

WHY THE FUTURE LOOKS GOOD FOR SMALLER LAW FIRMS

by Ward Bower

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Large, corporate law firms have dominated the legal profession since the 1960's. Professors Galanter and Palay documented the era of large law firms and their exponential growth in Tournament of Lawyers.¹ However, the current recession is a challenge for the large, corporate law firm. Large firms face the effects of the recession with excess capacity and infrastructure commitments (people, technology, space) which were made in anticipation of continued exponential growth. Some firms have downsized dramatically and started over. Others are "hunkered down" and waiting out the storm, at reduced levels of profitability. Some will surely liquidate or dissolve.

At the same time, many small or mid-sized firms are growing steadily, both in revenues and profits, while some of their larger counterparts struggle. Groups of lawyers have successfully spun off from large firms to create even more profitable smaller firms and boutiques. Successful smaller firms eventually become mid-sized firms. The much-heralded demise of all mid-sized firms predicted by at least one prominent legal management consultant not only has not come to pass, but has proven false. There are and will continue to be successful small and mid-sized law firms that are well managed with a coherent, market-based strategy. The firms vulnerable to extinction are poorly managed firms, regardless of size, as evidenced by the business failure of dozens of large law firms over the past decade.

The "new legal marketplace" exhibits a number of characteristics which make the future bright indeed for well-managed smaller and mid-sided firms. Consider the following.

Costs

There are no economies of scale in law practice in the sense that larger firms always have higher per lawyer overhead, on average, than smaller firms. This has been true throughout the 29 years of Altman Weil's annual *Survey of Law Firm Economics*, and in every other law firm economic survey of which the author is aware. Lower costs are a potential source of competitive advantage both in pricing and profitability, particularly in a marketplace seeking alternatives to the hourly fee.

Client Fee Resistance

News reports proliferate regarding corporate client scrutiny of bills for rates, hours, staffing, and even the hiring of bill auditors to attempt to save legal fees. The lower cost

¹Galanter, Marc and Palay, Thomas, Tournament of Lawyers, University of Chicago Press., 1991

structure of small and mid-sized firms and their economic base which is less dependent upon associate leverage makes them an appealing alternative to large firms in the eyes of demanding, cost-conscious clients.

Affordable Technology

Historically larger firms have enjoyed the advantage of being able to spread costs of technology and research resources over larger numbers of lawyers, availing themselves of resources not available to smaller firms. The advent the affordable personal computer and ability to access research resources through networks have eliminated this competitive advantage of larger firms. Lawyers in smaller firms have today and in the future will have access to the same technology resources as large firms do, at the same per lawyer cost, or even less.

Pace of Change

The pace of business and economic activity throughout the world has accelerated. Mergers, acquisitions, management changes, divestitures, strategy changes and business failures happen in a blink of an eye. Smaller firms are much more agile and adaptable than larger firms, and with proper strategic focus, should be able to identify and exploit opportunities for competitive advantage well ahead of less agile large firms. The success of smaller firms in making themselves more appealing to some corporate clients through strategic focus and operational efficiency exemplifies this point.

Advertising and Websites

The availability of advertising to apprise potential clients and referral sources of a firm's existence or capability enables small firms to compete with larger firms who otherwise are better known because of their sheer size and presence. The Internet also allows even a solo practitioner the same visibility as a large law firm through a customized website.

Corporate Client Focus

Corporate clients, whose legal needs are more sophisticated and ability to pay greater, have traditionally been the domain of large law firms. However, in the search for greater value in legal services, more corporations today are evaluating legal needs to determine which services are capable of performance by smaller and mid-sized, local or regional firms, rather than brand name institutional firms. Many legal matters encountered by corporations these days do not fit into either the "bet your company" or specialized expertise categories demanding resources of a large firm. Smaller and mid-sized firms increasingly are beneficiaries of this trend, gaining access to important corporate clients whose attention they previously could not have attracted.

Globalization

Increases in the volume of world economic activity between nations has led to an increase in foreign investment and business expansion into the United States. Smaller and mid-sized firms can compete with larger firms for inbound legal business for foreign clients provided they have the requisite expertise. For many foreign-based investors or businesses, the only expertise needed is domestic legal advice, which smaller and mid-sized firms are as well positioned to provide as their larger, more expensive counterparts.

Small Business Growth

During the 90's, larger U.S. corporations downsized and cut costs in order to become, or remain, competitive with foreign producers and suppliers. At the same time, small businesses boomed, creating millions of new US jobs. Small business success creates opportunity for smaller and mid-sized firms, which are better equipped to handle their legal needs, and coincidentally, to "grow" with successful clients.

Bifurcated Legal Employment Market

The legal press has highlighted the dramatic increase in starting salaries at major law firms as one visible aspect of the "war for talent." But it is a bifurcated labor market for new law graduates. Other than top graduates of national law schools who command these high salaries, there is an oversupply of lawyers in the United States, creating a buyers' market for legal talent. Whereas small and mid-sized firms had difficulty recruiting quality candidates during the 70's, 80's and 90's, today they are able to attract candidates with good credentials at much lower compensation and potentially high profit margins.

Contract / Temporary Lawyers

Another development carrying over from the 90's has been the contract or temporary lawyer, frequently with good training and credentials, law practice experience, a desire either to work on a part-time basis or to work for a number of different law firms in seeking the right fit for a full-time employment opportunity. Many lawyers simply do not want to do what one has to do as an associate in a major law firm, in order to become a partner and live the rest of one's life that way.

This residual labor pool of qualified lawyers is a resource which can be tapped by smaller law firms on a case-by-case basis, in order to make them competitive with large firms for matters requiring special staffing or expertise. And they can compete without having to risk the fixed costs involved in hiring large numbers of associates and providing offices, equipment and staff for them.

Strategic Planning

For all of these reasons, the future should be bright for smaller and mid-sized law firms. However, to be successful in this environment, smaller and mid-sized firms must have a strategic plan. They cannot attempt to be "everything" to every client, and must concentrate on core competencies (those things they do arguably as well as large firms)

and targeted market segments (industries, types of clients, etc.). They furthermore must use their size advantage to serve clients better, faster and cheaper than their larger competitors, without a sacrifice in quality of performance. They also must be ready to decline a matter when it is one they cannot handle, due to workloads or resources required. Successful smaller firms will develop relationships with selected larger firms who are likewise committed to their core competencies, which although different may be complementary, giving them reason to outwardly refer some matters to small firms competent to handle them.

Successful smaller firms also will develop strategies to communicate their competitive advantages to clients and prospective clients. Consistent communication and performance in these carefully selected niche areas can assure a small or mid-sized firm a successful economic future, even in tomorrow's increasingly competitive legal marketplace.

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