

An Altman Weil Special Report

2018

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 2018

Now in its tenth year, with half the universe of US law firms with 50 or more lawyers participating, the *Law Firms in Transition Survey* has become a unique resource for insight on law firm strategy and the opinions of firm leaders. The annual survey has tracked a continual shift in awareness, acceptance – and some persistent resistance – to legal market change. As market perceptions among law firm leaders have evolved over the last decade, we have seen new operational tactics emerge and take hold in some firms resulting in real improvements in profitability and long-term sustainability.

A decade of change: 2009-2018

In 2009, US law firms were confronting the effects of the Great Recession and facing market dynamics they had never faced before. Corporate client purchasing strategies changed quickly and significantly. Clients were pulling back on large amounts of legal work, canceling projects, railing about egregious inefficiencies in law firm service delivery, and demanding and receiving enormous discounts on hourly rates. Lawyers who had consistently billed 2,000 hours a year saw their work all but dry up. Senior partners, watching their retirement accounts plummet, dug in their heels and resolved not to retire.

Law firms reacted by laying off thousands of (mostly younger) lawyers and staff and withdrew their offers to new graduates. Cost-cutting became the norm and major expenses were deferred. Many firms hunkered down and went into survival mode. Pundits, law firm leaders and, yes, some consultants issued hyperbolic proclamations that law practice would never be the same.

Altman Weil's *Law Firms in Transition Survey* was born out of the confusion and anxiety of that time. Our objective was to assess the nature and disruptive influence of the recession and its aftermath, gather hard data on what law firms were doing in response to new challenges and opportunities, and determine which responses were achieving the best outcomes. We sought to provide clear, credible information that would facilitate law firm planning and operational decision making.

Ten years on, we think law firms face a different kind of threat. The recession was a 'known' event (albeit severe) to be endured and managed – as law firms had done in

prior economic downturns. The threat in 2018 is broader and more nuanced, arising primarily from the sweeping force of technology evolution over the last two decades that has resulted in the commoditization and commercialization of more and more legal services. This new threat wasn't caused by the recession, but the recession was clearly an accelerant.

Naturally, law firms have focused on their financial health and performance in the aftermath of the recession. Although few have recovered to pre-recession levels, most have achieved a reasonable level of 'comfort' on the rising tide of general economic recovery.

We think this creates a false sense of security and a mis-direction of focus in many law firms. In reacting to the last crisis, they fail to recognize the next. Most law firms continue to plan for short-term, incremental improvements in performance, while deferring or slow-walking more forward-looking actions to address long-term, systemic threats.

*In 69% of law firms,
partners resist most change efforts.*

– 2018 Law Firms in Transition

Managing the transition

Clearly, there was no extinction event that made law firms irrelevant after the recession. However, there was a hastening of the pace of transition into new operating modes. Most law firms have been able to manage their transitions to achieve at least moderate performance gains or to maintain acceptable performance by just keeping on.

Few firms have taken full advantage of the disruption as an opportunity and run with it to distinguish themselves from competitors. Being a thought leader and early adopter of new methodologies and technologies is a clear differentiator that few law firms have embraced.

Can law firms sustain their current position – of moderate, reactive change – over the long term? Or will external market forces beyond their control ultimately compel

a tipping point? After ten years, this is still an open question in the minds of too many law firm leaders, and for most partners.

*Equity partners are not busy enough
in 51% of all law firms.*

– 2018 Law Firms in Transition

Real and persistent threats to the status quo

Clients want greater cost effectiveness and value – and they are in a position to insist. This is not new, but the recession accelerated the demand for greater efficiency and lower overall costs. Clients are clamoring for more cost-effective legal services and technology-driven process improvements. A host of alternative service providers have created a new set of lower-priced competitors for many law firms. If a firm does not provide reliably high-quality outcomes and client service at predictable, agreeable prices, there are other providers that will.

The overall demand for legal services (billable hours) has decreased in the aggregate since the recession, and all of the dynamics that affect hours available to traditional law firms clearly indicate a continuing downward trend. Commoditization, new technology tools, and 'non-traditional' competitors are all permanent changes to a post-recession market. Demand for law firm services will not return to pre-recession levels – *ever*.

As a result, there are too many lawyers in many law firms. Average billable hours have shrunk by hundreds of hours per attorney since before the recession and are unlikely to rebound unless the oversupply of lawyers decreases significantly. More work is going in-house, being redirected to non-law firm providers and being redefined or eliminated through the application of technology.

*59% of law firms are not feeling enough economic pain
to motivate more significant change.*

– 2018 Law Firms in Transition

Is urgent change really necessary?

Balanced against these external threats is a fundamental truth - *law firms still make a lot of money*. Overall, law firm partners continue to enjoy very healthy incomes.

Revenue, profit and income growth may have slowed in many firms – but remain at historically high levels. This reality often impedes any serious interest in change among partners who would normally be expected to drive it.

An improving economy has made law firms think they can raise rates more aggressively again to drive profit growth. But this kind of thinking may create a false sense of security. There is a short-term threat posed by the next inevitable downturn – which will put pressure on firms that are already less resilient than they should be. But more importantly, there is also a long-term threat to overall sustainability that cannot be ignored.

Long-term sustainability

If firms are doing reasonably well economically by making limited course corrections, why should they embark on a long-term innovation and change mission?

We believe that even though the future is unclear, there are some fundamental truths that must be acknowledged:

1. Law firms are no longer operating in a closed system in which virtually all legal service providers play by the same rules. There are outside players with outside money and a commercial mindset who are offering viable legal service alternatives to clients. They are established; they are growing; and they are not going away.
2. New, smart technology is a pervasive force for change that extends into every facet of our lives. It is a force that is literally changing everything – at a staggering pace – and the legal market will not be immune.

3. Change moves in only one direction. There is no going back.

Longer-term challenges demand longer planning time frames. Too often law firms are myopic when thinking about changes in the way they do things. For firms to be successful in the future (not just survive), they must have an effective business model that looks beyond short-term financial returns to support and advance long-term sustainability.

Such a business model will incorporate effective allocation of key human and technology resources and flexible, scalable operational processes that deliver both

profitability and potent client value. Although most firms acquiesce to client demands, those firms that anticipate demands and bring innovation to their clients will be highly sustainable.

There are clear signals that some law firms are making a shift to new business models that will serve them well in the future and improve their sustainability. Those that do not recognize the urgent need to begin the change process may ultimately be unable to catch up.

We strongly recommend acting with urgency on each of these things:

Look outward and plan for change

Refocus strategy externally. Too many law firm plans focus on fixing internal issues, rather than on clients and markets. This is a mistake. Ask if executing your plans will lead to more efficient delivery of services and add value for clients. How will you become more transparent, forward-looking and client-facing? Are you selling what clients want to buy? How will you sell more, and to whom?

Strategic thinking must evolve and become more forward-looking to deliver offerings that resonate with clients and enable law firm sustainability.

Only 38% of law firms are actively engaged in experiments to test innovative ideas or methods.

– 2018 Law Firms in Transition

Incorporate innovation into every strategic plan including practice group plans. Require practice leaders to think through how they might experiment with new approaches to staffing, pricing and efficiency. Conduct selected experiments with an eye toward learning and building on what works. Experimentation is imperative.

Innovation can be confusing and is often misunderstood. Put simply, pursuing innovation is simply finding ways to do things better that are valued by clients and have ready application in the marketplace. To be truly effective at innovation, you must budget time and money for it, support and embrace experimentation with alternative methods and systems of delivering service and accept that failures are a

necessary part of the learning process. It is okay to try to minimize risks, but escaping risk entirely is impossible.

Technology can and often will be a part of innovation, both to improve the efficiency of current processes and to develop new and better approaches to legal service delivery. But don't neglect other things such as new labor models and new pricing methodologies in your innovation efforts.

*Overcapacity is diluting profitability
in 58% of all law firms.
– 2018 Law Firms in Transition*

Pay close attention to the firm's greatest asset – human capital

Deal with overcapacity and under-performance by decreasing the number of chronically unproductive lawyers in your firm by 50% over the next two years. Until you take this on, your firm will face a major ongoing drag on profitability that is an impediment to sustainability. The hard reality is that too many lawyers are doing work they are significantly overqualified to do, and clients do not want to pay for that.

Extend the analysis to practice areas as well as individuals. Hard decisions must be made regarding allocation of firm resources (including management attention) to the strongest and best-positioned parts of the firm. Remove chronic weaknesses and build on strengths.

Actively manage senior lawyer transitions. Almost 40% of firms surveyed attribute chronic lawyer under-performance to partners who are 'coasting into retirement.' The absence of rigorous management of lawyer and client transitions is a huge, ongoing problem in the legal profession as Baby Boomers extend their careers ever longer. We've seen firms lose their next generation of owners while waiting for the seniors to transition out.

Own what it means to be an owner in your firm. Spell out the expectations for equity partners and adhere to those standards strictly, fairly and consistently over time – across all offices and practice areas. With the growing number of non-equity owners and clear data showing ongoing underproductivity, firms simply cannot allow more people into the equity tier who do not add anything beyond being a good lawyer. By

doing this, you will take the first step toward a re-envisioned staffing model driven by innovation, automation and external market change.

*50% of law firms do not believe they project
a distinct, compelling value that differentiates them from competitors.*

– 2018 Law Firms in Transition

Define your value proposition and communicate it

Pursue real differentiation. Why should clients hire you? In a flat-demand market, where there is not enough work to go around, you must have a compelling answer. The ability to differentiate your firm from similar competing firms is fundamental.

Law firms can differentiate in one or more of the following areas: practice range, industry expertise, geographic footprint, best-in-class quality, cost/price value, service delivery and client relationship management. Any firm or practice group can decide to differentiate themselves in one or more of these ways. Today, service delivery (efficiency) and cost/price (the client value proposition) are clearly what clients are focused on. Achievement of true differentiation typically requires change, doing some things differently, pursuing innovation aggressively and putting client needs first.

Every firm must define and demonstrate what makes it different and better than competitors. Firms that can develop a clear, easily-communicated, client-facing brand or message built upon one or more true differentiators will enjoy powerful competitive advantage. Client response will tell you whether you have it right.

Audit marketing and business development activities based on what clients want, not what you want. Simply increasing the volume of business development activity will not guarantee increases in billable hours and top-line income. Certainly, more – and more innovative – business development is a rational response to decreasing demand, but those efforts must be married to firm, practice groups and individual lawyer strategies.

Once you have developed a client-facing strategy incorporating a definition of your differentiating value, you will have a much more compelling message to take to the market. This will be significantly more effective in attracting and retaining clients

than just increasing the volume of traditional marketing efforts. You will have a better story to tell.

*69% of firms believe the pace of change is increasing.
This number has been 60% or higher each year since 2012.*

– 2018 Law Firms in Transition

Pick up the pace.

Without a crisis, it's hard to create a sense of urgency. But waiting for a crisis is never a good strategy, as then any actions you take will come too late. Law firm leaders need to engage their influential partners now in the thoughtful consideration of current market change and likely future outcomes. Those partners need to care about the future of the firm – or, at the very least, get out of the way.

What should law firm leaders do? It's not possible to get everyone to commit to innovative strategic thinking and execution at once. There will be early adopters who see opportunities and pursue them, late adopters who will believe it when they see it, and others who may never get on board. The challenge for leaders is to enlist a small cohort to start the innovation process with urgency and pace and begin to educate and bring others into the fold as rapidly as possible. Leaders should focus daily on supporting the continued efforts of early adopters by providing encouragement, resources, time, and staff support. Make it part of your leadership mission.

About the Authors

Thomas S. Clay is a principal of Altman Weil, Inc. With over 30 years of 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.

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The 2018 Law Firms in Transition Survey

Conducted in March and April 2018, the *Law Firms in Transition Survey* polled Managing Partners and Chairs at 801 US law firms with 50 or more lawyers. Completed surveys were received from 398 firms (49.7%), including 45% of the 500 largest US law firms and 52% of the AmLaw 200.

A copy of the survey can be downloaded at: www.altmanweil.com/LFiT2018.

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