Flight of the Rainmakers

by Dan Binstock

Fear and uncertainty are two words that sum up the sentiment at large law firms today. Many large firms took an unexpected punch to the gut over the past year, and the landscape for the rest has changed.

Lawyers and legal journalists have wrung their hands over law firm dissolutions, layoffs, salary freezes, smaller bonuses, maximizing collections, optimizing billing rates and other financial matters. One issue that hasn't received as much attention, but will likely move to the forefront in early 2009, is the "flight to quality" among rainmakers who have lost confidence in their firms' ability to thrive.

"Flight to quality," a term used in the investment world, refers to investors moving their money from riskier to more stable investments. This usually occurs during times of fear and uncertainty. And given that "fear and uncertainty" sum up the sentiment of many law firms, and that many are bracing for a less stable year, major revenue-generating partners may well launch their own flight to quality this year.

LESS MONEY FOR ALL

In 2008, a fading economic picture translated into lower revenues, which translated into lower profits per partner. Many of the current cost-cutting measures (freezing salaries, layoffs, etc.) are being done to minimize future reductions in profits per partner, since this figure plays a critical role in both retaining current partners and recruiting laterals with portable practices.

When I speak with partners about compensation, comments such as, "Last year I made X, but I'm expecting much less this year," are not uncommon. These remarks are often accompanied with a nervous chuckle.

Those nervous chuckles can be particularly grating on the ears of the biggest revenue-generators, who are less than thrilled to see their equity decrease in value due to their less productive colleagues. It shouldn't be surprising that partners who generate a lot of revenue themselves tend to be more bottom-line-focused than, say, service partners, i.e., those who don't have self-sustaining practices and rely on others to feed them work.

It's not just their own immediate earnings that can be an incentive for partners to look elsewhere. Right now, I'm hearing many more partners asking questions about a firm's stability, its overall business model and its ability to weather the storm. One or two years ago, the idea of making 20 percent more income (at a firm with comparable billing rates and a comparable platform) was often enough to justify a lateral move. Today, many partners are much more reluctant to jump ship for what might be only a short-term spike in compensation.

TAKING A CLOSER LOOK

The recent high-profile dissolutions of Heller Ehrman, Thelen and now Thacher Proffitt & Wood have focused the attention of lawyers considering a new home. Partners -- especially those with portable practices and hence more options -- have been evaluating their firms' business models in light of the new economy. According to James Jones, law firm consultant and managing director of Hildebrandt, while the recent high-profile dissolutions were rooted in causes that started before the current downtown, lawyers can't help but wonder and evaluate whether their firms are making some of the same mistakes.

In scrutinizing their firms' cost-control efforts, profitable partners are paying particular notice to the retention of unproductive partners, as this constitutes significant overhead. At certain firms, some of the most profitable partners are worried that management is not making enough of those difficult economic decisions. As Peter Zeughauser, a law firm consultant and chairman of Zeughauser Group, puts it, "the current economy is making it more difficult for firms to continue to subsidize unproductive partners." I've also heard the sentiment expressed more ominously: "We need to stop carrying all this dead weight, or we'll all be dead weight."

To be fair, not all rainmakers are beating the drum for layoffs. Some strongly oppose reducing partner head count as a short-term cost-cutting measure because of the major long-term repercussions it can have on culture, morale, recruiting, media attention, etc.
Key partners at certain large firms are also concerned that their firms may have priced themselves too high, especially given corporate clients' increasing sensitivity to rates. According to Jones, "Lots of firms have reported that clients are insisting on rates being frozen, or even decreased, in 2009."

Some of the firms that stretched their billing rates to cover the sharp rise in associate salaries over the past few years are having trouble competing for certain clients in this new economy. Zeughauser notes, "A lot of firms who felt they needed to pay competitively with the leading firms are now facing the reality that, in a downturn, clients are more discerning about what they are willing to pay high rates for."

There's a segment of firms that wanted to stay competitive in the salary wars but today are falling short on the prestige and brand strength needed to justify their heightened billing rates. "Increased price pressure will cause more partners to think more carefully about the right platform," says Zeughauser.

In this case, Zeughauser is both predicting and describing the current reality. The latest news reports of lateral moves often include comments like these from litigator Jeffrey Jacobovitz, who has just moved from Schiff Hardin to the smaller McCarthy, Sweeney & Harkaway. Last week Jacobovitz told The BLT (*Legal Times*' blog), "There's a market out there for smaller cases and smaller companies that cannot afford the big firm in this economy." He also said he hoped to have "better control over" his hourly rate.

Whether the "right" answer is to lay off or hold onto certain service partners, to stick with the big firm or seek more flexibility at a smaller firm, partners -- especially those bringing in the most business -- will keep asking and monitoring. They are trying to read the tea leaves to determine whether they and their firms are appropriately positioned.

SURVIVAL OF THE FITTEST

Traditionally, the first half of the year has a higher level of movement at the partner level. Some partners wait until January and February to receive their equity payouts. This year, a firm's weak economic performance in 2008 will be the icing on the cake. Over the next few months, expect to see a higher-than-usual level of movement among those with portable practices.

For partners considering a flight to quality, it's important to acknowledge the (somewhat) obvious point that higher profits per partner does not necessarily equate to a "higher quality" firm. What's more important than the firm's absolute numbers is the direction and future trajectory of its financial data, among other things. Zeughauser and Jones agree that "quality" in the current landscape also encompasses such factors as whether the firm met, exceeded or missed budget, and by how much, last year; its debt levels; reductions or delays in partner draws; departures of important partners and practices that will adversely affect the firm; strength of recent lateral hires; viability of the firm's strategy; diversity and strength of its client base; revenue over time; rate structure, clients' ability to pay rates, and the firm's ability to be flexible if needed; and the presence of countercyclical practices within the firm.

There is a group of firms that stands to benefit from this downturn and pull away from the pack. These select firms are anticipating a strong (relatively speaking) showing in the next Am Law 100 survey (to be published in May) and view this as their chance to cherry-pick rainmakers from firms that may be heading in the wrong direction. "A recession can result in stronger firms getting stronger and weaker firms getting weaker," Zeughauser notes.

If the management committee at your firm is concerned about losing some of your key revenue-generators, Zeughauser and Jones have some common-sense advice that is often neglected: Sit down and have honest, one-on-one conversations with those rainmakers to find out what the firm needs to do to make them happy and keep them feeling valued. It's surprising how often this basic step never occurs.

Lastly, whether you are a partner anticipating a move or a firm looking to hire a lateral, recognize that this is a time to act on opportunity but also a time to be cautious. As Jones sums up, "Due diligence is more important now than ever ... for both firms and partners." But due diligence can only go so far, so remember the critical importance of trusting your gut and intuition too.

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