SMOCK
LAW FIRM CONSULTANTS

BETTER RESULTS THAN EXPECTED WITH POSITIVE PROSPECTS – BUT ISSUES STILL TO BE ADDRESSED

SMOCK LAW FIRM CONSULTANTS' LEGAL MARKETPLACE OUTLOOK FOR 2014 AND BEYOND

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This monograph presents the results of Smock Law Firm Consultants' (SLFC) annual survey of the legal marketplace conducted in January 2014.

- It is similar in scope (and questions) to the *"start of the calendar year"* surveys we have conducted in prior years. The survey also asked the respondents to make qualitative comments on each of the questions. Thus, we have comprehensive quantitative and qualitative responses in most areas of questioning.

- To add context, we augmented the quantitative results of the survey with personal and phone interviews with managing partners and senior administrators. We asked three things – how these firms and their competitors did in 2013, what they expect for 2014, and what they see for the next few years and beyond.

This monograph is presented in the following sections – an overall summary, demographics of the survey respondents, 2013 performance and results; expectations for 2014, and SLFC's comments and recommendations.

<u>SUMMARY</u>

Right out of the box, it is apparent that most law firms did better in 2013 than both the pundits and the firms themselves thought they would do. While late 2012 was a heady rush (all of those transactions completed to beat feared early 2013 tax increases), 2013 was seen (throughout the year) by many law firms as a drag. Results were down and we heard – in our discussions with law firm managers in late summer and early fall – that even the cautious (and conservative) budgets set for 2013 were in real danger of not being achieved. We heard the figures *"5% to 10% below budget"* often. But, results for 2013 came in much stronger than projected, rate increases (in the neighborhood of 4%) on average mostly held (but realization percentages down), and law firm managements remained focused on improvements that can/should have an impact on future performance and profitability.

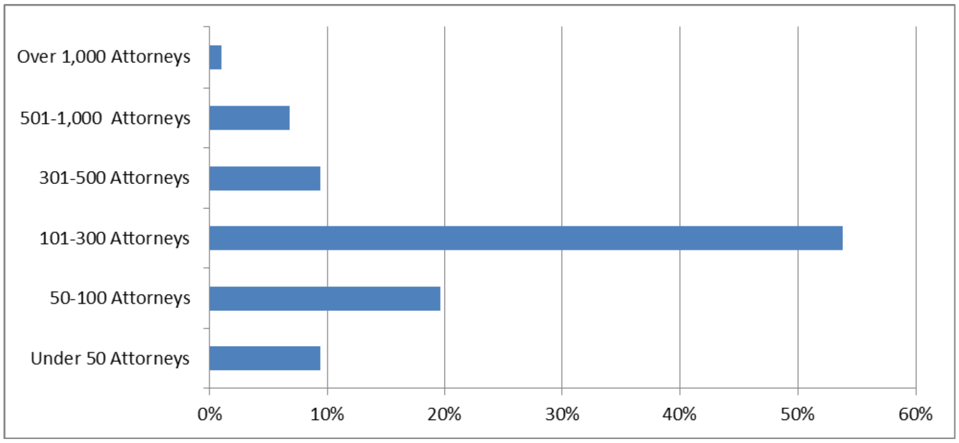
While *"cautious optimism"* is again the watchword for looking into 2014 and beyond – the degree of enthusiasm for probable positive performance in 2014 is more positive than we would have presumed. Rate increases in the neighborhood of 4% are predicted again and there is optimism that these raises will hold (even with continuing client pressure on fees). Simply put, 2014 is seen as positive – growth is predicted in 21 of 23 of the standard legal practices and there is a general perception that overall demand will rise, but not significantly.

The primary 2014 worry/issue is top line growth. How can firms achieve it in a period of either very slowly rising or declining demand? And for 2014, the bloom appears to have come off the rose for AFAs (although they remain an issue in the broader client push for value). That client push for value and continuing rate increases certainly portend a clash between client demands and outside law firms' need for revenue growth.

As Smock Law Firm Consultants looks at these results, we clearly see the need for law firms (who do want to prosper) to be doing those things that enhance firm performance above and beyond what has happened to date – that is, to thrive rather than survive. These include reengineering legal services, focusing their teams on industries and client needs, tackling leadership and succession needs, and the old adage *"running this firm like a business."* Success will be based on how well they serve their clients and add value – not how large they are or how many offices they have.

SURVEY RESPONDENTS' DEMOGRAPHICS

Between January 7th and January 21st of 2014, 125 law firms completed the survey (a small reduction from the preceding year) and there was good balance in the leaders/managers who responded – 49% were the Managing Partner/CEO (i.e. – the chief attorney leader/manager) and 51% were the Executive Director/COO (i.e. – the chief non-attorney manager). We had to contend with the *"polar vortex"* in the first half of January and we believe it did affect our response rate. However, 125 firms is a good response – and it has produced both interesting numbers and, particularly, well thought out qualitative responses.



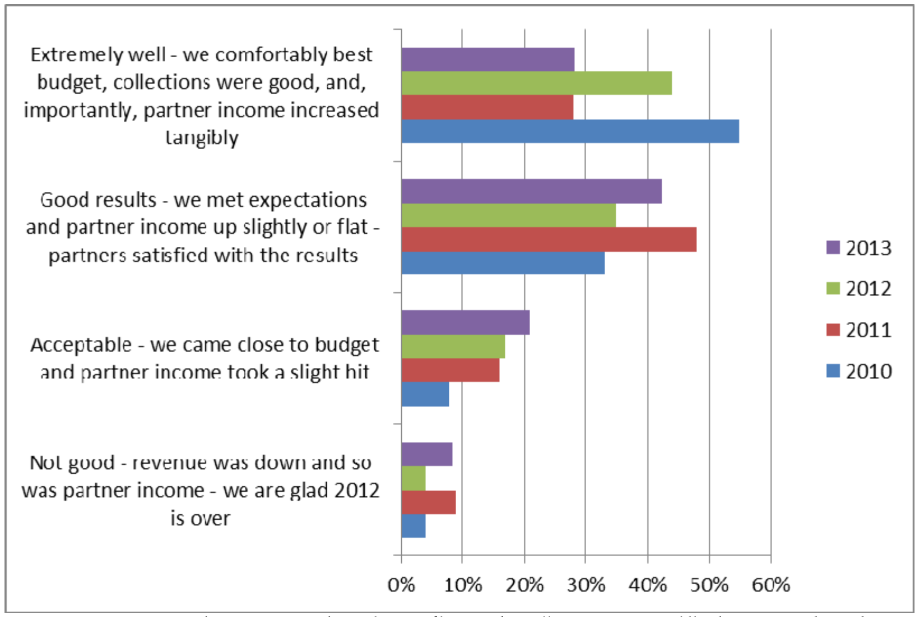
We asked the respondents to tell us the area of the country of their headquarters office or largest office and to categorize the *"reach"* of the firm. The results are shown below. In both cases, the distribution is much broader than in prior years. If you take the Northeast, New York, Middle Atlantic, and Southeast as *"the East,"* they constitute 39% of the respondents, compared to 47% in the Midwest (where – as a firm – we started and still maintain our office address). 86% considered their market to be regional, national, or global – up from last year.

Area of Country of HQ or Largest Office	
Northeast	10%
New York City	4%
Middle Atlantic	11%
Southeast	14%
Midwest	47%
Southwest	11%
Mountain	2%
West Coast	2%

Type of Firm	
Local	14%
Regional	66%
National	19%
Global	2%

HOW DID YOUR FIRM DO IN 2013?

The results of this prior year *"performance"* question for 2013 were positive, but not as positive as last year's responses (for 2012). 2013 did not have the end of the year transactional push that 2012 had (namely in anticipation of the massive tax increases that never came about). Having said that, the combination of *"extremely well"* (28.3%) and *"good"* (42.4%) combines to 71% (as opposed to *"acceptable"* and *"not good"* at 29%). So, we would maintain that performance in the legal market (even with a slight falloff in 2013) is both more predictable and more positive than virtually any industry. It may be that the very positive responses at the end of 2012 were a short term phenomenon caused by the fact that so many firms did well in the last quarter of 2012 and that the positive 2013 results more closely reflect the *"new normal"* the pundits keep harping on.



The qualitative comments to this question varied as they always do – from the positive *"best year in our history, units value up 23%," "new, large matters coupled with a good bread and butter business," "we exceeded budget and distributed over two months of extra draw to equity partners,"* and *"continued pounding our expenses"* to the negative *"lack of contingency settlements," "surprisingly down after a good 2012," "2013 was a year when more clients than normal did not pay their legal bills,"* and *"flat is the new up."*

We drilled down a bit deeper to see how the responding firms' **practices** did in 2013 by rating 23 different practices in one of three categories (*3=solid increase, 2=flat, and 1= down*) – so, the higher the score the better. These results are shown below.

Practice	2013 Rank	Rating Score
Real Estate	**1**	**2.6**
Financial Services	**2 (tie)**	**2.5**
Patent Prosecution, Trademarks, Copyrights	**2 (tie)**	**2.5**
Intellectual Property Litigation	**4 (tie)**	**2.4**
Health Care/Life Sciences	**4 (tie)**	**2.4**
Regulatory/Government Affairs	**4 (tie)**	**2.4**
Immigration	**4 (tie)**	**2.4**
Energy	8 (tie)	2.3
White Collar Litigation	8 (tie)	2.3
Commercial Litigation	10 (tie)	2.2
ERISA/Employee Benefits	10 (tie)	2.2
General Corporate Representation	10 (tie)	2.2

Practice	2013 Rank	Rating Score
Trusts and estates/wealth management	10 (tie)	2.2
Mergers & Acquisitions	14 (tie)	2.1
Corporate Securities	14 (tie)	2.1
Labor and Employment	14 (tie)	2.1
Insurance Defense	14 (tie)	2.1
Antitrust	14 (tie)	2.1
Public Finance	**19 (tie)**	**2.0**
Alternative dispute resolution	**19 (tie)**	**2.0**
International arbitration	**19 (tie)**	**2.0**
Environment	**19 (tie)**	**2.0**
Bankruptcy/Financial Restructuring	**23**	**1.7**

**The Rating Score is the weighted average calculated by dividing the sum of all weighted ratings by the number of total responses*

While the changes from year to year are subtle – they do tell a story. After being in the dumps for a few years, **real estate** was the **highest performing practice in 2013**, followed by a tie for second for **intellectual property (patents prosecution, trademarks, copyrights)**, and **financial services**. Not surprisingly given the national downturn in that practice, **bankruptcy/financial restructuring** brought up the rear, followed by **environment, international arbitration, alternative dispute resolution,** and **public finance**. These latter practices were predicted to grow dramatically under the current administration in Washington, but failed to do so.

The qualitative comments on practice performance were also interesting – and quite varied. While one firm said that *"both our trial and business departments were up notably"* and *"IP prosecution posted the strongest growth in the firm followed by healthcare,"* there were some negative comments, such as *"litigation is disturbingly down," "ordinary corporate and traditional regulatory work appear to have migrated to in-house counsel," "business climate remains difficult, thus affecting a number of our practices."*

As in prior surveys, we asked the responding firms to rate **specific strategic operational improvements** (from a list of 26) they had focused on in 2013 using the following scale (*3=high priority – have and are addressing, 2=know it needs addressing – but not a top priority, and 1=not on our radar screen*). So, **any score above 2.0** can be viewed as a positive response. The responses are shown in the following table.

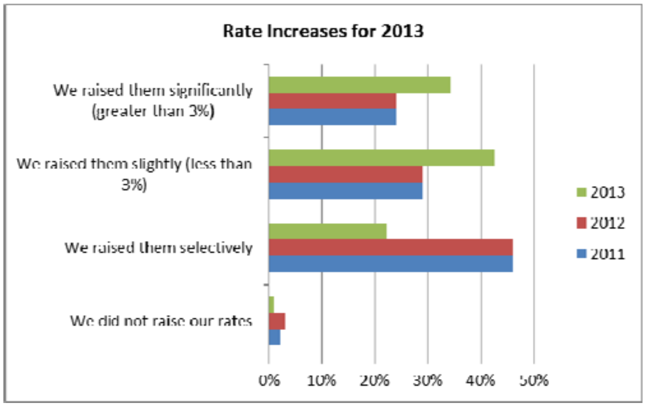
Operational Improvement	Rank	Rating Score
Dealing with underperforming partners	**1 (tie)**	**2.7**
Technology and technological advancements	**1 (tie)**	**2.7**
Practice group management improvements	**3 (tie)**	**2.5**
Practice group planning and execution	**3 (tie)**	**2.5**
Individual partner business development planning and execution	**3 (tie)**	**2.5**
Increased lateral hiring	**3 (tie)**	**2.5**
Firm strategic plan development/ revision	**3 (tie)**	**2.5**
Better firm strategic plan implementation	**3 (tie)**	**2.5**
Website revision/improvement	**3 (tie)**	**2.5**
Client and firm management succession planning and transition	**3 (tie)**	**2.5**
Better associate training and development	11 (tie)	2.4
Industry focused marketing	11 (tie)	2.4
Regular, formal client feedback	11 (tie)	2.4

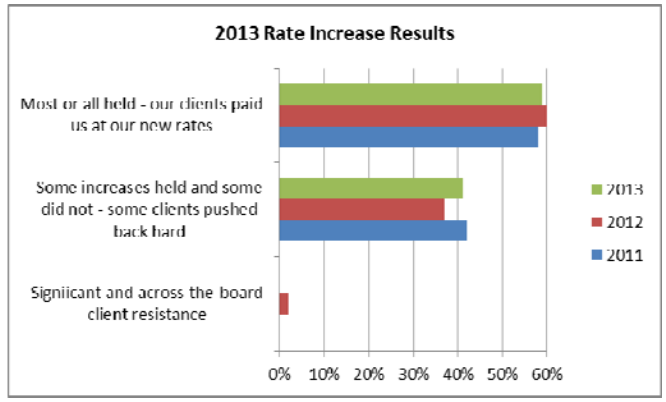
Operational Improvement	Rank	Rating Score
Better associate training and development	11 (tie)	2.4
Management on achieving specific metrics, goals, and objectives	15	2.3
Alternative fee approaches (AFAs)	16	2.2
Project management techniques/training	17 (tie)	2.0
Process improvement/reengineering process	17 (tie)	2.0
Smaller mergers/acquisitions	19	1.9
Creative space deployment (to facilitate teams and collaboration)	20	1.8
Revising the partner compensation and reward system	21 (tie)	1.7
Cutting back on practices and/or people to restore and/or maximize profit	21 (tie)	1.7
Revising partner structure – equity/ income	**23**	**1.5**
Firm governance restructuring	**24**	**1.5**
A large transformative merger	**25 (tie)**	**1.3**
Revising the associate salary and reward structure	**25 (tie)**	**1.3**

The highest rated management improvement, convincingly, was a tie – **dealing with underperforming partners** (as in the three preceding years) and an additional one added this year, **technology and technological advancements**. There was an eight way tie for third (only .2 behind the two in first place). As in prior years, we have reached a straightforward conclusion – most firms are focused on solid and potentially useful operational improvements. These higher rated improvements, generally, are those things that produce a tangible result, have some substance to them, and do not serve as window dressing (like *"firm governance restructuring"*). Simply put, we feel that law firm managements are generally focused on the right things – although we will make some recommendations for further improvement and focus later in this monograph.

The qualitative comments by the respondents were instructive. The focus on the substantive improvements (mentioned above) has been a multi-year effort for many firms and, as one said, *"now the firm is more metrics oriented, bottom line focused, and more outward looking than ever before." "It takes time to turn any ship around, especially one populated by conservative people, but we are heading in the right direction."* But, the common obstacle seems to be *"attorney resistance to change"* when it comes to *"teamwork, succession planning, and coming up with better ways to do things."*

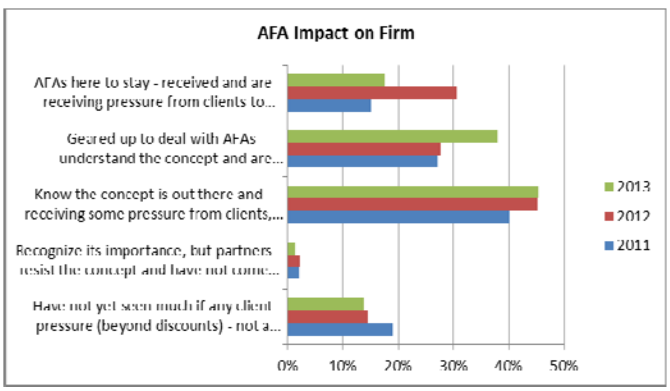
Relative to **rates**, the broad cross section of law firms raised rates for 2013 as a continuing strategic (and defensive) move. 99% raised their rates with the largest group raising them *"slightly."* And interestingly, 59% said that *"most or all held"* and 41% said *"some held and some did not."* But, realization rates have continued to fall off – so not all rate increases are holding.

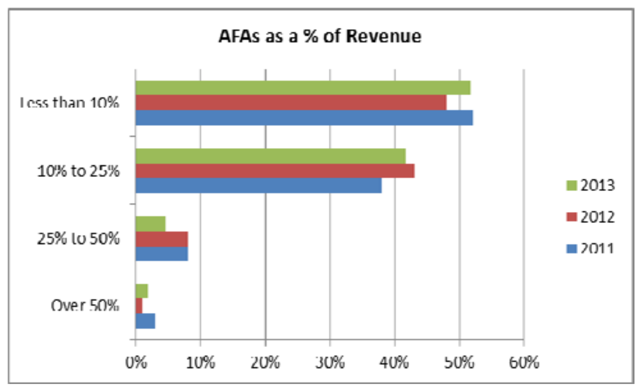




The qualitative comments on rate increases were interesting. *"Interestingly and surprisingly, a much higher percentage of our rate increases held in 2013 than what we expected." "We increased rates by 4%." "The bigger the client, the more likely there will be rate pushback." "Law firm billing must change…no other business could tolerate some of the billing practices employed by law firms." "Discounts off 'rack rates' seem to be the favorite of most clients – welcome to Macy's."*

The **trend to alternative fee arrangements (AFAs)** stalled in 2013. For the last three years, we have seen slow but steady recognition of and response to AFAs as a key factor in client service and billing. The responses this year appeared to temper that trend. The belief that *"AFAs are here to stay"* dropped from 30% to 18% – to us, pretty significant. Responses to *"know the concept is out there, but we are not receiving a lot of pressure"* grew from 40% to 45% - consistent with the above change. And, 94% of the respondents saw AFAs constituting less than 25% of their revenue (52% less than 10% and 42% in the 10% to 25% range).



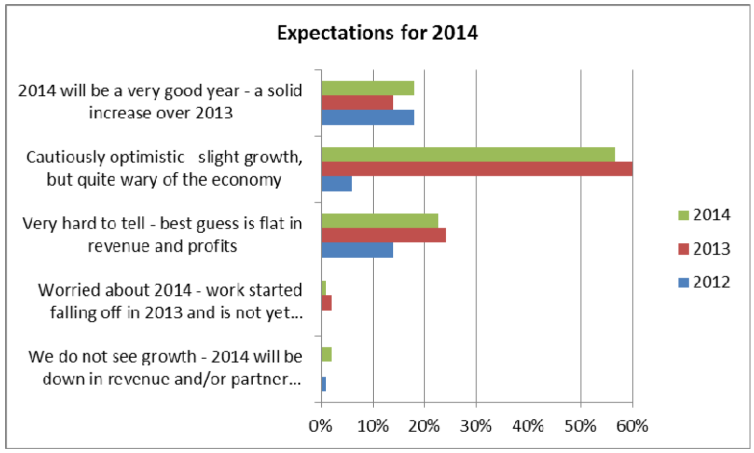


The qualitative comments of the respondents tend to back up the numbers above. *"We are prepared to work with clients in any form and we discuss it with clients, but in the end most just ask us for a discount." "We still find the most common request is for a discount, based on volume." "We are not to the point where more than a few of our partners understand it or have the skill set to manage to a budget."* But the reverse also exists, *"anyone who thinks AFAs are a fad, is missing the point – Fortune 500 clients expect discounts, frozen rates, and creativity with AFAs – this stuff is here to stay."*

SLFC hears from law firms' clients while conducting client interviews as part of strategic planning assignments and we believe AFAs do remain a factor – particularly among larger companies. And, since most firms want to do more and more work with larger clients, AFAs will continue to be a factor and may rise in importance. In other words our advice remains as before, *"ignore AFAs at your peril."*

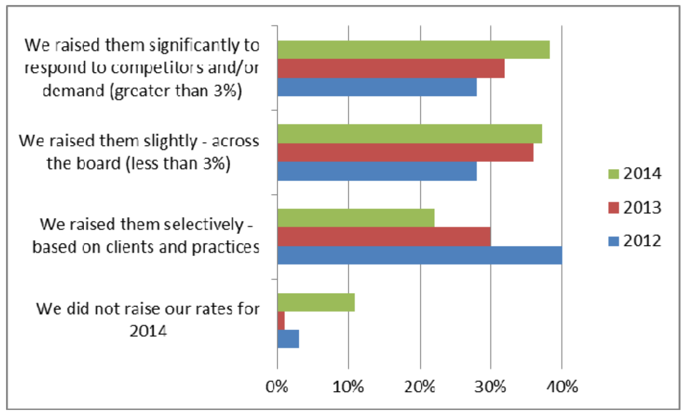
EXPECTATIONS FOR 2014

As we did for 2011, 2012, and 2013, we asked the firms about their **general expectations for the next year (2014)**. The quantitative or statistical, responses were very close to last year – although the percentage of very optimistic firms jumped from 12% to 18%. The positive responses were 74% of the respondents – higher than 2013.



When one looks at the economic issues out there (national debt, job creation or lack thereof, etc.), the most rational answer – as it has been for the last three years – has to be *"cautiously optimistic."* Because, in many ways, what else can you say? But, the numbers are a bit more optimistic and the respondents' comments were even more so. *"Clients, potential clients, and top quality people and practitioners are showing more and more interest in our firm – so, we see real opportunities." "If the trajectory continues, 2014 will be a very solid year." "We are really more bullish than cautiously optimistic." "We culled some non-performers, which was very difficult, but necessary – the message about change in our profession is finally beginning to sink in."* But some concerns filter through the comments – *"we have raised our rates as much as we can – so, raising the top line in 2014 is what will provide a path to profitability – one that will not be easy." "Things seemed to slow down at the end of 2013, and that is continuing, so we are concerned."*

Until something changes in the fabric of the legal market, we will continue to recommend that well managed law firms raise rates annually – not merely as a positive strategy, but as a defensive move. If a firm falls behind its primary competitors in rate increases, the impression is clearly created that *"they are not as good."*



The results of our **annual question on raising rates** drew a response similar to last year's, but the percentage of those firms significantly raising rates jumped from 31% to 38%.

We also drilled down on the **2014 expectations by practice** for 2014 (*3=solid increase, 2=flat, 1=down*). The results are shown below. The higher the score, the higher the expectation for success.

Practice	Rank	Rating Score
Health Care/Life Sciences	**1 (tie)**	**2.6**
Intellectual Property Litigation	**1 (tie)**	**2.6**
Patent Prosecution	**1 (tie)**	**2.6**
Real Estate	**1 (tie)**	**2.6**
Financial Services	**5 (tie)**	**2.5**
Energy	**5 (tie)**	**2.5**
Mergers & Acquisitions	**5 (tie)**	**2.5**
General Corporate Representation	**5 (tie)**	**2.5**
Commercial Litigation	9 (tie)	2.4
Regulatory	9 (tie)	2.4
Corporate Securities	9 (tie)	2.4
ERISA/Employee Benefits	9 (tie)	2.4

Practice	Rank	Rating Score
Public Finance	9 (tie)	2.4
Labor and Employment	14 (tie)	2.3
White Collar Litigation	14 (tie)	2.3
Immigration	14 (tie)	2.3
Insurance Defense	17 (tie)	2.2
Trusts and estates/wealth management	17 (tie)	2.2
Environment	**19 (tie)**	**2.1**
Antitrust	**19 (tie)**	**2.1**
Alternative dispute resolution	**19 (tie)**	**2.1**
International arbitration	**22**	**1.9**
Bankruptcy/Financial Restructuring	**23**	**1.8**

In terms of statistically measuring 2014 expectations, there was a four way tie for first that did not produce any surprises – **health care/life science, intellectual property litigation, real estate,** and **patent prosecution**. And, **bankruptcy/financial restructuring** and **international arbitration** had the lowest expectations. Also, with the exception of the two lowest practices, 21 of the 23 practices were expected to grow (i.e. – had a rating score greater than 2.0) – an indication of the positive nature of 2014 expectations.

There were not a lot of comments made on individual practices for 2014, but some interesting ones. *"Typically, the transactions side does well in up markets (which should be the case in 2014 and beyond) – so we will grow there and if we can also grow litigation, it will be a great year." "The truth is 2014 will be pretty much like 2013 – so the practice group trends will probably be very similar."*

We asked the respondents to rate each of 26 **strategic/operational improvements** relative to their expected focus for 2014 (3= *at the top of our list – a top priority, 2=may be addressed – but not a top priority, and 1- will probably receive no attention*). Continuing its importance, **dealing with underperforming partners** was at the top of the list (4th year in a row) and tied with **technology and technological advances**. As with what was done in 2013, the 2014 expectations focused on meaningful improvements – that is, those things that will have real impact on revenue, costs, and performance. Also consistent with 2013 efforts (and prior years' surveys) was the item least highly rated – **a large transformative merger**. While we understand that not many firms are planning on doing a large transformative merger, there were a number of such mergers in 2013 and we expect to see (and participate in) even more in 2014.

The qualitative comments do add some context to these responses and, importantly, a focus on the right things. *"Our focus in 2014 will be on practice and industry groups." "How do you measure success, if you do not identify goals and objectives? I do not understand how firms can run themselves by the seats of their pants." "Most of our priorities are continuations of initiatives already started."*

Strategic/Operational Improvement	Rank	Rating Score
Dealing with underperforming partners	**1 (tie)**	**2.6**
Technology and technological advances	**1 (tie)**	**2.6**
Industry focused marketing	**3 (tie)**	**2.5**
Regular, formal client feedback	**3 (tie)**	**2.5**
Better firm strategic plan implementation	**3 (tie)**	**2.5**
Client and firm management succession planning and transition	**3 (tie)**	**2.5**
Individual partner business development planning and execution	7 (tie)	2.4
Practice group planning	7 (tie)	2.4
Practice group management improvements	7 (tie)	2.4
Increased lateral hiring	7 (tie)	2.4
Better associate training and development	11 (tie)	2.3
Better associate training and development	11 (tie)	2.3
Firm strategic plan development/ revision	13 (tie)	2.2

Strategic/Operational Improvement	Rank	Rating Score
Website revision/improvement	13 (tie)	2.2
Management focused on achieving specific metrics, goals, and objectives	13 (tie)	2.2
Alternative fee approaches	16 (tie)	2.1
Process improvement/reengineering	16 (tie)	2.1
Project management techniques/ training	18 (tie)	2.0
Smaller mergers/acquisitions	18 (tie)	2.0
Creative space deployment	20	1.7
Cutting back on practices and people to restore and/or maximize profitability	21 (tie)	1.6
Revising partner compensation	21 (tie)	1.6
Revising partner structure – equity/ income	**23**	**1.5**
Firm governance restructuring	**24 (tie)**	**1.4**
Revising the associate salary structure	**24 (tie**	**1.4**
A large transformative merger	**26**	**1.3**

In this year's survey, we asked an additional question on management improvements – *"are there other management/operational improvements you have implemented…that are a top priority of your firm's management?"* The answers were few but interesting and included – *"relocating half of our HQ to the suburbs for lower rent," "developing clear expectations for each partner," "implementing a firmwide digital dictation solution,"* and *"focusing on reducing variable costs."*

Since *"increased lateral hiring"* is such a strong current effort of most law firms, we then asked about **growth plans for 2014** by personnel category (*1= decrease, 2=same number, and 3= growth*) and then compared these responses to prior years, as shown below.

	2014		2013		2012		2011		2010	
	Rank	**Rating Score**	**Rank**	**Rating Score**	**Rank**	**Rating Score**	**Rank**	**Rating Score**	**Rank**	**Rating Score**
Associates	1	2.7	3 (tie)	2.2	1	2.8	1	2.7	1	2.6
Equity Partners	2 (tie)	2.2	2	2.5	2 (tie)	2.4	3	2.4	2 (tie)	2.4
Income Partners	2 (tie)	2.2	4	2.1	2 (tie)	2.4	2	2.6	2 (tie)	2.4
Of Counsel	5	2.1	1	2.7	5	2.2	4 (tie)	2.2	4 (tie)	2.1
Paralegals	2 (tie)	2.2	3 (tie)	2.2	4	2.3	4 (tie)	2.2	4 (tie)	2.1
Staff	6	1.7	6	1.9	6	2.0	6	2.1	6	1.8

These figures are quite consistent year-to-year and they do underscore the recognized importance of adding qualified associates. Many firms continue to see their number of associates fall off – often as a result of cost cutting moves and, we believe, just as much from partners hoarding what would normally be considered *"associate work."* Also, law school hiring is either *"down"* or *"way down"* depending on the firm. In 2014, that could conceivably become even more acute, so we are encouraged by *"associate growth"* being back on top of growth priorities.

Some representative qualitative comments made regarding this *"personal growth"* question follow. *"We expect to grow our legal staff by 5% this year." "We'll be adding counsel and associates, which will balance expected partner retirements." "We will continue to increase our use of staff attorneys." "We'll continue to see decreases in our non-lawyer population, as we make better use of technology and continue to outsource." "We need to increase our attorney/staff ratio."*

LONGER TERM MANAGEMENT TRENDS

We also asked the responding firms to *"look over the horizon"* and rate 20 talked and written about future trends in the legal marketplace, some of which we adjusted this year (from last year) to be consistent with the trends spouted by the pundits. (*4=a significant trend that will impact our future; 3=a trend of significance that will not greatly impact us; 2=this trend may or may not happen, but will have little impact; and 1=this trend will not occur and/or impact the U.S. legal marketplace*)

Longer Term Legal Management Trends	Rank	Rating Score
Clients' continuing and increasing focus on value (i.e. – results/cost)	**1**	**3.8**
Need for improved skill sets in attorneys (and non-attorneys) in project management, fee estimation, and related skills	**2 (tie)**	**3.4**
A focus on reengineering the way that law is practiced so that clients (and firms) benefit from improved cost benefits and predictability	**2 (tie)**	**3.4**
More legal work from larger companies to medium sized firms across the country and less to the much larger firms	**2 (tie)**	**3.4**
Reductions in equity partners to those who *"really bring in the bacon"* and function as true owners	**5 (tie)**	**3.2**
Less large company/client market share to the large, multi-office, highly leveraged firms and more to smaller and/or mid-size firms	**5 (tie)**	**3.2**
Deleveraging of law firms (more partners and less associates)	7 (tie)	3.0
Declining value of and emphasis on law school recruiting – lateral associates becoming the primary means of hiring associates	7 (tie)	3.0
Client insistence on alternative fee arrangements (AFAs) – the billable hour will continue to slowly die	7 (tie)	3.0
The rise in the overall importance of teams – reflected in revised partner compensation systems to reflect multiple attorney performance (client teams, group marketing, etc.)	7 (tie)	3.0

Longer Term Legal Management Trends	Rank	Rating Score
Increased law firm mergers and acquisitions over the next five years – continuing consolidation of the legal landscape	11 (tie)	2.9
Decline in law firm brand loyalty by long-standing clients	11 (tie)	2.9
Increasing use of non-attorneys to support practice management, project management, pricing, client acquisition, etc.	13 (tie)	2.8
Clients' use of diversity/inclusion and diversity statistics as a primary decision factor in selecting outside counsel	13 (tie)	2.8
Globalization affecting virtually all businesses and thus affecting all business oriented law firms	13 (tie)	2.8
Continued consolidation of the larger law firms in concert with parallel creation of focused smaller boutiques	**16 (tie)**	**2.7**
Restructuring work assignments and workload to meet the varied lifestyle needs of attorneys and staff	**16 (tie)**	**2.7**
The rise of the virtual law firm – many attorneys practicing from home – not as many real offices	**18**	**2.5**
More large company/client market share to the large, multi-office, highly leveraged firms and less to smaller mid-size firms	**19**	**2.3**
Backroom research and/or document review done offshore (Mumbai, etc.)	**20**	**2.0**

As was the case last year (and more than likely through 2015 and beyond), **clients' continuing and increasing focus on value (i.e. – results/cost)** was the most significant trend, which places it in an interesting juxtaposition with the continuing rise in rates – there is either a real clash coming or it is already here. Again, the continuing decline in realization is probably a direct impact. There was a tie for second place – **the need for improved skill sets in attorneys and non-attorneys in project management, fee estimation, and related skills** and **a focus on reengineering the way that law is practiced so that clients (and firms) benefit from improved cost benefits and predictability**.

Vis-à-vis these long term management trends, there were some interesting qualitative comments. *"Is the fall in demand a long term trend or will a rising economic tide lift both the regional and global firms?" "The present time in the legal market is truly exciting – I wish I was just getting out of school and starting all over again." "The emphasis by clients on value is not going away – this, more than any other trend, needs to drive the way in which we run our business."*

SMOCK LAW FIRM CONSULTANTS' COMMENTS

As we look at the survey results – the objective numbers, the qualitative comments, and the interviews we conducted both in-person and by phone – we see opportunities to comment from our perspective, these follow.

2013 Was a Better Year Than Expected

As has happened often in the last few years, 2013 turned out to be a better year than projected and expected. Once again, many law firms were saved by very good year end cash collections. If you go back to late summer and early fall 2013, both legal market prognosticators and law firm managing partners and executive directors were talking about numbers at least 5% to 10% below their own conservative, cautious plans. While that did happen for some firms, the survey results show that it did not for most.

- If you raise rates 4% (on the average) and also take concrete steps relative to underperforming partners, non-attorney staffing levels, and other costs (as most firms have done), it provides one heckuva margin for partner profit, if you can keep most attorneys reasonably busy.

- Yes, there are more competitive pressures in the legal marketplace and more are coming. But, a firm that manages the basics and serves clients well ought to do just fine financially, regardless of the economy. That has certainly been the case – generally – over the last few years. The majority of firms (greater than 70%) who respond to our survey every year are more than pleased with their results. It would be hard to find another industry or profession (how about MDs?) with that level of performance satisfaction.

Law Firms Are Generally Focused on the Right Things

The results from the questions about managerial and operational improvements clearly support the assertion that law firm managements are paying attention to those things that can have a positive impact on law firm performance and client service. While law firms still spend too much time worrying about internal things, there has been a decided shift in the last few years to an improved focus on clients and the kind of things firms need to accomplish to grow and enhance revenue (such as organized client feedback).

The *"Path of Least Resistance"* Still Prevalent

The biggest obstacle to focusing on these things appears to be partners' collective resistance to change and most law firm managements' standard response to partners' resistance to change – **the path of least resistance**. For instance, law firms will look long and hard at secretarial staffing and secretarial workloads, but avoid a similar look at the process of delivering the legal service to clients (where the substantive and competitively necessary improvements can and must be made). They will appoint the partner with the largest book of business to be practice team leader because they are afraid to offend that person. And, the lack of law firm managements' demanding consistent accountability is a direct result of that path of least resistance.

For a law firm to succeed in the present and future environment the path of least resistance approach to management will have to change significantly. In other words, more *"courage"* is needed.

Firms Worried About Top Line Growth, But It Is Hard to Come By

There is no question that the general concern of many (or most) law firms is how to positively influence top line growth. The problem is that it is difficult to achieve that top line growth in a period of slightly increasing (or slightly decreasing) legal service demand. Simply put, law firm revenue growth is tied most directly to the economy and the economy has not dramatically grown. We do see better economic growth in 2014 than 2013, but not spectacular growth and probably the same can be said for 2015. While our national policy makers are perfectly capable of screwing this up, we do see significant economic growth in 2016 and beyond. This substantive growth will translate to revenue growth for law firms.

For the next couple of years – the ability to dramatically grow top line revenue is pretty much limited to:

- Strategic, planned growth in industry and other defined market segments (i.e. – treating your industry groups as business units and focusing on where you can grow market share).
- Developing new and creative approaches to gaining a much greater percentage of your good clients' legal business – food companies would call it a *"greater share of the plate."*
- Successfully executing one or more strategic mergers that give you a bigger share of the legal work in your areas of strength. You will not get there by acquiring onesie/twosie laterals.
- Developing approaches for providing services to clients more effectively, efficiently, and profitably – in effect, building a better mousetrap that you can clearly differentiate.

Beware of Laterals as the Strategic Answer

Virtually every time we meet a new firm, we ask them what the growth strategy is and we usually hear – *"attracting laterals with books of business."* There are two fallacies here.

- Attracting onesie/twosie laterals is a very good strategy for improving the Firm's DNA – but not for growing. A good lateral attraction process (and most firms lateral attraction programs are short of good) usually just covers attrition (and attrition – planned and unplanned – is picking up again).
- Many laterals are on the market now, because firms have been dealing with underperforming partners. And, industry data clearly indicates that most laterals (as high as 75%) fail to deliver as promised in their new firm.

Unavoidable Clash Between Continuing Rate Increases and Client Pressures

In this survey, we reported on the fact that most law firms are raising rates annually and some quite significantly. It is not the 6% to 8% experienced annually in the *"seven years of plenty"* going into 2008 – but, the average appears to be about 4% and that is very significant in comparison to inflation, economic growth, and price rises in other industries.

These continuing rate increases directly clash with continuing client pressures on fees and outside legal costs – and they have a direct impact on realization, when clients push back. Some clients have taken work in-house (often the commodity work where large firms could historically charge full rates) and others are transferring work to less expensive firms. This inherent conflict will not go away – the Firms who can demonstrate differentiating value (results/cost) will be successful and others will not.

We Applaud the Continuing Focus on Underperforming Partners

It has been four years now that underproductive partners have been at the top of the list of management improvements that firms have accomplished and/or intend to accomplish. And the qualitative comments this year, as well as our interview results, indicate the real progress is being made.

However, a key fallacy still exists – the relatively widespread belief that the way to deal with underperforming partners is to cut their pay. No, the way to deal with underperforming partners is either (1) to help make them performing (through a variety of strategies) or (2) get rid of them. You only cut their pay to be fair to the rest of the partners and except in unusual cases, cutting their pay does not serve at all as a catalyst for improvement. We have often said that cutting the pay of an underperforming partner only results in that person going from being an *"underperforming partner"* to a *"ticked-off underperforming partner."*

Bloom Off the Rose on Alternative Fee Arrangements

While alternative fee arrangements remain an important concept, the overall trend to broaden use of AFAs has clearly slowed down. There are a number of reasons for this:

- It is a lot easier for clients (and their outside law firms) to deal with discounts, than the intricacies that go into well thought out alternative fee arrangements (e.g. – how do you measure success?).
- Alternative fee arrangements are not an end in themselves. They are a tool used by clients as part of focusing on value. A simple way to say this is that clients want value, not alternative fee arrangements. If they can perceive value in discounts, than that becomes their AFA of choice.

The Legal Market Is Changing, but that Change Is Evolutionary, Not Revolutionary

Each year since the *"great recession"* there have been lots of articles, speeches, and presentations talking about the radical change in the legal marketplace. These have contained a myriad of interpretations of *"the new normal"* and what that means. Certainly, the practice of law is not what it was ten years ago, when the sky was the limit. But importantly, change and these changes have been and remain evolutionary. The legal marketplace is changing more rapidly than it has in the past, but the pace is still pretty darn glacial. The *"new normal"* is different from the *"old normal,"* but not different enough to cause wholesale and revolutionary changes in legal education, law firm structure, partnership promotion, partner compensation, and a whole host of things that change and adjust year-to-year, but not dramatically.

SMOCK LAW FIRM CONSULTANTS' RECOMMENDATIONS

Each year in this monograph, we develop a series of recommendations for law firm management to consider and focus on in the coming year (and, often, beyond) and we also try to place those recommendations in a creative context. Thus this year, we decided to list our recommendations as a series of steps that we would take if we were the new firm Managing Partner/CEO of a larger mid-size law firm whose historic results have been – at best – very, very middling. This fictional firm has not done as well as its competition in terms of partner income, growth, reputation, and stature. This new managing partner was elected by the partnership (with a good bit of support by the younger partners who do not subscribe to the *"path of least resistance"*) to grow partner profitability, move upstream in reputation and stature, and, ultimately, grow in size.

More Information and Transparency – Less Democracy

If there is a new managing partner, he/she has to have the authority to manage. So, the first step as MP is to cut democracy dramatically (by installing empowered managers at the Firm and practice level) and dramatically increase transparency and the flow of information. In other words, we expect partners to be very informed as owners, but not necessarily to act as managers (and the two are definitely not the same). As an aside, it is our belief that most firms with a high level of democracy in decision making and virtually no fixed responsibility for management usually perform comparatively quite poorly. In other words, partners in those firms pay considerably (in $ and reputation) for their ability to weigh in on each and every decision. The desired management style is to take on the difficult things first, not follow the standard (and cowardly) approach of *"path of least resistance."*

Articulating the Vision

The Managing Partner must articulate – over and over – the vision of the firm, what it expects to be when it grows up. While we believe that the process of *"setting the vision"* should have broad participation, articulating it and keeping in front of everyone is the Managing Partner's (CEO's) role. There has to be a vision, it has to be understood and reinforced, and it has to be repeated and reinforced.

Restructuring the Firm

The Firm cannot grow its profitability or stature unless it is restructured so that responsibility is clear, collaboration is the norm, and performance is clearly expected and measured. That restructuring involves setting up industry and practice teams that respond directly to client and market needs. We would expect a full teamwork culture and collaboration from all members of these teams. Yes there will be team leaders, chosen for their ability to be leaders and managers (not on the size of their books of business), but everyone on the team will have a role to play.

Very, Very Serious Industry/Practice Team Management

If we are going to rely on industry and practice teams as the primary element of organization in the law firm, then we are going to take it very, very seriously. These teams would be responsible for marketing (getting work); doing the work (delivering the service); producing planned and expected financial results;, and hiring, retaining, and developing people.

While dependent on the clients being served and the businesses firms are in, we expect that a majority of these teams will be industry focused, not legal service focused. They will be multi-disciplinary and focused on the specific needs of clients in a given industry or market segment. Broad cross-marketing and cross-selling will be expected and rewarded. And, their leaders would be empowered, supported, and well trained (i.e. – leadership training).

Focus the Entire Organization on Client Service

Once we have dealt with restructuring the firm, we would focus the entire organization on the concept of client service and ensure that the clients' interests are always first – for everyone (including all of the non-attorney staff). Most law firms say that is the way they operate – but many clearly do not. All firm decisions would be tested against a single concept – *"how does this improve client service?"*

To enhance client service we would have an ongoing client feedback program at the firm and team levels – we would constantly ask our clients, *"what can we do better to serve you?"* And, clients of a reasonable size would undergo client service planning (conducted collectively by those who serve the client) – for which the objective is *"how can we better serve a client?"* not *"how can we get more work?"*

Detailed Planning at the Firm, Practice, and, If Appropriate, Office Level

From an operations standpoint, we will ask that all team leaders and others within management set specific goals for what they need to do and how they need to be measured (which will be agreed upon with firm management). These goals will be well publicized throughout the organization and the compensation for team leaders will partially be influenced by the ability of the team to meet those goals. These goals would – across the Firm – be translated into specific plans (strategic, operating, marketing financial) and Firm performance measured against these plans would be the primary week-to-week and month-to-month management monitoring effort.

Reengineering the Process of Client Service

As can be seen from the trends in the survey, the concept of reengineering the processes of the practice of law is becoming accepted as necessary by a broad range of pundits (although still greatly resisted by firms' partners). If we were running a firm, this would be a key way to focus on improving and maintaining long term profitability. To paraphrase John Candy in Stripes, *"we must be a lean, mean fighting machine."*

We would not start with the secretaries, the non-timekeepers, or non-essential tasks – but directly on the practice of law in the teams. Using trained resources we would reengineer (with the participation and cooperation of all timekeepers) how services are delivered. We would also let our clients know what we are doing and why (*"to better serve them"*) – in fact, we may enlist their help in doing it.

Real Estate Simplification

Assuming that the firm's lease will be up in the foreseeable future, we will begin immediately looking at real estate and redesigning the physical way we practice law (as part of the above reengineering). If collaboration is important, then our ultimate new offices would look more like McDonald's corporate headquarters than that of a large law firm. Further, there is one word that will not describe our office space – *"fancy."* In fact, we will use our real estate not only as a way to be more efficient in serving clients, but as a differentiator in the mind of our clients.

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This completes our annual look at the marketplace – we hope it has been useful to you and your firm. Smock Law Firm Consultants' partners go into a good bit of effort to develop this annual survey and interpret its results. We do it for three reasons – (1) it provides considerable input into the market we serve; (2) we hope, it is useful to clients and non-clients alike in considering the coming year and beyond; and, importantly, (3) it enables us to demonstrate our knowledge of the market and set us apart from those consulting firms we compete with. If you would like to discuss this monograph, the survey results, or the broader impact on the market, please contact any of us.

NEW PARTNERSHIP TO ADDRESS LAW FIRM LEADERSHIP NEEDS

We also want to use this 2014 annual review of the legal marketplace to announce a strategic partnership.

- While we have (1) dealt with the issue of *"law firm leadership"* in specific consulting assignments for years, (2) written and spoken widely on the topic, and (3) participated in formal leadership training (particularly Gary Fiebert's law firm leadership class at SUNY and a similar webinar he conducted for PLI), we are not going to get into the business of law firm leadership seminars and leadership coaching.

- Although some of our consulting competitors are in the leadership seminar and coaching business, we have decided not to for two reasons – (1) we do not have an approach that is unique enough to put us out well ahead of those competitors and (2) we have allied with a firm that has proven experience with a unique, creative approach in training and development (and particularly in law firm leadership) – **ImprovEdge**.

ImprovEdge (www.improvedge.com) is the premier improvisation-based training organization in the country, providing workshops, online courses and keynotes that teach critical business skills. Using their depth of research in leadership, organization dynamics and psychology, ImprovEdge creates learning experiences for law firm professionals to think on their feet, improve collaboration and differentiate in their market. The company is the silver Stevie International Award winner for Most Innovative Company of the Year 2012, and clients include ESPN and over 20 well recognized regional, national, and international law firms. The results they have achieved are exceptional. Smock Law Firm Consultants supports ImprovEdge by bringing our vast law firm management experience to support ImprovEdge's programs.

ABOUT SMOCK LAW FIRM CONSULTANTS

Smock Law Firm Consultants is a focused strategic management consulting firm serving law firms (our primary industry concentration), other professional service firms, and commercial entities. We help law firms address and resolve those key issues that have a major impact on a firm's near term success and its long term direction and focus. We have seven key areas of practice – (1) **strategic planning** at 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; and (7) **strategic management issue resolution**, assisting in resolving issues of vexing management concern.

We believe there are three factors clearly set us apart.

- The primary success factor for any consulting firm are the results achieved by our clients – in both the near and longer term. Our client references can speak directly to those results.

- Our *"first string"* and, actually, our **only** string (Smock, Giuliani, Fiebert, and Walker) is, simply, **the most experienced group on senior consultants serving the legal profession**. The four partners bring a collective relevant experience of greater than 160 years and **each** has greater than 40 years of varying but relevant experience in law and professional firm management.

- We tailor our approach to every consulting assignment to the unique needs and requirements of the client. We are known for our **originality and creativity** in doing that and for our scrupulous avoidance of *"law firm management dogma."*

Again, thank you for either participating in our survey or considering its results – or both.

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