because the legacy a retired partner leaves requires an ongoing trust relationship involving the successor partner to secure and maintain the clients. In today's competitive environment, clients are rarely passed on from one generation to the next without the risk that they will consider an alternate

service provider. This means that younger partners must also contribute to the succession efforts and their independent efforts to establish trust and retain the client must be recognized and rewarded as well.

In summary, law firms would be wise to consider broader demographic, social and economic pressures as they undertake strategic planning. Further, they should pay particular attention to the labor and client relationship challenges that will occur in the coming decade. Finally, they must ensure that management has the tools to deal effectively with a variety of succession and labor market issues. ♦

<sup>1</sup> See *Compensation Systems in Private Law Firms*, 2003 Edition, Altman Weil® Publications, Inc.

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## Effect of Retiring Baby-Boomers on Demographics

In 1960 the birth rates for the seven largest industrialized nations were generally from 2.5 to 3.6 with one nation at 2.0. In 2000, those rates declined to a range of 1.2 to 2.0. Note that a fertility rate of 2.0 would only allow a nation to replace its population. Lower fertility rates would likely lead to declining population levels absent the mitigating affects of increased life expectancy and immigration. Life expectancy at birth in the U.S. in 1960 was about 68. In 2000 it had increased to about 74.

The tables on the right depict the changes that the retiring baby boomers will bring to our demographics. The numbers of retiring and older Americans will surge and in the 20-year period that comprises the retirement period for baby-boomers will grow at rates that are well beyond that of the younger segments of our society.

The ratio in Table 3 is one of the key metrics to understand the cost pressures on social security and Medicare. The Congressional Budget Office (CBO) offers this stark warning:

“...In the next 30 years, the number of people age 65 or older will double, while the number of adults under age 65 will rise by less than 15 percent. In addition to those demographic changes, costs per enrollee in federal health care programs are likely to continue growing faster than inflation....Over the long term, growing resource demands for those major entitlement programs [Social security, Medicare and Medicaid] will exert pressure on the budget that economic growth alone is unlikely to alleviate; left unchecked, such demands could pose an obstacle to higher standards of living.”

**Table 1**

% of Total	2000	2010	2030	2050
Under 20 years	28.5%	26.9%	26.2%	26.0%
20–64 years	59.0%	60.1%	54.2%	53.4%
65–84 years	10.9%	11.0%	17.0%	15.7%
85 and older	1.5%	2.0%	2.6%	5.0%

**Table 2**

Growth Rate	2000	2010	2030	2050
Under 20 years		0.3%	0.7%	0.7%
20–64 years		8.6%	0.3%	0.6%
65–84 years		2.3%	3.0%	0.3%
85 and older		3.6%	2.3%	4.0%

Average annual growth rates are shown above.

**Table 3**

Ratio	2000	2010	2030	2050
20 to 65 years group to 65 and older group	4.7:1.0	4.6:1.0	2.8:1.0	2.6:1.0