

# SMOCK•STERLING

## Strategic Management Consultants

### EARLY 2010 – HOW'S IT GOING? A LOOK AT THE LEGAL MARKETPLACE THROUGH 3/31/10

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First quarter 2010 operating results are in the books for all law firms and 2009 results have been posted for the AmLaw 100 (the big guys) and are about to be posted for the AmLaw 200. In order to both gauge how things have been going in the marketplace and to provide valuable information to our clients and friends, Smock•Sterling Strategic Management Consultants once again surveyed the legal marketplace, similar to what we did in October 2009.

- We reported on that prior survey in two recent monographs ([“The Legal Marketplace in Late 2009 – What Law Firm Leaders Are Saying Now”](#) and [“Our 2010 Legal Market Outlook: Strategic Thinking for a Fragile Recovery”](#)).
- This monograph reports on the results of our most recent survey of the marketplace – conducted in April 2010.

It summarizes and draws conclusions from the results of that survey and includes the specifics of the survey, feedback on final 2009 results, respondents' expectations for 2010, initial results from 2010's first quarter, and Smock•Sterling's conclusions (what do the results mean?) and recommendations.

#### SPECIFICS OF THE SURVEY

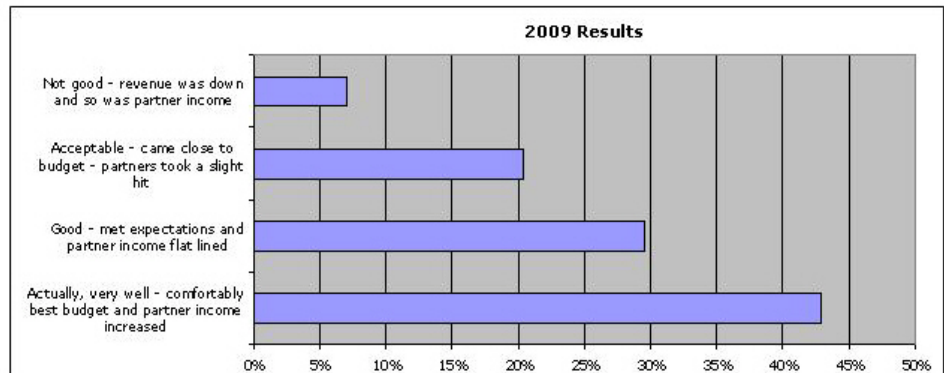
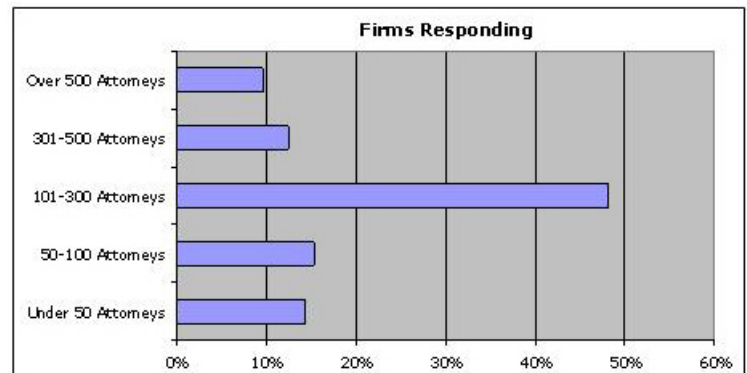
We conducted a web-based survey of the primary attorney leader/manager and the primary non-attorney leader/manager of our law firm clients/targets – the survey was open only a short time – the week of April 5<sup>th</sup> through April 12<sup>th</sup>. We had responses from 114 firms, a very good response rate for such a “flash” survey.

Individual responses were anonymous and held in strict confidence. We do not know who responded.

#### FINAL 2009 RESULTS – HOW DID THE RESPONDENTS DO?

We asked, in a multiple choice question, how firms did in 2009. We expected a positive response – but, were surprised as to how positive the responses were.

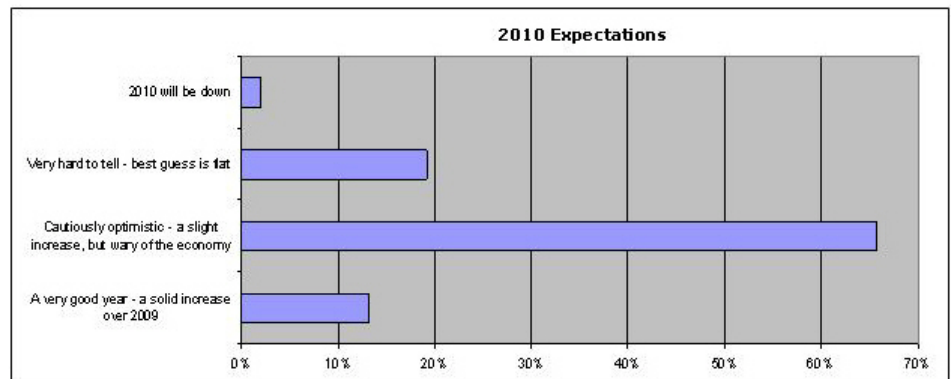
- Over 72% did well or had very good results – only 7% said “not good.”
- This was a marked improvement in just six months from our October 2009 survey where only 11% said “very well” – in April 2010, 43% said “very well.”
- Also, there was a significant decrease in the less positive responses – in April 2010, 28% said either “not good” or “acceptable,” in October 2009, 45.5%.



## 2010 – WHAT DID YOU EXPECT FOR THIS YEAR?

We then asked law firms what their expectations for 2010 were and are.

- Over 75% of the respondents either saw a very good year ahead (13%) or were cautiously optimistic (64%).
- Interestingly, only 2% saw 2010 down from 2009 and only 19% saw 2010 as “flat.”
- Not only do the respondents see 2010, generally, as a good year – but, most firms we know, being prudent, budgeted 2010 results to be flat. Thus, relative to managing internal expectations for partner income, the probable results in many/most firms will be well ahead of projections. In 2010 – across the board – partners will more than likely do very, very well.



In order to get a sense for how specific practices were expected to do, we asked the respondents to rate their expectations for a broad range of practices on the following scale (1=solid increase, 2=flat, and 3=down).

- The resulting scores were very close (and packed). Energy had the highest score, but was followed closely by bankruptcy, commercial litigation, health care, regulatory, and white collar litigation.
- We asked for opinions on 20 separate practices – only two, commercial loans and financing (expected to be flat) and real estate (flat to down) were less than positive.

Practice	Rank	Rating Score
Energy	1	1.4
Bankruptcy/Financial Restructuring	2 (tie)	1.5
Commercial Litigation	2 (tie)	1.5
Health Care	2 (tie)	1.5
Regulatory	2 (tie)	1.5
White Collar Litigation	2 (tie)	1.5
Intellectual Property Litigation	7 (tie)	1.6
Labor and Employment	7 (tie)	1.6
Environment	9 (tie)	1.7
ERISA/Employee Benefits	9 (tie)	1.7

Practice	Rank	Rating Score
Public Finance	9 (tie)	1.7
Corporate Securities	12 (tie)	1.8
General Corporate Representation	12 (tie)	1.8
Patent Prosecution	12 (tie)	1.8
Antitrust	15 (tie)	1.9
Immigration	15 (tie)	1.9
Insurance Defense	15 (tie)	1.9
Mergers & Acquisitions	15 (tie)	1.9
Commercial Loans and Financings	19	2.0
Real Estate	20	2.3

In terms of 2010 expectations, we asked the respondents to rank (from one to five, with one being the most important) this year's management emphasis on the five elements/drivers of profitability.

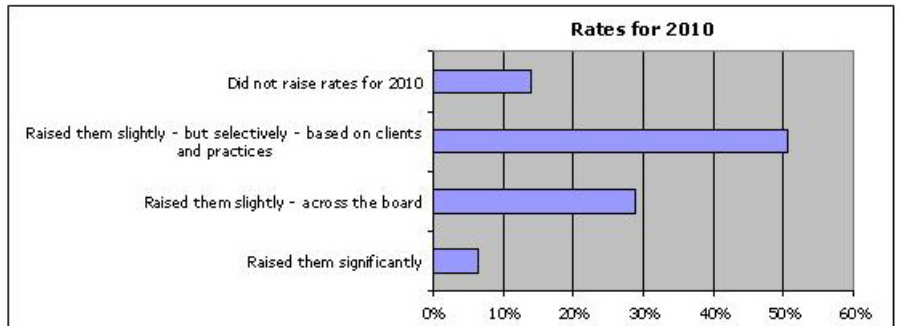
The results were both decisive and interesting and shown below in their rank order with their rating score:

Profitability Driver	Rank	Rating Score
Utilization/productivity	1	1.7
Realization	2	2.6
Cost Control	3	3.2
Rates	4	3.6
Leverage	5	3.8

If you go back a few years, rates and leverage probably would have been at the top of that list. Certainly rate increases drove profit growth from 2000 to 2007 with leverage not far behind. Now, the clear emphasis is on the more difficult drivers to both manage and positively influence profitability. For instance, if you want to increase utilization/productivity, it takes a heckuva lot more effort than the mere stroke of the pen than went into raising rates.

Speaking of rates, we did ask the respondents what they did about rates for 2010.

- Interestingly, 86% raised rates – to some degree – in 2010 and only 14% did not.
- But, we believe these responses need to be taken with a grain of salt. We know from our day-to-day interactions with law firms (and from interviewing their clients as part of strategic planning assignments) that client pressure on fees is both significant and unrelenting.



- Thus, the rate increases are certainly valid responses, but how much of those increases most firms will be able to realize is – we would postulate – up in the air (thus, the emphasis on realization).

With regard to 2010 expectations, we asked what we believe is the key question – what are your priorities for key strategic and operational improvements in 2010? We gave respondents a choice of 19 generally accepted improvements and asked that they set priorities (1=high, 2=needs addressing, and 3=not on our radar screen).

- We believe that any score lower than 2 shows a reasonably high management priority and 12 of the 19 improvements fit that.
- At the top of the list was a tie – practice group planning and increased lateral hiring. Following was another tie – dealing with underproductive partners, practice group management improvements, industry focused marketing, and regular formal client feedback.
- We were impressed with the responses – they were generally focused on “substantive” improvements that can have a positive near and long term impact on firm competitiveness and profitability. Three of the top six are practice group related (practice group planning, practice group management improvements, and industry focused marketing).

Improvement	Rank	Rating Score
Practice group planning	1 (tie)	1.5
Increased lateral hiring	1 (tie)	1.5
Underproductive partners	3 (tie)	1.6
Practice group management improvements	3 (tie)	1.6
Industry focused marketing	3 (tie)	1.6
Regular, formal client feedback	3 (tie)	1.6
Alternative fee approaches	7 (tie)	1.7
Better strategic plan implementation	7 (tie)	1.7
Better associate training and development	9 (tie)	1.8
Strategic plan development/revision	9 (tie)	1.8

Improvement	Rank	Rating Score
Project management techniques/training	11 (tie)	1.9
Smaller mergers/acquisitions	11 (tie)	1.9
Website revision/improvement	13	2.1
Revising the associate salary structure	14	2.4
Revising partner compensation	15 (tie)	2.5
Partner structure – equity/income	15 (tie)	2.5
Governance restructuring	17 (tie)	2.6
Balanced scorecard/performance measurement	17 (tie)	2.6
A larger merger	17 (tie)	2.6

Finally, we asked about staffing expectations – whether or not the respondents expected staff increases for each of six staff categories (1=growth, 2=same number, and 3=decrease)

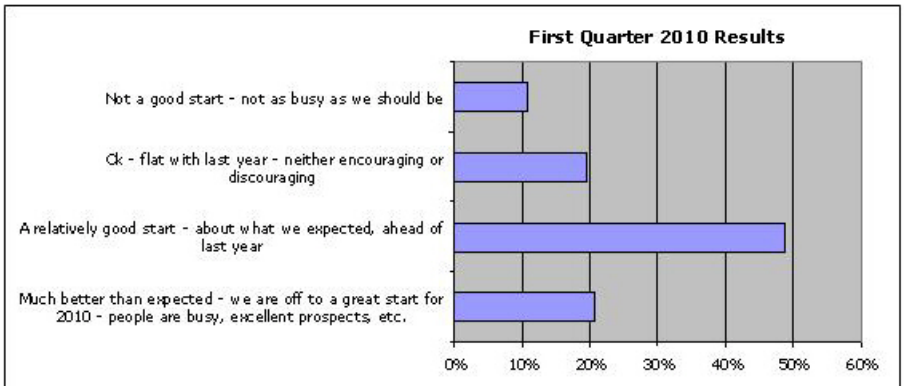
- There are expectations that the number of associates and, then, equity and income partners in the responding firms will grow.
- Of counsel and paralegals are expected to experience essentially no increase, with some further cuts expected for these firms’ staffs.

	Rank	Rating Score
Associates	1	1.4
Equity Partners	2 (tie)	1.6
Income Partners	2 (tie)	1.6
Of Counsel	4 (tie)	1.9
Paralegals	4 (tie)	1.9
Staff	6	2.2

## THROUGH THE FIRST QUARTER OF 2010 – HOW'S IT GOING?

To find out how firms did through the first quarter of 2010, we paraphrased the Mayor Ed Koch question of “*how am I doing?*” to “*how's it going?*”

- Greater than 20% said “*much better than expected*” and almost 50% said “*a relatively good start*” – nearly 70% positive responses.
- Less than 20% said they were flat with last year and only 11% said they were not off to a good start.
- This bodes very well for positive results in 2010 – because as we said, this year's budgets are unusually conservative (generally flat). Beating such an estimate ought to be relatively easy for most firms, particularly those off to such a good start.



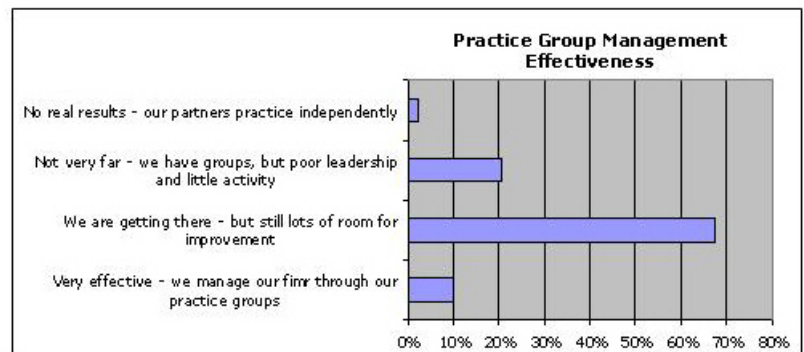
Much has been said about the impact of a variety of outside influences/factors on law firms. We asked how firms are being affected by these factors in 2010 (1=significant impact, 2=some impact, 3=no impact).

- Client fee pressures, as could be expected, are at the top of the list.
- The other external factors average scores are all between 2=some impact and 3=no impact. A priori, we would have expected more significant impact from many of these.

External Factors	Ranking	Rating Score
Client fee pressures	1	1.7
Requests for proposal	2 (tie)	2.1
Slow cash collections	2 (tie)	2.1
Alternative fee/billing requests	4	2.2
Increased competition from smaller firms	5	2.3
Increased client monitoring of your staffing activities	6 (tie)	2.4
Client evaluation of outside attorney relationships	6 (tie)	2.4
Increased competition from larger firms	6 (tie)	2.4
Competitors trying to hire your people	9	2.5

We believe that the present and future legal marketplace economic conditions (e.g. – continuing pressure on fees) require law firms to become much more creative in improving firm profitability. At the top of the list, as shown previously, are more effective practice groups. We asked the respondents to describe the level of effectiveness of their practice group organizations.

- Only 10% said that their practice group management was very effective.
- Less than 25% said that their practice group management had achieved “*no real results*” (2.1%) or had “*not advanced very far*” (20.7%).
- The great majority (67.4%) said “*we are getting there.*” While that is positive, practice groups have been a major fixture in most firms' management structures for over thirty years – how long does it take to get there?



## **WHAT DOES IT ALL MEAN?**

We believe there are some key conclusions that can be drawn from the survey and the recent performance of most law firms.

- First, firm lawyers and lawyer managers should walk down the hall and thank their COO/CFO/Executive Director for outstanding performance in 2009. While most firms revenues were down and, in many cases, billable hours were down, these key non-attorney managers addressed the cost side of the equation, cut an enormous amount of expenses, and literally *"saved their firms' bacon."* Without this competence and effectiveness, there would have been considerably greater problems among law firms with some severe repercussions.
- The resiliency of the diverse law firm business/economic model was clearly shown in the recent downturn – under what might be characterized as *"intense combat conditions."* Simply put, the model worked and what economic dislocations law firms suffered were quite tame when compared to their clients – regardless of industry.
- There is no question that clients pressure on fees will continue – for a variety of reasons.
  - First, clients now know they have tremendous bargaining power – most were able to make significant cuts in outside counsel costs and they recognize that pressure, if applied, will continue to result in concessions, discounts, and, in some cases, givebacks.
  - Clients' businesses have not recovered like those of their outside law firms. Yes, the economy is turning around and gaining strength – but for many clients, it is a long, hard road to full recovery and they are not there yet.
  - There is a psychological element – the ACC Value Challenge and informal communications among general counsel have reinforced the fact that clients are in the driver's seat (yes, it is truly a buyers' market). As relayed to us by more than one general counsel, informal means of communications among general counsel include comparing ways to continue to cut outside counsel costs (and, thus, squeeze their law firms). No longer are they complaining about what outside counsel make (or charge) – they now know they can do something about it.
- A number of changes occurred (and continue to occur) in the legal marketplace in response to the economic downturn. We do not expect that the following will go away as the economy returns.
  - First, the renewed emphases on value and quality will continue to trump size in the market. It is now believed that *"bigger is not better – better is better,"* regardless of size.
  - For the past twenty-five years, the competition for legal services (and talent) has continued to increase. That competition was exacerbated in the downturn by clients pulling back work and focusing lowering outside counsel costs.
  - Law firm leaders, and a very good number of their partners, know effective law firm management is now a key driver of law firm success – both professionally and financially. The need for active management of firms, practices, offices, and, importantly, client relationships will continue to increase.
  - There is no question that the legal marketplace is undergoing a changing fee environment – client pressure on fees in many cases includes an insistence on alternative fee arrangements. Most firms will have to become considerably more facile with managing matters to fixed budgets and with a wide variety of project management skills. While some project management activities, and their current hype, bear the risk of becoming another law firm management fad (remember TQM), alternative fee approaches are here to stay.
  - Associate lockstep compensation is going away – at a very rapid rate. There was also an expectation that the level of associate salaries would come down. In most markets, that has not happened – it should, but it probably will not. What is true is that the process and reliance on hiring inexperienced associates for the partner track straight out of law school has been radically altered.
- Finally, the dramatic increase in contract/staff attorneys will continue to aid in handling large matters/cases – in response to fee pressures, the high cost of partner track associates, and the recognition that using these attorneys can be a valid strategy.

## WHAT SHOULD LAW FIRMS DO IN RESPONSE TO THE SURVEY FINDINGS AND PRESENT ENVIRONMENT?

We believe law firms should consider a number of key strategic/management steps and/or improvements to deal with the previously presented findings from this survey.

- First, take active management very, very seriously at the firm and practice levels. *“Laissez faire”* no longer works and the firms that actively manage their resources will fare better than those who do not.
- We believe the most critical element of active management is the active management of a firm’s practice groups (legal specialties, industries and markets, and client teams). It is no longer sufficient to say *“we are slowly, but surely getting there”* – rather, you have to get there and, clearly, sooner rather than later.
- And, active firm management means ensuring that the firm and each of its practices have a stated strategy and are clearly executing against that strategy. The value of effective strategy implementation has increased exponentially along with effective practice group management.
- As shown in the survey, there is a reasonably high priority placed in 2010 on dealing with underproductive partners – virtually every firm’s *“elephant in the room.”* Last year’s cost savings, in most cases, did not deal with chronic underproductive partners, now everyone can clearly see that proverbial elephant and those cases need to be dealt with effectively. It is a truism that, in a continuing war for talent, productive partners have options, underproductive partners do not.
- Firms have to continue and enhance their communications with their clients. They have to clearly demonstrate and document the value they are providing and undertake and continue formal client feedback processes. And where there are teams (even small teams) serving clients, these teams have to come together on a regular basis and plan for better serving that client/those clients and adding more value.
- Now is the time to *“get back in the game”* with prudent investments in growth – people, practices, and services. All successful businesses must grow to survive (a clear capitalistic imperative) and firms and especially their successful practices must get back on the growth curve.
- For many firms (most notably high quality mid-size firms), this marketplace is presenting a real *“window of opportunity.”* More and more companies are looking for real value and are willing to consider firms that provide high quality at a competitive cost. That window will close – firms need to act now or in the very near future to take advantage of it.
- Finally, we suggest that law firms move forward to achieving the kind of client service, management, and leadership equilibrium necessary to be successful in the near and longer term and to remain the kind of firm where exceptional attorneys want to practice. We believe that this equilibrium comes from each practice and each partner knowing, understanding, and acting on their specific roles in carrying out their firm’s vision and strategy.

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This completes our view of the present marketplace, based on the April 2010 survey.

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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