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HOW IS 2014 GOING IN THE ATLANTA LEGAL MARKET AND WHAT ARE THE LONGER TERM ISSUES?

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This monograph presents the results of a series of Smock Law Firm Consultants' (SLFC) interviews with CEOs, Managing Partners, Administrative Partners, COOs, and Executive Directors of Atlanta based law firms (both in-person and by phone – nine firms in total, seven in person).

- It is similar to efforts (and resulting monographs) from the same type of interviews we recently conducted in the Chicago, New York, and Cleveland markets.
- We used a very straightforward process. John Smock contacted Atlanta based firms prior to a scheduled trip to Atlanta to request a brief interview. We asked for thirty minutes of their time, promised anonymity, and previewed this monograph to the interviewees in draft form, prior to its release.
- We wanted to know two things – how Atlanta law firms were doing and will do in 2014 and what the interviewees saw as longer term issues and their implications.

This monograph is organized in the same way as the interviews – what is happening and will happen in 2014 and, then, the interviewees' view of longer term issues and their impact. Also, after describing what the interviewees said, we have put in our two cents, relative to what SLFC thinks the interviewees had to say means, and what firms should do about it.

We should note that we combined a number of the comments of the interviewees in the following points. For instance, if two people said essentially the same thing (and they often did), we combined their comments into a single one.

How Is 2014 Going and What Does it Look Like for the Rest of the Year?

While our prior analyses in Chicago, New York, and Cleveland made it clear that 2014 (now and for the remainder of the year) were expected to be positive and strong, the general results for firms in Atlanta were exceptionally positive (although not unanimously so). The comments of the interviewees follow.

- 2014 has been a very good year so far – it is shaping up to be our best year ever for gross revenue and net income.
- 2014 a better year than 2013, which was not hard to do – we see a very strong second half of the year (particularly the fourth quarter), as growth in transactions continues to accelerate.
- We have gravitated to much more of an industry focus and that has clearly been the right thing to do – it focused us, we are getting more and better work, and, importantly, there is less pressure on fees if you have demonstrable industry expertise.
- Most of our competitors are also doing well – but we see a pattern where the out-of-state firms that opened in Atlanta (either by a small merger, or by acquiring laterals) are struggling (i.e. – losing people and not performing well), as are the Atlanta firms who picked up small firms or laterals in other southern cities.
- As said by a couple of the large firms – the Atlanta market has become less important to us, our success is more dependent on national and international clients and industries, and trends in the use of legal service.

- We have lost some key younger partners – some to other firms, but most to in-house positions. They see a better future there, they do not have to work as hard (the lifestyle issue), and the rewards are more than competitive.

- We are busy and doing well, but our receivables are starting to stretch out – a direct negative impact on revenue and profitability.

- Across our Firm – litigation (in terms of cases and prospects) is not where it has been and where it needs to be to keep our litigators fully utilized.

- One firm said, *"our 2014 rate increases of 4% are sticking (some of our competitors raised them even more) – we will probably do the same again next year."* Another firm we talked to raised their rates 2 1/2 % and those are also sticking. And, the others we interviewed raised rates variably by practice and they are also sticking.

- We are cobbling together a series of strategies (for this year and next) to increase our profitability – improved margin is a very important objective.

- Intense client rate pressure remains – that will remain a fact of life until the excess capacity in the legal market (i.e. – too many attorneys for the legal work available) works its way through the system.

- More and more work is being handled in-house – this is cyclical, but we expect it to continue for a while more, before it shifts the other way (back to outside counsel).

- All of our practices are busy, not the mixed performance (some busy, some not) of before.

    - Our practice groups are generally 5% to 10% ahead of budget with a strong 4th quarter ahead of us.

    - And profit performance has improved – we are looking very hard at profitability and margin (on clients, attorneys, and matters), but we know our competitors are too.

- The economy is not great – but it is better than 2013, which was better than 2012 – we are not at full throttle yet, but we are enjoying the bounce from what it was.

- Virtually every firm we talked to discussed their increased focus and emphasis on profitability – a clear trend away from top line revenue and charged hours.

- We will have a flat year – our billings are up, but collections are down and dragging out.

- This year we have worked hard on partner productivity with some solid positive results and some real disappointments.

- The second half of 2014 and most or all of 2015 will be focused on growth – enhancing our market position.

- For 2015 and beyond, we will have to be much better and much more effective in dealing with non-performers – they are clearly standing in the way of progress.

Longer Term Issues and Implications

We also asked the Atlanta firms about the longer term issues they see and the implications from those longer term issues.

- More and more litigation work (and work in other practices) will be going to contract attorneys and paralegals – since fewer partners will be named, the need to recruit and retain *"partner track"* associates is considerably less.

- While our hiring is growing, it is barely matching the aging of the partner base – when an older partner retires, there is no one to replace them.

- Successful business development is critical to our future. We do not do it very well now and we will have to improve dramatically.

- Two longer term issues (actually, two sides of the same coin) are impacting us – companies are not spending as much in outside legal fees (thus, the pie is getting smaller) and our clients are bringing more and more work in-house.

- Clients use of alternative fee arrangements are still increasing – but at a decreasing rate. We are getting better and better at it and have to be.

- AFAs are still slowly creeping into use by our larger clients – we expect that slow creep will continue.

- There is a real critical long range strategic question we cannot answer – when will the economy pick up and start growing robustly again? Next year, 2016, or never?

- We and our competitors are considering the associates that want to be partner and those that do not want to be partner in two separate buckets and treating them differently.

- We recognize that revenue growth (even increases in revenue) will be constrained by the market, so our longer term focus is – how do we make more money (i.e. – more margin) on what we are doing and who we are doing it for?

- Matter management and, thus, matter profitability are much more important issues for us than they were.

- Future space needs and costs are very important factors in managing our business and relative to impact on longer term financial results (said by virtually all interviewees in some way).

    - There are some space/real estate trends we can see, such as – office size will go down (*"no more big sprawling partner offices"*), there will be more open than closed offices, and hoteling (like the accountants have done) will increase (but, probably not for partners).

    - Unfortunately, the only real opportunities to take significant action to impact space costs are during lease renegotiating or a move to another office/building.

- The biggest change on the horizon is virtual law firms

    - They can compete for lots of work with large clients and able to cut their rates dramatically.

    - While quality is and will remain an issue, clients clearly do not want to pay for large offices in large cities.

- Law firm merger discussions are picking up (*"we are getting more and more calls"*) – we expect that this will be a trend for at least the next three to five years. While we generally do not want to merge, some of our partners are beginning to talk about it.

- There is continuing (and increasing) pressure on rates and costs, particularly on meat and potatoes legal work.

- We are losing profitable work to in-house attorneys. The aura of inside counsel has changed. They are of similar quality as the best outside counsel firms – in fact, that is where they get their new hires.

- Use of contract lawyers is also increasing, particularly in large firms, where they staff large cases/matters. You can often get really good attorneys who like that kind of work. But, what scares us is that our clients can hire contract attorneys just as easily as we can.

- Law firms will be looking more and more like accounting firms in the future – better managed, partners really functioning as employees, smaller individual offices, and specific quantitative expectations (to which individual partners are held accountable).

- Associate (baby lawyers) recruiting has been scaled back by our firm and our competitors. But, associates are leaving again (partners are still hoarding associates' work, so these associates see no future) and, thus, we do have a pipeline issue.

- The key worry/question – will demand for outside legal services increase, so we can grow without taking work away from others?

- Our marketing/business development model as well as the business development model for most other firms needs assessment and, probably, some change – what works and where and how do we get the best bang for the buck?

- Succession in client relationships and firm and practice management issues remains an unresolved issue. Also, the degree of leadership needed to manage client relationships and lead firms and practices is not as evident in younger partners as in prior generations.

- We view the better use of technology, increased and more effective partner productivity and delegation, and considerably more efficient use of space and other fixed costs as the strategies to improve profitability. Just trying to cut costs will not get us there.

<u>Smock Law Firm Consultants' Comments</u>

Following are our comments and suggestions based on what the Atlanta legal market interviewees had to say and, in comparison, with the interviewees in the other markets where we did the same thing (Chicago, New York, and Cleveland).

<u>Comments</u>

There is an obvious pattern of conclusions emerging from all four markets and we assume this will be evident in our upcoming annual survey of the law firm legal marketplace.

- First, law firms in 2014 are doing awfully darn well.

    - A year ago at this time there was considerable angst about 2013 results – law firm managers (CEOs and COOs) were predicting shortfalls from budget, some quite significant, and a disastrous fourth quarter. But that did not occur, the actual strong last quarter of 2013 saved many firms' results and kept their partners happy.

    - This year, results are very, very positive through the first three quarters of the year – with most predicating a very strong fourth quarter and a significant jump in 2014 results over 2013. There will be a good number of earnings records (both individual partner and firm) set this year – and individual partner income will take a significant jump.

- The areas of focus – mentioned frequently to us in the Atlanta interviews and those in other markets – are, very arguably, the right places to expend time, effort, and resources.

    - **Profitability** improvement was the most often mentioned in the Atlanta interviews and there appears to be a good focus on all five of David Maister's drivers of profitability (utilization, rates, realization, leverage, and margin). Although we are particularly sensitive to the common mistake in law firms of believing that the silver bullet to grow profit is to control costs – that does not appear to be the default position of the Atlanta people we talked to.

- **Industry focus** was also brought up as a strategy to grow work and improve profitability. We have been preaching the value of industry specialization for a long time and it really does work.

- **Underperforming partners** have been at the top of the list of concerns for law firm managers for at least the last three years (in our annual national surveys). Certainly the Atlanta interviewees both spoke about its remaining importance and as an issue where they have and are making progress. Unfortunately, we see too many firms feel that reducing the income of underperforming partners is sufficient to address this issue. No, chronic underperforming partners have to be moved out to make room for performing ones.

- Finally, the Atlanta interviewees underscored the importance of a pivot back to **growth**. There is a recognition that successful businesses have to grow to remain successful. And, the firms we talked to are paying attention to ways to do this. We remain concerned, however, that the default strategy to grow, in the minds of many firms, is to *"recruit laterals with books of business."* In truth, it is very hard to substantively grow with laterals – because, even if you bring in some good ones, attrition across the firm takes its toll and many firms are merely treading water.

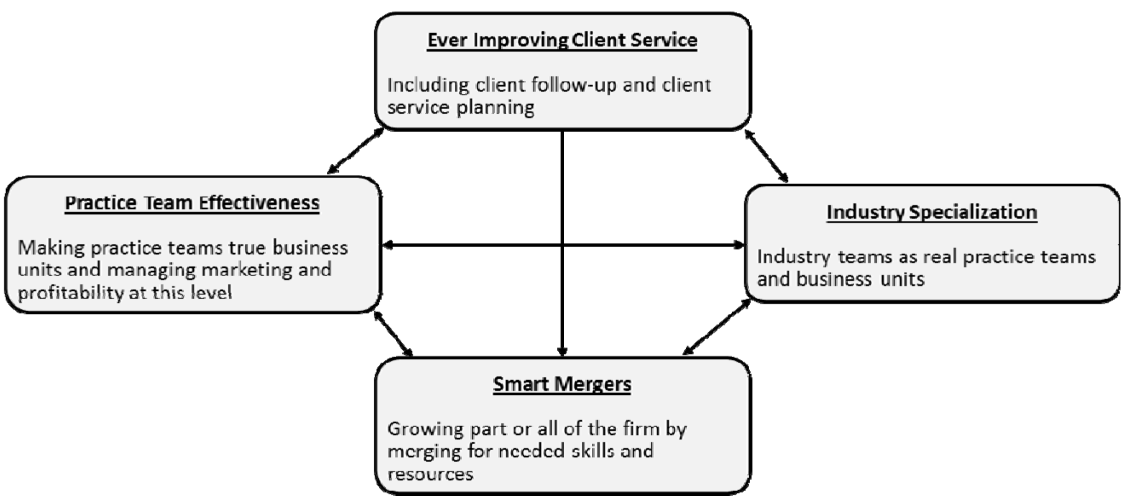
So, the Atlanta interviews proved to us that law firm managers are and have been focused on the right things.

Recommendations/Suggestions

We do have some suggestions in response to what the firms had to say.

- On **growth**, we suggest that firms focus their growth efforts on all four of the major (*"Big Four"*) strategies for growth as shown below and which are, by definition, interrelated and supportive.

The *"Big Four"* Growth Strategies



- Manage **profitability** by setting specific goals for performance among all five drivers mentioned previously (utilization, rates, realization, leverage, and margin). Do not focus exclusively on margin. Most firms and practices have – given their business, clients, and services – differing balances among the five drivers. So, recognize that balance, interaction, and interdependence in setting specific objectives.

- And, related to managing the *"big four"* growth strategies, ensure that you have sufficient **marketing/business development** resources to support and foster firm growth. Those resources clearly should support practice team and industry focus teams – not individual partners and *"their practices."* And, probably every three years or so, most firms should review their marketing/business development efforts and ensure their continued effectiveness. They should clearly not be viewed as prime opportunity for cutting costs as in what we often hear, *"we are wasting lots of money on marketing."*

    - There was a recognition – by both larger and smaller firms – that marketing and business development resources are essential to successful growth and, ultimately, a firm's continued success.

    - There was also recognition that (in our Atlanta conversations) that, historically, these resources certainly have not been focused on the most important things or have been politically diverted away from the most important things.

This completes our follow-up to the Atlanta interviews. We hope it has been useful to the firms that participated and those firms who compete in the Atlanta legal marketplace.

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John Smock is the founder of Smock Law Firm Consultants and has been a strategy focused management consultant for 44 years across a wide range of industries and – for the last 30 years – with a particular focus on law firms.

Smock Law Firm Consultants is a focused strategic management consulting firm serving law firms (our primary industry concentration and 80% of our work), other professional service firms, and commercial entities. We help law firms address and resolve those issues that have a major impact on a firm's near term success and its long term direction and focus. In doing that, we have seven key areas of practice – (1) **strategic planning** at the firm and practice levels; (2) **strategic plan implementation and execution**, in essence, helping clients do what they said they would do; (3) **mergers and combinations assistance**, helping identify, negotiate and implement combinations; (4) **practice team/group management**, helping the practice team concept achieve its potential; (5) **law firm economics**, helping our clients improve profitability and deal with longer term financial issues; (6) **operational excellence**, improving both the effectiveness and efficiency of firm operations (both the front office and the back office); and (7) **strategic management issue resolution**, assisting in resolving a variety of issues of vexing management concern.

We are *"on the cloud"* and our four partners are based in Lake Forest, IL/Charleston, SC; Weston, CT; Long Island, NY; and suburban Detroit and our staff is in suburban Chicago.