

Managing Partner Outlook: Another Year of Clients Demanding More Value

by Patrick J. McKenna

In early January I posed a couple of questions to a group of managing partners representing firms from every corner of the country. The questions: “As you think back over this past year, 2010, what surprised you the most; and what do you anticipate that lawyers should expect to see in 2011?”

I was pleased to receive detailed responses from firm leaders from New York and Chicago to Atlanta and Dallas; and from New Orleans and San Francisco to Seattle and Minneapolis. All in, I heard from lawyers across 20 different States, representing firms from 100 to over 1000 lawyers in size. Those responses came either by way of written feedback or in many cases the opportunity to engage in some interesting and thought-provoking discussions. What follows is a summary of what I heard:

Question #1. *As you think back over the past year’s events, what surprised you the most in 2010?*

Irrespective of firm size, the highest-ranking issues that firm leaders identified all centered around five common themes:

➤ **The State of Uncertainty**

As one leader tactfully expressed it for many of his peers, “We anticipated a year of uneven performance and business growth in fits and starts. And, that is pretty much how it went. Although by scratching and clawing, we were able to exceed our yearly revenue budget . . . a conservative budget.”

The same reactions were reinforced by a couple of managing partners who stated, “I also was surprised that demand in the industry did not increase in certain practices over the course of the year,” and “I was surprised that there was not more of a comeback in some of our practices — which leads me to believe that perhaps the 2009 blip was not really a blip — but more of a seismic shift.” In spite of this decrease in demand, some were thankful that their clients survived, “We did not see the degree of adverse economic impact we expected. While certain clients were stressed, we experienced no failures or defaults.”

From a large Mid-Western firm, “At first I was surprised that things did not recover as much as we had anticipated for 2010, especially in the M&A area. Then I was surprised at how aggressively some of the coastal firms began to cut their rates and structure alternative fees to obtain and retain work. From yet another firm in the Mid-West came this comment, “What surprised me the most was the choppiness of the recovery. I think we were all fooled when things picked up earlier in the year, only to see work drop off again, although workflow now seems to be picking up. The choppiness has led to less optimism about the sustainability of the recovery, however. “

One managing partner expressed it in very empathetic terms when he explained, "I continue to be somewhat surprised that the mental state of many attorneys and staff is still quite fragile as to the uncertainty from the financial meltdown of late 2007 through 2008."

➤ **Adapting to Change**

The strongest subject matter to engage this group of managing partners can be reduced to one word: *change*. It was expressed in different ways and from various perspectives.

From a West Coast firm I heard, "A not-so-pleasant surprise was a stark realization that there are no silver bullets that will spur a rapid recovery, and it's going to be three to four more years of challenges, particularly in some markets and practice areas, before we can see a return to 'normalcy' - - whatever that may then be."

From one firm on the East Coast I heard, "The biggest surprise to me is how slowly lawyers in large firms are heeding the calls from their leaders for transformational changes in how they practice notwithstanding the enormous changes that are occurring in the marketplace." Yet, from another large firm in the Mid-West came this response, "My biggest surprise in 2010 was the acceptance by lawyers of the many changes which have occurred in the past two years and the willingness to adapt to these changes in the profession. "

A number expressed surprise that more firms didn't "bite the dust" and "surprise that more law firms did not fail or dissolve." From a Chicago firm, "I was surprised by the absence of radical change. Instead it was more incremental, and more of a 'right-sizing'."

➤ **The Noise Over Alternative Fees**

On a related note was the broader issue of legal fees. One firm leader expressed it this way: "It continues to astound me that clients continue to be willing to use major large law firms at extremely high costs, when there are other terrific options available."

And in California the thought expressed was, "I am surprised by the continued reign of billable hours as the primary model for the delivery of legal services. After all the fanfare and hype in the press over the past couple of years, most clients still seem to prefer sticking with billable hours although there certainly has been an up-tick in other types of engagements - - it just hasn't been anywhere as dramatic as predicted."

From two other West Coast firms I heard a similar refrain, "Though I am not necessarily surprised, the noise for alternative fee arrangements has eased in place of a clamor for simply lower fees and costs. I must say in terms of other firms in the broader legal community, some firms' decision to restore entry-level associate salaries to the excessive levels that existed previously, to me, was inexplicable. An economic crisis - - a terrible thing to waste - - appears to have been wasted. I think this will create opportunities for regional mid-sized firms who have shown more discipline and will be able to offer greater value."

From Chicago, "Yes we were softer on billable hours, and yes we got some fee and fee quote pushback, but we were able to cope and actually to use the scenario as an opportunity to adjust our expense structure, both on the staff and the attorney side, to offset the revenue challenge."

➤ **Lateral Movement**

One ever-present issue that was also raised by a couple of firms was *partner mobility*. Some firms didn't see as much activity as they would have expected while others were surprised by the number of exits coming from larger firms.

One firm leader from a Chicago-based firm went into more detail: "I was surprised by the lack of movement by quality lateral candidates. If you exclude lateral movement from firms that are in trouble and as a result of people being forced out of their firms, movement was limited. What does that tell us? Are lawyers becoming more loyal? I doubt it. Are they more comfortable with the devil they know? Is there a fear of jumping to a firm that might have poor finances?"

At the other end of the spectrum were the comments of a Kansas City managing partner, "I was surprised by the degree of lateral activity driven by an interest in partners leaving high rate firms."

➤ **The Pace of Collections**

A number of firms cited collections as an issue that surprised them. "Although 2010 was a good year, the slowdown in accounts receivable was surprising to me. We adjusted and had much better success with our A/R turns in the second half of the year."

From a New York Firm I was told, "I was pleasantly surprised by clients cleaning up past due amounts for legal work performed in 2007, 2008 and early 2009. As lawyers are generally among the last to be paid, this gives us hope that at least our client are experiencing an economic up-tick."

This reaction from another, "Finally, while collections slowed as anticipated during the year, I was shocked at how strongly collections came in at year end, at least in part attributable to redoubled collection follow-up on our part. " And from a similar sized firm in Texas, "I was surprised by the decrease in legal demand in Texas; with very strong collections at year-end."

➤ **The Prosperity of Mid-Sized Firms**

And, of course, no discussion of 2010 surprises would be complete without some reference to how well the mid-sized law firms performed. From Cleveland, I was told, "Although I have believed it for a good while, I'm pleasantly surprised at how true it is that mid-size firms can compete successfully against mega-firms for very sophisticated work, resulting in very strong performance results for mid-size firms coming out of this recession."

From West Virginia, "We were surprised by the rates we were able to get. Much of what was written indicated that higher rates in 2010 would be hard to attain. We did not see much resistance, but that in part may be due to relatively low mid-market rates." To Los Angeles, "For us, it was a good rebound year after a bad 2009."

Over to Indianapolis, "We experienced both growth in the face of a tough economy, including growth in the number of lawyers, growth in our revenues, and growth in our client base." And even in economically-ravaged Detroit, "While the economy has been

experiencing difficulties, 2010 was an excellent bounce back year and we are looking to increase our staff during the first quarter of 2011!”

Question #2. In your view, what should lawyers expect to see in this coming year?

With this second question, perspectives were surprisingly similar, irrespective of what area of the country the particular firm leader resided. That said, I segregated the responses by size of firm to allow a comparison between National versus Mid-sized firms.

FROM THE LARGER NATIONAL FIRMS . . .

➤ **A Continued Restructuring**

Perhaps not surprising, a number of firms predicted “a continued de-equitization of the partner ranks.” A Louisville-based managing partner put it diplomatically, “I think that many will find that their firms have structural imbalances (read, ‘too many underperforming partners’) as opposed to simply being victims of the cyclical economy. This will lead to fundamental upheavals that will take a number of forms in the coming years.”

From the managing partner of a 500-lawyer firm I heard, “In 2011, firms that do not merge will shrink in size as leaders rely more heavily on those who ‘get it’ and tire of trying to force changes on people who refuse to alter their behaviors. The latter will be left behind in law firm environments that no longer tolerate poor performance. In short, a continued ‘shake out’ but one that many lawyers could probably have avoided.”

His comments were reinforced by one participant who stated, “I would expect that, despite continued financial challenges, we will see more lateral movement and merger activity among law firms. There has been a reluctance during the downturn, but pent-up demand for change should begin to overcome financial conservatism, particularly as firms that have weathered the storm well make themselves available to lawyers at firms who have not done so well.” And then echoed by this comment, “I expect to see a lot of lateral partner movement as practices pickup and partners begin to leave firms that they believe did not fairly support them during the downturn of their practices. “

A couple of firm leaders commented that they “expect a focus on efficiency and a restructuring of traditional support staff models in favor of something that is more project management oriented.”

➤ **Even Greater Emphasis On Value**

Among the law firms participating, many commented that they expected a greater emphasis on providing value to clients. A number of the managing partners I spoke with related how they had been receiving letters from their clients asking for even further billable hour reductions in 2011.

From a San Francisco-based managing partner, I heard, “I feel that, over the long term, the legal services profession will be under heightened pressure to demonstrate the actual

necessity of services rendered rather than defaulting to the 'business as usual' routine of reproducing what's been done in the past."

From yet another firm was this, "I expect large coastal firms will moderate their aggressiveness on price reductions. I expect firms will continue their cost controls, but do not anticipate further cutbacks. And I expect that per partner profits will increase over 2010."

"We will begin to get a feel for whether the extreme cost-sensitivity of corporate law departments and their focus on alternative fees is a temporary recession-driven emphasis or a more permanent feature of the legal market."

➤ **Practice Area Predictions**

A number of firms offered various predictions for which specific areas of practice may flourish in 2011. One predicted that "demand will increase in the Mergers and Acquisitions practice and to some degree in real estate this year," while a Dallas-based firm leader suggested, "I expect we will see a robust transactional year focused more on corporate and energy work than real estate -- though I think even real estate will awaken from its slumber."

I heard, "I expect to see strong pickup in the M&A and corporate finance (especially public offerings) space." "I expect to see heavy pickup in bankruptcy filings, with a decline in residential foreclosures." "I expect to see a general increase in law firm workloads and revenues, but continued conservative hiring at the entry level."

This reaction from another, "The soft commercial markets (particularly those that are real estate driven) and reluctance to lend that have characterized the recent period are likely to continue. This will drive continued softness in transactional practices until a sustained growth pattern emerges from the fits and starts we are seeing now."

And I received this prediction "I expect natural gas infrastructure and perhaps power generation to be big topics by year-end."

FROM THE MID-SIZED FIRMS . . .

Up and Down the East Coast:

Many firm leaders articulated their largest challenge as being how to handle increasing competition together with more demanding clients. As one firm leader expressed it, "I expect more of the same, in terms of challenges in the economy and challenges facing law firms. I suspect we will continue to discover and adapt to the 'new normal'." From a firm leader in Cleveland, "I think we're going to see more of the same, meaning in particular continued price pressure, with all of its attendant issues, control of overhead, project management, and the like."

On this same theme, I heard, "I expect increased competition primarily from a rate standpoint. I sense some firms will be much more aggressive in 2011." Seconded by another, "I expect fixed fee proposals to be even more prevalent." Yet another commented,

“I expect an increased demand for more alternative methods of service delivery and pricing as clients are becoming more sensitive to what they believe to be the need to obtain value from their attorneys.”

The issue of containing costs was still prevalent among a number of firms with a New York managing partner commenting on the need to “Tame the costs and problems associated with electronic discovery,” and a Florida-based firm commenting that they expect “Less and less need for premier office space as less clients visit their lawyers. The internet has clearly reduced the ‘face to face’ communication which has taken place over the years between lawyers and their clients.”

In the Mid-West the message was similar:

One leader summarized it nicely when he told me, “Lawyers should expect that clients will be more demanding - in structuring fees and staffing assignments for starters. I also believe that the consolidation in the industry will accelerate in 2011.”

As another managing partner expressed it, “I’m having conversations every second day with GCs who want a 15% reduction in their 2011-2012 rates. They are not interested in discussing alternative fee arrangements or discussing efficiencies, they just want discounts. And that’s fine, we will trade volume for fees. Meanwhile, we have gotten out of training young lawyers. Instead we are reallocating resources to lateral hires.”

From A Chicago firm leader I was told, “Creativity in pricing to give clients more certainty in legal spending is here to stay. Be it fixed fees, segment pricing, it is here to stay. While there is some limited movement away from big law by large businesses, business leaders leave scads of money on the table by going to big law for most of their legal needs. Not sure why that trend continues.”

As yet another managing partner framed it, “I fully expect increasing demand from clients, particularly from in-house counsel, for better value from outside counsel. Clients are looking for shorter turn-around times and placing a heavy emphasis on having access to project tracking systems.” And from another, “Rate pressure is not going away, even as the recession ends. I expect increased discussion (but maybe not action) on controlling litigation costs. It doesn't do anyone (plaintiff or defense bar) any good to make litigation so expensive that everyone wants to avoid it.”

A number of respondents worry about **better marketing**. Said one, “Lawyers must engage in more rainmaking, with a economy that is consolidating businesses, not growing new ones, there will be more competition for clients. I think we'll continue to see some layoffs of lawyers from the large to medium size firms that have tried to be all things to all people. This will put additional talent on the street.”

As one leader bluntly put it, “Competition for business is just going to increase, particularly in relatively stagnant markets. We are all fighting over a shrinking (or at least not growing) pie.” An Indianapolis firm leader added, “I expect that the overall practice of law will get harder, not easier. Starting salaries for associates will inch up only slightly.” Yet another comment reflected the issue of productivity, “I’m concerned for how to handle the non-retiring member whose book of business and contribution has been dropping.”

Then there were those firm leaders who expressed a degree of confidence in what 2011 might bring, "I honestly don't see why we won't be in for a great year." According to one respondent, "The economy, and thus deal flow, is going to improve, regulation and enforcement by the government isn't going away, our expense structure has been controlled, and we showed we could deal with the recession and in the process honed our management skills. We needed to sharpen our focus and we needed to improve our efficiency, and I think we have."

And Over on The West Coast:

From Los Angeles, I heard, "For 2011, I predict a very slow and marginal but continuing incremental economic recovery, with attention on the public side to being more realistic and fiscally responsible (which will require a several year sustained effort). For law firms, this means another year of working very hard to hold ground and do a little better. We will stay very focused on efficiency and operating lean. Clients will continue to be very demanding regarding discounting and pricing. The best strategy is to remain focused on a firm's practice strengths and work for competitive gains there."

A San Francisco firm leader added, "We see a continued slow recovery, with opportunities to carve out more business from larger firms by delivering new service delivery models that have us taking more risk (having more skin in the game) and clients having greater value, cost predictability and better service."

On a related note another respondent expressed it this way, "In 2011, we will continue to see rate and cost pressure, emphasis on "value" - demand for more value at less cost. To keep some lawyers busy, they will need to be agile and capable of adapting, but resist the temptation to dabble. This will tax their creativity and business sense, and could - - if not well managed - - increase liability exposure. We must be mindful, also, that what we are doing throughout this time will define - - whether we like or intend it or not -- the new normal once the recovery is complete."

From another, "We expect the economy to continue to be flat and there are a lot of expense holes that have to be filled, such as state and multiemployer pension funding. It gets more difficult for any firm to establish and improve its name recognition in the legal services buying business and other communities. They have so much coming at them and at such speed that there is not good knowledge about who are the best lawyers for their legal issues. We are doing major software upgrades this year, and are working to educate and professionalize or approach to alternative billing methods to the billable hours."

And finally, from Seattle came, "I think (hope) larger organizations will continue to realize they can hire sophisticated and capable counsel at regional firms who cost less money but are more responsive and equally capable to their large-firm counterparts. The huge glut of new attorneys with weak job prospects will continue to grow as firms remain hesitant to hire those with minimal skills."

Patrick J. McKenna (www.patrickmckenna.com) has worked with the top management of premier law firms internationally to discuss, challenge, and escalate their thinking on how to manage and compete effectively. He is co-author of the business bestseller First Among Equals and currently co-leads a bi-annual program entitled First 100 Days: The New Managing Partner's Master Class, usually held at the University of Chicago.