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Strategic Management Consultants

AN UPDATE ON THE 2010 LEGAL MARKETPLACE

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For the past ten years or so and more frequently since the global economic meltdown in the fall of 2008, Smock♦Sterling's partners have – both in-person and through internet based surveys – reported on developments in the legal marketplace.

- [Our last report on the legal marketplace](#) was published and posted on our website in May. It was based on a survey we conducted in April 2010 after the first quarter results were available.
- We receive unusually positive reaction to these monographs and surveys. Our clients and contacts tell us that they are insightful; they share them with their management teams and/or all of their partners; and they particularly commend the practical advice we provide.

We plan on doing a full update on the legal market in the next few months – as we do annually. But, as a result a variety of recent meetings and discussions we have had with law firm CEOs/Managing Partners and COOs/Executive Directors (both in consulting assignments and in sessions discussing the legal marketplace), we felt an interim update on the legal marketplace was in order. This update on the marketplace is not intended to be comprehensive, but rather passes on to you what we are hearing and offers some general suggestions that we hope are useful to you.

WHAT WE HAVE BEEN HEARING

As Smock♦Sterling has met with and queried law firm leaders we have heard the following.

Conclusions in Smock♦Sterling's May 2010 Monograph Are Holding

In May (as a result of our April 2010 survey), we reported that *“over 75% of the firms queried either saw a very good year ahead or were cautiously optimistic.”*

- That generally optimistic view has held – most firms we have talked to feel that 2010 will produce solid financial results – particularly in comparison with what were very conservative estimates and budgets.
- But, some of that April 2010 optimism has been tempered over the past few months – 2010 will generally be a good year financially, but the upside potential is not materializing as significantly as some felt it would.

That April survey also surfaced a series of strategies that firm managements intended to deploy in 2010 to improve both short and longer term results. We were impressed – then and now – with the substance of these responses.

- The most frequently cited management strategies (of 20 possible ones) were *practice group planning, increased lateral hiring, dealing with underproductive partners, practice group management improvements, industry focused marketing, and regular formal client feedback.*
- Based on talking to our clients and friends in the legal market, both **increased lateral hiring** and **regular formal client feedback** have been widely addressed. Lateral hiring is clearly up and most healthy firms, by now, have increased their lateral recruiting efforts (as it is believed that some very good assets are available right now). Also and importantly, many firms have jumped on the client feedback bandwagon – simply put, we cannot see any reason why firms would resist talking to their clients.

- With the other four of the top six – *practice group planning, dealing with underproductive partners, practice group management improvements, and industry focused marketing* – progress appears to be more spotty.
 - While firms continue to address **practice group management** (and it is clearly a higher priority), effective of practice group planning, group leadership, and group performance remains elusive. Simply put, the level of progress has not been satisfactory to many of the firms we have talked to. There are a number of reasons for this – but, the reluctance to go to fully effective practice group management is at the top of the list.
 - And while addressing the **underproductive partner** issue (which exists in virtually every firm in some way) is often discussed, some firms have bitten the bullet, but most continue to defer the unavoidable, making the problem even more acute.

Practices and Partners Expected to Turn It Around in 2010 – Generally Have Not

Directly related to the underproductive partner issue, the one new development/issue we have heard (over and over in the last couple of months) is that many of the practices and partners that did not perform well in 2009 (and, in most cases, also in 2008) have also not performed well in 2010 (when many in their firms hoped/prayed they would rebound).

- Excluding real estate (which is generally down in most firms), these “*down practices*” and “*down partners*” are quite random and are firm specific rather than market specific. It may be a transactions practice (or partners) in one firm, a litigation practice (or partners) in another, and a specialty practice in still another.
- However, we do see a pattern in this – in reality, these practices and partners are much more of a longer term productivity/performance problem than just a recent one. The hope that their performance would improve in 2010 has been, in many cases, a case of management “*whistling past the graveyard*” or “*punting*.”
- What is clear to us is that a very large percentage of these practices and partners will probably not rebound in 2011. Rather, they represent a longer term management issue that needs to be dealt with sooner rather than later.

The Economy Has Bottomed Out and Is Showing Some Signs of Life

Regardless of your political persuasion and whatever you believe are the reasons, we clearly did not have a “*summer of recovery*” in the summer of 2010. But, the firms we have talked to do see some hopeful signs.

- The economy, in the minds of most law firm managers (as well as the economic prognosticators) likely bottomed out late in 2008 or early in 2009. Some segments are doing better than others, but few believe (with the exception of some doomsayers) that there will be a “*double dip recession*.” That said, economic growth remains sluggish.
- Fortunately, many clients are back to looking at the longer term future and are investing in projects/products that have legal implications. Law firms are seeing their advisory and project support of “*future oriented*” initiatives picking up. As one of our clients put it, “*we are now getting calls asking for legal advice rather than just complaining about our bills*.”
- In many firms, transactions are either coming back strongly or just coming back. The specter of capital gains tax increases is likely driving some of this – depending on a firm and its client base. The abundance of cash on many companies’ balance sheets is driving it as well. Most transactions practices are off life support – but, they could still use more work.

Trepidation Regarding 2011, But No Longer Fear of the Unknown

As law firms look to their prospects for 2011, there is considerably more trepidation in early fall 2010 than there was in the spring.

- Six months ago, most law firm managers were relatively optimistic on the economy and 2011’s prospects – now they are increasingly concerned.
- In early fall, those problem practices (mentioned above) still exist and now it is generally accepted that those problems will carry on into 2011. Also, they know that even those practices that are performing well could use more work – very few practices across the country are operating at full capacity.

- The planning for 2011 is proceeding rationally. There is no longer the palpable *"fear of the unknown"* that existed in early 2009 (remember the bunker mentality – when some lawyers feared the private practice of law might cease to exist). Law firm managers know that clients need their firms' services and there will be reasonable demand for these services in spite of the economy. The *"greatest recession since the Great Depression"* clearly did not sink the legal marketplace.
- Most firms are planning on modest rate increases (in the 3% range) for 2011 and there are reasonable expectations for business expansion (certainly in high priority practices), but budgets and financial plans will more than likely be prudently conservative for 2011.

A Pick-Up in Law Firm Merger/Acquisition Activity

We are seeing (and the merger counters confirm this) a pick-up in law firm merger and acquisition activity – not just in completed combinations, but in the consideration and contacting of potential merger partners/ acquisitions. But in late 2010, there are a couple of differences:

- First, there is a decided movement away from larger true mergers (i.e. – *"mergers of equals"*) towards the acquisition of smaller firms who fit a firm's strategy and needs – **everyone wants to acquire, but no one wants to be acquired**. Mergers like the recently discussed Orrick/Akin Gump combination are clearly the exception.
- And thankfully, many firms considering mergers or acquisitions are recognizing that there is usually *"house cleaning"* required on the front end to make it work. The common negotiating tactic of *"take all of us or none of us"* does not cut it in a competitive environment. Weak practices and weak partners need to be dealt with on the front end.

A Continuing Lack of Understanding of a Firm's Strategy

As we conduct our consulting assignments, we continually hear the complaint/refrain that *"I do not understand our firm's strategy."*

- Often that is an obvious excuse to avoid doing what a firm's strategy calls for – as in, *"since I do not understand it, I cannot be held accountable for doing it."*
- But, it often reflects Firm management's inability to articulate where the firm is going, why, and what it takes to get there – and to repeat and reinforce that strategic direction.

Finally, Many Firms Have Seen and Acted on the Need for Effective Firm and Practice Management – But, Many Still Do Not Get It

Even during the significant downturn in 2009 (and late 2008), most law firms saw relatively little negative financial impact on partner income (particularly when compared to corporate profits).

- Firm management (lawyers and non-lawyers) focused on and dramatically cut expenses and continued a trend towards more effective management at the firm and practice levels. This had a very positive impact on defending partner income – it avoided the decreases that could be expected from a fall-off in revenue.
- Perhaps most clearly, because of its pocketbook effect, the value of effective management was underscored to law firm partners – many of whom had historically scoffed at investing in firm or practice management.

But, there are still many partners in many law firms that:

- Do not see the value of lawyers and non-lawyers spending time managing the affairs of the Firm (planning, evaluating, measuring, etc.) and, importantly, do not see the value that accrues to a law firm from effective management (and leadership)
- Also, do not see any reason to reward management activity (firm or practice) – even if that activity clearly produces an economic benefit to the firm and its owners
- Relish the independence of the individual operating in his or her economic, professional, or emotional best interest – even if it hinders firm performance, its reputation, and its growth.

SOME SUGGESTIONS FOR THE REST OF 2010

Our end of the year assessment of the market will spell out a series of strategies for firms to consider – in the New Year. But, given what we talked about in this update, we do suggest you consider the following.

- It probably goes without saying, but we suggest you approach 2011 conservatively – your financial plans should reflect the current uncertainty in the market. The year 2011 may see a significant bump up in legal services, revenue, and partner income – but, it would be better to plan conservatively and over perform than the reverse.
- If you have not placed practice group improvement at the top of your management check list – do so! Doing it right (as most firms do not) offers – we believe – the greatest opportunity for revenue and profit improvement available to a firm. You do not create internally generated revenue growth at the firm level – you only can at the practice level.
- Where appropriate, you should restate the firm's overall strategy to all in the firm – clearly and repeatedly. And, you should also clearly communicate progress towards achieving that strategy. Many partners do not "*connect the dots*" and doing so for them is a key function of management.
- Finally, we believe it is important to address those practices and partners that have not performed well and, you know deep down, will not. Dealing with these uncomfortable issues now will not impact 2010 performance, but doing so will clearly positively impact 2011.

This completes our interim update on the legal marketplace. We welcome your comments.

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Smock♦Sterling Strategic Management Consultants serves a wide range of law firm clients on national basis in six key areas of practice – strategic planning, strategy execution, practice group management, firm mergers and combinations, high level economic counsel, and resolving vexing strategic management issues. Our four partners – John Smock, John Sterling, Peter Giuliani, and Joe Walker are clearly the most experienced "*first string*" serving the legal marketplace.

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