

An Altman Weil Special Report

2020

Law Firms in Transition: **Executive Summary**



About Altman Weil, Inc.

Founded in 1970, Altman Weil, Inc. is dedicated exclusively to the legal profession. It provides management consulting services to law firms, law departments and legal vendors worldwide. The firm is independently owned by its professional consultants, who have backgrounds in law, industry, finance, marketing, administration and government. More information on Altman Weil can be found at www.altmanweil.com.

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Law Firms in Transition 2020

Here we are again.

When the Altman Weil *Law Firms in Transition Survey* debuted in 2009, the nation was pulling out of a deep recession. In an environment of slow demand growth, extreme price sensitivity and intense competition, it was obvious that law firms needed to deliberately improve on their approaches to pricing, staffing, technology deployment, process efficiency, profitability analysis, practice leadership and lawyer accountability to meet the external demands of a more challenging marketplace and the internal demands for income security and viable career paths.

Did law firms adapt and transition as needed to achieve lasting competitive advantages? Some did while most did not—at least not in full. This year's survey highlights the persistent disconnect between what firm leaders agree they should have done during the intervening years and what they actually accomplished. The survey findings point to the many opportunities still available to firms that choose to pursue them.

In 2020, amid a global pandemic and a stalled economy, firm leaders are presented with an opportunity for another reset—an opportunity to truly rethink what a law firm ought to be doing to meet the needs of a marketplace *that has already changed* in terms of how clients define and measure value and what they're willing to do to make sure they get it. Clients will be pushing anew for pricing concessions, predictable budgets, more efficient staffing, more sophisticated utilization of preferred technologies, better communication relating to goals and metrics, and new strategies to create winning outcomes. Corporate law departments will reassess how, when and how much they use outside counsel. Competition from well-funded law businesses will surely accelerate.

Will law firms respond by rethinking their methods and structures to align with clients' expectations?

History says that most will not.

Will this time be different?

Law Firms in Transition?

Over the last decade, the *Law Firms in Transition* surveys have provided the legal profession with deep, broad-based data on the challenges and circumstances facing law firm leaders, what firms have done in response to evolving market conditions, what's worked and what has not.

What we've documented, above all else, is that law firms—by nature, by design, by temperament—are slow moving organizations. Some firms have been fast movers, but the overall pace of change in legal practice has at times seemed agonizingly slow.

This comes as no surprise. We know from experience¹ that law firms prefer to follow, not lead. Indeed, the question we are asked most frequently is “What are other law firms doing?”—an inquiry that makes plain a followership strategy and that bakes in a slow pace of change.

In each of the last few years, we have debated whether “Law Firms in Transition” was even a meaningful description of what the survey data have long shown—that most law firm partnerships don't want to change, aren't good at it, and by and large don't think it's necessary.

Maybe they're right. The years following the Great Recession brought gradual change and improved profitability. Firms were aware of shifts in clients' buying behavior and responded in some ways, testing new approaches, being more responsive to clients, but not turning themselves inside out. They did enough to stay even with peer firms and rose on the tide of general economic prosperity.

Over the years, firms have done well to reduce their debt and improve liquidity. Many firms developed policy frameworks to manage lawyer/client transitions, addressed pockets of overcapacity among lawyers and staff, selectively adopted new technologies and hired non-lawyer specialists to manage niche operations like pricing and project management.

¹ From experience and from our survey data. The 2014 Law Firms in Transition Survey (page 14) found that only 10% of law firm leaders thought that change in the profession would be driven by law firms. 90% of firm leaders thought that change would be driven by clients, technology, generational transitions or other factors. Law firms never intended to lead.

In our assessment, work was left undone in each of those areas. However, as the economy predictably rebounded and demand slowly returned, firms were able to increase rates while hiring more slowly to deliver higher per-lawyer production and improved financial performance. For the 2019 fiscal year, more than half of all firms (52.2%) reported gross revenue increases of 4% or more—easily the highest proportion this survey has ever reported.²

Then Coronavirus Happened

Through early March 2020, we were looking at a continuation of positive trends and heady optimism. The survey, which was launched on March 3, captures that moment “before” coronavirus. Most firms were reporting a strong start to the year and healthy pipelines of work.

Then everybody ran into the brick wall of the coronavirus pandemic and the immediate consequence of sharp economic contraction. Unlike a normal recession, there is no predictable arc of how the current downturn will play out. How long, how deep, how painful—nobody knows for sure.

What we do know is that in the 2019 survey, only a handful of managing partners were highly concerned that a broad economic recession would negatively affect their law firm in the next five to ten years.³ We know from the 2020 survey that large majorities of law firm leaders were counting on higher billing rates, increased billable hours, improved leverage, higher realization and cost control measures to contribute to higher margins and improved firm performance.⁴ Hopes of more billable hours at permanent rate increases have been dashed in many firms. By April, law firms’ annual projections were being totally reworked based on best guesses of how public policy decisions and economic regeneration might play out later in the year.

Positioning for the Future

Disruption and uncertainty always bring opportunities to get ahead. For example, back in 2009, firms of all sizes saw opportunities to take work from larger firms as clients looked for high-quality work at lower rates and for leaner staffing of matters and cases. Firms pursued opportunities to hire laterals and groups due to

² 2020 Law Firms in Transition Survey, Altman Weil, Inc., page 55.

³ 2019 Law Firms in Transition Survey, Altman Weil, Inc., page 3.

⁴ 2020 Survey, page 63.

downsizing at competitor firms and the ability to offer more agreeable rate structures, overhead costs and culture. Many firms found the motivation to address inefficiencies and waste, deal with performance issues, fix partner compensation and benefits, address weak practice areas and offices, and be more disciplined in managing their finances. They improved upon firm policies and procedures, managed the transitions of senior partners, improved their operations and support staff models and developed greater strategic clarity. Such opportunities abound in the current environment.

Since the pandemic struck, we've seen firms deploy all the tactics one might expect in an economic crisis—pay cuts, furloughs, layoffs, reduced draws, expense cuts, deferred distributions, suspension of 401(k) contributions, cancellation of summer programs, postponement or rescinding of associate hires and the like. We've learned that firms can pivot quickly. Lawyers and staff can work remotely. Administrative tasks like billing can be done remotely. Courts are learning to function remotely. Deals are being done remotely.

The transition to work-at-home seemed to go relatively smoothly for most firms and many were pleasantly surprised to find that remote work... works! Many firms have been surveying their lawyers and staff about their work-at-home experience and are already recalculating their office space needs going forward. We anticipate that firms will be able to save as much as 3.5% of revenue over time from renegotiated leases. Of course, some of the savings will go toward supporting remote workers, but those costs should taper off after initial investments. There are new questions about what remote work will mean to training, collaboration, relationships, job satisfaction, loyalty, retention and the like, but the technological barriers are mostly gone, connectivity and collaboration tools will continue to improve and solutions to the “people issues” that will arise in law firms have already been adopted by other types of organizations.

There will be further disruption ahead as the virus evolves and society responds. As a result, law firms should expect greater volatility and plan accordingly. Budgets and plans should have more contingencies built in and should be updated rigorously every quarter based on new circumstances and projections.

2020 Survey Highlights

Law firms in general have not demonstrated the will to change their legal service delivery model to increase the value being delivered to clients. In every year from 2013 through 2020, managing partners gave law firms mediocre marks (a median rating of 5 on a 10-point scale) in terms of their seriousness about changing the service model.⁵ The low marks are jarring when one considers that managing partners recognize that the market has changed substantially over the last ten years⁶ and that firms needed to change to stay competitive.⁷ Less than 2% of firm leaders strongly agree that law firms have changed as much as was needed,⁸ which invited many clients to look for answers elsewhere.⁹

For years, large majorities of managing partners have agreed in theory on the need to improve practice efficiencies in the face of intense competition, ongoing commoditization of legal work, price pressures and encroachments of non-law-firm competitors.¹⁰ Yet, as reported in the 2020 survey, only 22% of firms have attempted to systematically reengineer their work processes and only 31% have provided ongoing project management training and support to their attorneys.¹¹ Among the firms that are trying to make progress in those areas, most have not yet seen their efforts translate into significantly improved firm performance. These two tactics are merely examples—the same is true for most of the tactics mentioned in the survey. We encourage you to study the What Works charts in detail as you order your leadership priorities.¹²

This year's survey asked managing partners to rate their firms' progress toward maturity in key areas of the law firm business model. The results show that overall, firms have a long way to go. A majority of firms characterized their current progress as zero or early-stage development in the areas of pricing, staffing and efficiency.¹³

⁵ 2020 Survey, page 9.

⁶ 2020 Survey, page 10.

⁷ 2020 Survey, page 11.

⁸ 2020 Survey, page 12.

⁹ 2020 Survey, page 3.

¹⁰ In this year's survey (page 1), 95.1% of law firms leaders identified "Focus on improved practice efficiency" as a permanent trend in the profession. That number has been 93% or higher in each of our last ten surveys (page 2).

¹¹ 2020 Survey, pages 38-40.

¹² The tactics being used by law firms, and their effectiveness, are summarized in the survey's Appendix for easy reference.

¹³ 2020 Survey, page A1.

Firms are a bit further along in their use of profitability data, with 56% of law firm leaders reporting intermediate or mature stages of development.¹⁴ However, we are still seeing a disconnect between being able to generate reliable profitability data and actually using the data in collaboration with practice group leaders to make strategic investment decisions.¹⁵ Management teams must continue to refine their profitability analyses by client, matter, practice area, etc., understand what the data are telling them and make fact-based decisions to drive performance gains.

Of course, sluggishness on the part of some firms does not impugn all firms. Leading change may be difficult, but is not impossible, and some firms have excelled. The most effective leaders have created collaborative firm cultures, rewarded people who led or contributed to change initiatives, put forward looking leaders in key roles, actively solicited ideas for improving processes and client service, and experimented with innovative new ideas.¹⁶

Firms have gotten much more serious in recent years about investing in professional staff to manage operations. In addition to their core administrative professionals in finance, human resources, marketing, IT and business development, firms have added specialists to manage or support recruiting, professional development, data analysis, client relationships, client value and pricing. Most firms of 250 lawyers or more have full-time employees dedicated to each of those functions. More than 20% of those firms have full-time people working on innovation and strategy.¹⁷

We have been pointing out for years that the profession is significantly overstaffed and underemployed, particularly at the non-equity partner level. While some progress has been made,¹⁸ half of all firms and 60% of large firms still say that their non-equity partners are not sufficiently busy.¹⁹ Most firms (84%) report having underperforming lawyers.²⁰ In nearly a quarter of all firms, more than 10% of lawyers are considered underperformers.²¹ Half of all firms said overcapacity was diluting

¹⁴ 2020 Survey, pages 49 and A1.

¹⁵ 2020 Survey, page 50.

¹⁶ 2020 Survey, pages 14-17.

¹⁷ 2020 Survey, pages 22-24.

¹⁸ 2020 Survey, page 32.

¹⁹ 2020 Survey, pages 25-26.

²⁰ 2020 Survey, page 30.

²¹ 2020 Survey, page 31.

their overall profitability.²² And most of that was reported before the current calamity took a bite out of lawyer workloads.

Many law firms look the same to prospective clients—they do not project a distinct and compelling value that distinguishes them from similar firms. Differentiation is imperative in a highly competitive market like the one we can expect this year and next, yet only 55% of law firms leaders think their firm is clearly and specifically differentiated.²³ Our experience is that some firms misunderstand what being differentiated in the eyes of clients really means. Being smart, experienced lawyers who get the job done—is that enough? Not if your five closest competitors can say the same. We think a heightened focus on true differentiation, especially at the practice group level, is a must for most firms.

Leading Change

We are not suggesting a total overhaul of law firm structure, systems and culture. We know that won't happen. In the history of law firms, we have never really seen rapid, radical change, and we don't expect to see it now. However, firm leaders should be trying to push through four persistent barriers to change:²⁴

Partners resist most change efforts. Of course they do. Your firm's most powerful and influential partners—the ones who control client relationships, decide work assignments and enjoy the highest incomes—have the most to lose from any potential disruption to their relationships and work flows. Therefore, you might need to conduct experiments with adjacent partners and practices, develop proof of concept and work your way in.

Clients aren't asking for it. Many clients never did ask for significant changes from outside counsel, and some never will, but they have undeniably voted with their feet. Nearly 7 in 10 law firms have seen their corporate clients pull work in-house and most of the remaining firms said they see it coming.²⁵ If you wait for clients to ask how you can serve them better, you'll have waited too long. Clients want and expect to have conversations with you and your

²² 2020 Survey, page 29.

²³ 2020 Survey, page 5.

²⁴ 2020 Survey, page 13. The same four reasons have topped the list in each of the last five years.

²⁵ 2020 Survey, page 3.

partners about pricing, budgets, project staffing, matter management efficiency and value.²⁶

Firms are not feeling enough economic pain to motivate change. Some years are better than others, high earners can live on less, and partnerships know how to tighten the belt when necessary, as they have demonstrated over the past few months. It might provide some comfort to know that through the last recession, partnership cohesion was found to have been sustained or even strengthened in most law firms.²⁷ It takes a lot to kill a law firm, but still, it is going to be necessary to keep your most important partners happy (which is to say, well paid) and not let other firms entice them away with enough incremental compensation to overcome their loyalty, comfort and inertia. Improving your firm's margins, profitability and incomes will help you retain and attract key talent.

Most partners are unaware of what they might do differently. Curiously, we have observed that the class of intellectuals known as law firm partners are not a hugely curious lot when it comes to changing their ways. You'll have to work selectively and collaboratively with those who will work with you to identify new pricing and delivery models and try them out. If it's still true, year after year, that partners don't know what they might do differently, we see that as a failure of leadership. Firm management should be facilitating and requiring discussions along these lines to generate ideas, commitments and buy-in and to accelerate learning. Again, see the What Works charts for guidance.

Recommendations to Law Firm Leaders

Are law firms transitioning? Not at the scale or pace that should reasonably be expected. The investments made to date have not generally been consequential enough to significantly alter a firm's trajectory, impress discerning clients or generate sustainable competitive advantages.

Our recommendations have been right here all along: Improve the efficiency, value and profitability of legal service delivery; learn and improve as you go; build on

²⁶ 2020 Survey, page 6.

²⁷ 2014 Law Firms in Transition Survey, Altman Weil, Inc., page 8.

successes and systematize effective new methods by replicating them in other parts of the firm; and turn your real new capabilities into sustainable competitive advantages by committing to them, locking them into your organizational processes and structures, and communicating, supporting and demonstrating them to clients.

Our advice is embedded in the questions that we ask: What competitive trends are you seeing, what tactics are you employing to improve performance and which among them are working? Any of the tactics, executed effectively, should lead to improved performance and greater profitability.²⁸

Law firm leaders do not have to develop their own ideas of what might work—we have years of data to answer those questions. Get the information into the hands of your management committee members, practice leaders, industry team leaders and key administrators. Challenge them to test new approaches with urgency and purpose. Hold them accountable.

The things that have been shown to work for firms that do them—do those things. Things that firms aren't doing but that you think you can pull off—do those things too. Be selective, attack each chosen initiative with the full intention of succeeding, assemble a capable team to make it happen, be clear on the goals and deliverables, assign champions and budget, carve out the necessary organizational space, support it at the management level, and go.

Again, and still, the lack of aggressive adaptation and leadership on the part of most law firms presents a clear opportunity for your law firm to get ahead and stand out.

²⁸ As summarized in the 2020 Survey Appendix and presented in detail in the survey pages.

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The 2020 Law Firms in Transition Survey

Conducted in March and April 2020, the *Law Firms in Transition Survey* polled Managing Partners and Chairs at 794 US law firms with 50 or more lawyers. Completed surveys were received from 182 firms (23%), including 26% of the 500 largest US law firms and 26% of the AmLaw 200.

A copy of the survey can be downloaded at: www.altmanweil.com/LFiT2020.

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