



Like many professionals, lawyers are facing a ‘new normal’ following the recent economic turmoil. **ROBERT C. SAWHNEY** and **PATRICK J. McKENNA** explore whether this is just a difficult period or whether the game has changed forever.

While it has been a long time coming, the global financial crisis really does seem to be creating what many in the legal scene have come to call a ‘new normal’. The folks at Citibank are now projecting that in the United States, law firm revenues will decline across the board at anywhere from 5 to 10 per cent in 2010.

As if that weren’t enough, clients are demanding discounts and firms are experiencing declining realisation rates. This is evidenced by a leaked internal memo from a New York-based Global 100 firm that might sound familiar to others:

As you are all aware, our pricing power is diminished. In more and more areas, clients are seeking discounts or other billing arrangements. On new business pitches, discounts are routinely being sought. In 2007, our realisation was 110 per cent; in 2008, our realisation was 97 per cent; for 2009, we originally budgeted 93 per cent, and we are now running at a realisation of around 89 per cent ...

We are giving discounts on some litigation; we are giving discounts on bank and investment bank house account matters; we give busted deal discounts; we are willing to fix fees. If a particular partner rate or particular class rate is a sticking point, we can discount those rates to be competitive.

We can quote a blended rate. In brief, we are flexible on rates and want to do what we need to do in order to expand our share of the high-end business out there.

Additionally, a LexisNexis survey shows that more than half of in-house counsel in the US believe law firms are too profitable, while a different survey of corporate counsel claims that 55 per cent plan to reduce their spending on outside counsel in 2010. Clients are beginning to focus their market muscles.

Indicative of this is the creation of a new ranking system of law firms, initiated by America’s Association of Corporate Counsel (ACC), that now asks clients to rate law firms. Known as the ACC Value Index, it asks general counsel to rank their law firms on the following six criteria:

- Understands Objectives/Expectations
- Legal Expertise
- Efficiency/Process Management
- Responsiveness/Communication
- Predictable Cost/Budgeting Skills
- Results Delivered/Execution.

**“In brief, we are flexible on rates and want to do what we need to do in order to expand our share of the high-end business out there.”**

It definitely would seem that significant change is happening. Many have heard this, with the possibility of alternative fees being bandied around for years, but when it becomes front-page fodder in *The Wall Street Journal*, then one tends to sit up and take notice.

As a result, we are now seeing a number of forward-thinking law firms starting to change the way they do business in terms of associate compensation (from lock-step to merit-based), training and development, structure and decision making, as well as partner remuneration and reward systems. At a broader level, they are significantly changing their cultures.

#### LOCK-STEP VS MERIT-BASED REMUNERATION

In many ways, lock-step systems of remuneration put firms on autopilot as salary and billing rates are determined by an associate's length of service. Every year they get paid more simply because they have one more year of experience. Although not new, many more firms are moving to merit-based systems because they take into account performance. Early users of this system tended to focus too much on technical skills whereas now the criteria to measure performance are much more varied. Aside from technical skills, lawyers are judged on client-facing abilities, problem solving, and behaviours that lead to being a well-rounded lawyer. Meeting client expectations is central.

#### THE CHANGING FACE OF LAW FIRMS

Although doing so intuitively, some law firms are creating marketing cultures as they strive to reinvent themselves and become more competitive and more relevant to clients. This is happening in a number of areas.

#### ASSOCIATE REMUNERATION, PROGRESSION AND TRAINING

It has long been recognised that law schools and the training provided by law firms early in professionals' careers do little to prepare young lawyers for the realities of legal practice. Lack of client skills and business training has affected the overall value that clients receive. Firms are addressing this by changing the way associates are managed, measured and rewarded.

US firm Orrick, Herrington & Sutcliffe LLP was among the first to develop a tiered system for partner-track associates and career attorneys. This consisted of one track for the 'star' performers who are willing to do what it takes to become partners and another track for the 'solid B' players. Rewards are based on a merit system as opposed to lock-step, with the firm creating a number

of non-financial criteria to measure performance. In an interview with *The Wall Street Journal* law blog, the firm's Chairman Ralph Baxter said that while it is too early to tell, he was happy with the outcomes so far.

Another example is that of Wilmer Cutler Pickering Hale and Dorr (the 21st-highest-grossing firm in the US) which has created non-partner tiers of junior associates, senior associates, counsel and special counsel. Again, reward is based upon performance and there are different tracks for partner and career lawyers.

The firm's Co-Managing Partner, William Lee, says part of the reason for the change is the firm's move away from hourly billing to alternative fees.

These are not the only firms. Howrey LLP and Reed Smith have made similar moves and what we are seeing here is a realisation made by traditional corporations years ago: performance management must be more wide ranging than simply billable hours (financial) and that training and development must focus on the future long-term needs of the firm.

Those firms that just change their associate structures without concomitant changes in mindset and overall firm culture will not survive the shake-out. Interestingly, research by *Legal Week* (UK) shows that 96 per cent of partners are now in favour of merit-based reward systems.

#### PARTNER PERFORMANCE AND STRUCTURE

Lock-step systems of remuneration have long been criticised for not rewarding performance and allowing well-entrenched partners to ride along on the efforts of others. If partners perceive others to be contributing less but earning the same or more, they can easily become demotivated and less productive.

Merit-based systems, while more popular in the US, are beginning to catch on in Europe and parts of Asia (although in Asia, culture sees many firms favouring lock-step). They are designed to reward partners on their performance to the firm in a number of defined areas (i.e. leadership, revenue generation, coaching and client development).

Going beyond the seniority-based systems of lock-step, merit-based systems are, in our view, a step in the right direction to creating high-performance work cultures.

As highlighted by the examples below, we are seeing firms take action in terms of their partnership structures to improve firm performance.

It was reported recently in the UK's *Legal Week* that DLA Piper had engaged PricewaterhouseCoopers to overhaul its partnership model to better align responsibilities, performance management and rewards.

**“Many more firms are moving to merit-based systems because they take into account performance.”**

Currently using a three-tiered system of partnership (equity and two bands of fixed-share partners), it is speculated the overhaul could lead to a single tier of partners.

Meanwhile, Reed Smith in the US recently asked its 300 or so non-equity partners to contribute 15 per cent of their pay to firm capital in an effort to get non-equity partners invested in the business, share profit and be involved in risk sharing.

Certainly, there are other ways to get non-equity partners to feel invested, primarily through leadership, but it does signal an effort on the part of these firms to create a structure that is more cognisant of the changing business environment.

In Britain, Addleshaw Goddard decided against a move to all-equity-based partners and instead has concentrated on how it measures and manages performance. According to Managing Partner Paul Devitt: "We are determined to maintain and promote, for the partnership and for all our people, an environment which motivates them, helps them deliver even better for clients and achieves our strategic goals faster."

Again in the UK, Bird and Bird has been considering moving to a Legal Disciplinary Partnership (LDP) to allow non-lawyers into partnership as well as lawyers qualified in other jurisdictions but not recognised by the Solicitors Regulation Authority in the UK.

#### THE NEED FOR A COHERENT STRATEGY

With the ever-increasing competition of developed legal markets and the opportunities presented by emerging markets such as Asia, the need for strong decision making has never been greater.

A coherent strategy that is accepted and understood throughout the firm is crucial to the long-term viability of any professional service firm. This strategy should be clear on:

- which clients and industries the firm should focus on
- which geographic markets it should have a presence in and how to enter those markets
- which practice areas and services the firm should develop
- which strategic partners the firm should initiate alliances with
- how support functions such as human resources, knowledge management and marketing should be integrated into the overall strategic direction of the firm and its operations
- what performance measurements systems and criteria the firm should use.

Unfortunately, the anachronistic nature of most law firm partnerships and structures prevents this strategic ability.

Issues such as consensus decision making, narrow performance measurement criteria and a lack of willingness among partners to

share information all inhibit the ability of the firm to function as effectively as it could.

One may well ask, if this is the case, what structure and culture is most appropriate.

The answer may surprise many in that research shows it is a marketing culture – comprising client orientation, competitor orientation and inter-functional coordination – that has the most significant impact on firm performance.

A client orientation is concerned with a firm's knowledge and understanding of client needs and the marketplace in general. A competitor orientation revolves around the firm's ability to know what strategies its competitors are using and their strengths and weaknesses. This allows the firm to be differentiated and position itself knowledgeably in the market.

The last pillar of a marketing culture is probably the hardest for most professional service firms. Inter-functional coordination means the firm tolerates no functional silos and shares information across practice groups, offices and different levels of the firm. This aspect of knowledge sharing is vital to the performance of professional knowledge firms.

#### MOVING FORWARD

At the end of the day, a law firm is a group of people moving towards some common goal (like any organisation). Though there might be certain restrictions on the way law firms can structure themselves and indeed view themselves, achieving high performance in such firms is essentially no different to that of any other type of organisation.

Structures and systems should be designed so that they motivate people who are rewarded equitably. Recognising that people are different and have different motivations is hardly rocket science, and in developing different career paths firms do not need to discard solid B players just because they may not be partner material. Additionally, rewarding partners and associates based on wide-ranging performance criteria ensures that everyone is on the same page and contributing to the strategic direction of the firm. The key is to find a structure that suits your firm. ■

Robert C. Sawhney is Managing Director of SRC Associates in Hong Kong, which works with professional service firms on strategy, marketing and leadership issues. He is also author of *Marketing Professional Services in Asia* (Lexis Nexis, 2009).

bob@srchk.com

Patrick J. McKenna is an internationally recognised authority on law practice management and Co-Chairman of the Managing Partner Leadership Advisory Board.

patrick@patrickmckenna.com