Law firm performance and strategies for market leaders

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The 2009 Am Law 100 rankings by The American Lawyer showed that the average profits per equity partner of the 100 top-grossing law firms in the US declined by 4.3 per cent in 2008. It is clear that 2008 brought to an end, at least temporarily, what The American Lawyer called the "Law Firm Golden Age" – the five-year period that saw historic percentage increases in both revenue per lawyer (RPL) and profits per equity partner (PPEP).

The year 2008 marks a reversal in profitability growth trends

The 2008 Am Law 100 financial results confirmed that many of the firms with a significant New York-based capital markets practice (which had enjoyed the strongest growth in RPL and PPEP during the five years ending in 2007) had a weak year, while firms with a litigation focus, including many regional firms that offer service at lower fees and are less dependent on the flow capital markets transactions, fared better.

Average PPEP for the Am Law 100 has fallen, partly because the credit freeze that followed Lehman Brothers' 15 September 2008 collapse devastated 2008 fourth quarter and 2009 first quarter productivity and inventory, and increased the length of the collection cycle.

The credit freeze also decimated corporate finance and capital markets practices, catching many firms which had been hiring talent as if the preceding ten-year boom in the legal industry would continue unabated, leaving them overstaffed but with less demand for service.

Strategies for market leaders

The economic downturn will continue to impact firms of all sizes and practice areas throughout the legal industry. The Am Law 100 and Global 100 firms have been especially hard hit, and will need to act boldly to turn the crisis into an opportunity for important housekeeping and potential growth. Five proven strategies to help firms remain competitive in an uncertain economy include:

- Cost cutting;
- Strategic branding and positioning;
- Negotiating win-win alternative fee arrangements;
- Revenue-generation through client management; and
- Outsourcing.

Cutting costs

Economic challenges have led many firms to institute significant cost-cutting measures, but for many firms, continued and deeper cost cuts are needed. The following are some suggestions.

- Firms should take a sharp knife of payroll and other expense – some did so successfully in early 2009, but many still need to cut further;
- Firms should continue to lay off unproductive associates and partners and, if they have not already done so, firms should roll back salaries for all non-partner lawyers;
- Firms also need to act boldly to get out of unprofitable practice areas and locations, particularly those that do not align with their strategic growth plans;
- Most firms should materially scale back in lawyer hiring, as many have started to do; and
- During an economic rebound stage, there will be no shortage of recent graduates in the market for a job at Big Law, as well as a bountiful supply of outsourced talent to fill staging gaps.

Outsourcing

Based on the aforementioned market pressures, going forward many firms will need to build their leverage differently, turning to a flexible staffing model that relies more on outsourcing that on junior associates for routing work. In addition to hiring contract lawyers from reputable US-based outsourcing companies, firms should begin to look to the booming outsourcing industry in Asia – particularly India – to find lower-cost ways to do the work of first and second year associates that US-based outsourcing firms can offer.

Outsourcing commodity work, particularly when the work is being done under a flat fee arrangement, can reduce the cost of the work to the client and increase a firm's profit margins a classic win-win. But the benefits of outsourcing extend beyond improved margins and reduced payroll costs. Shifting routine work out of the firm will free talented young lawyers to cut their teeth on challenging work that will help them grow in their practice and become 'go to' lawyers sooner; and associates who feel that their firms are investing in their professional development are more likely to rise through the ranks acting like owners who care about the growth of the firm.

In addition to possible savings in occupancy costs associated with having a leaner staff in the US, outsourcing to India in particular makes good sense because it will allow firms to 'stick their toes in the water' in one of the most important emerging BRIC economies (Brazil, Russia, India and China). It behooves firms to deepen their connections to the increasingly important emerging economies over the next few years. Using outsourcing as a way to familiarize themselves with the Indian market – after developing and adequate quality control system – is one way to begin. It is true that not all leading firms are prepared to outsource to Asia; in the meantime, such firms can take advantage of the domestic outsourcing market, which can provide significant cost savings.

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