SMOCK
LAW FIRM CONSULTANTS

SMOCK LAW FIRM CONSULTANT'S LEGAL MARKET OUTLOOK FOR 2011 – BUILDING ON A GOOD 2010 IN AN ERA OF CONTINUING UNCERTAINTY

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This monograph presents the results of Smock Law Firm Consultants' survey of the legal marketplace conducted in early January of 2011.

- It is similar in scope (and questions) to prior surveys we have conducted of the marketplace. So where appropriate, we have made comparisons of the responses.

- We have augmented this web survey with recent interviews of law firm managing partners/CEOs and executive directors/COOs, conducted during our travels on consulting assignments/new business calls. These interviews add context to the survey results.

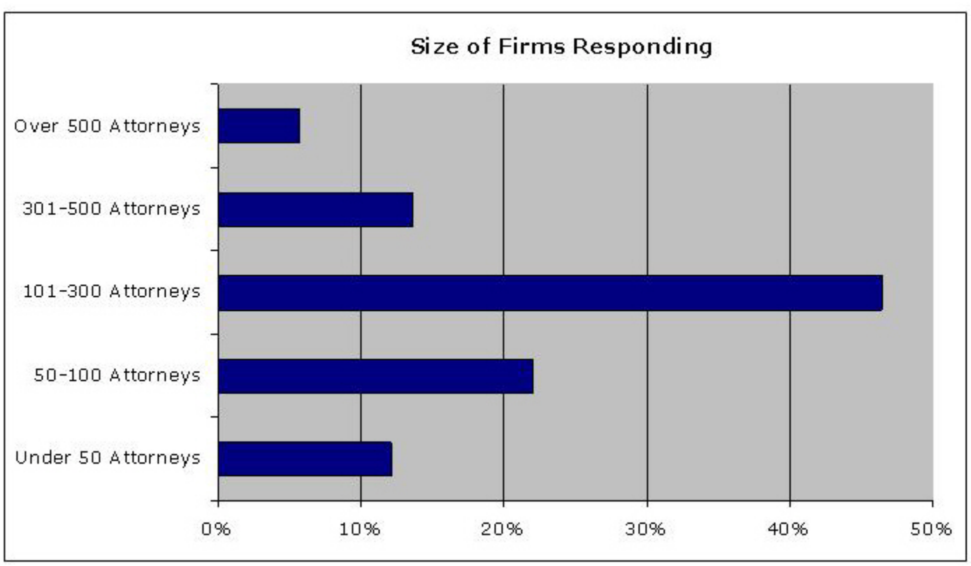
This monograph includes some brief specifics on the survey itself, the responding firms' 2010 performance, the respondents' expectations for 2011, their views on a number of law firm trends/changes, Smock Law Firm Consultant's conclusions on the survey results and what we heard in the interviews (what does it mean?) and, finally, a brief set of recommendations in response to these conclusions (what should law firms do in 2011 and beyond?).

OUR SURVEY

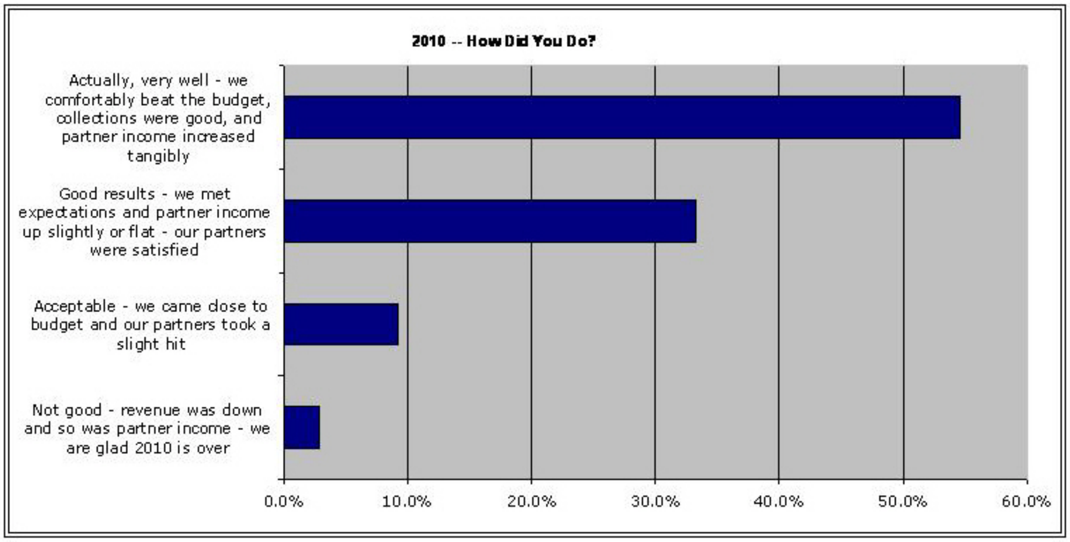
The survey was sent to the chief lawyer leader/manager and chief non-lawyer leader/manager in the Firms in our mailing/contact list. This web-based survey was made available to respondents on the web on January 4th and closed on January 12th.

As in prior surveys, we received a very positive response. 154 firms responded – up from 114 in our last market survey (an increase of 26%). And, there was solid balance – 43.2% of the respondents were the primary attorney leader in the Firm and 56.8% the primary non-attorney leader.

There was good distribution in the size of firms responding to the survey. We also asked (for the first time) what type of firm each respondent represented. The majority of firms were balanced business firms (78%), while the remaining 22% were specialty firms (IP, litigation, plaintiffs, transactions, etc.).



HOW DID YOUR FIRM DO IN 2010?



First, we wanted to gauge the overall results achieved in 2010. The responses to the question *"how did you do in 2010?"* were even more positive than we would have postulated (and we are optimists). 88% of the firms responding did either *"very well"* (55%) or *"good"* (33%) – this compares with 43% and 29% respectively on the same question for 2009 results in a similar survey in early 2010 (which we thought was clearly positive then). When you take a step back and question why, it appears that a combination of expense cuts, sufficient demand for quality legal services, and reasonable levels of productivity, as well as factors that varied on a firm-by-firm basis, resulted in these very positive 2010 results. While some industries continued to suffer into 2010 and some are still suffering, private law firms are not!

We then asked how law firms' specific practices (20 of them) did in 2010 (*1=solid increase, 2=flat, and 3=down*) – the lower the average rating score, the better the performance and the higher the rank.

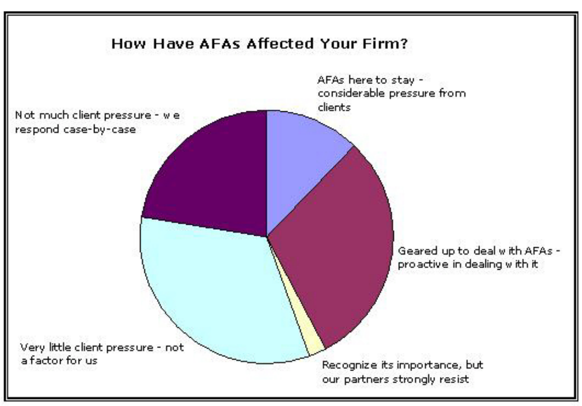
Practice	Rank	Rating Score
Bankruptcy/Finance restructuring	1 (tie)	1.5
Energy	1 (tie)	1.5
Health Care	1 (tie)	1.5
Commercial Litigation	4 (tie)	1.6
ERISA/Employee Benefits	4 (tie)	1.6
Labor and Employment	4 (tie)	1.6
Insurance Defense	7 (tie)	1.7
Intellectual Property Litigation	7 (tie)	1.7
White Collar Litigation	7 (tie)	1.7
Public Finance	7 (tie)	1.7

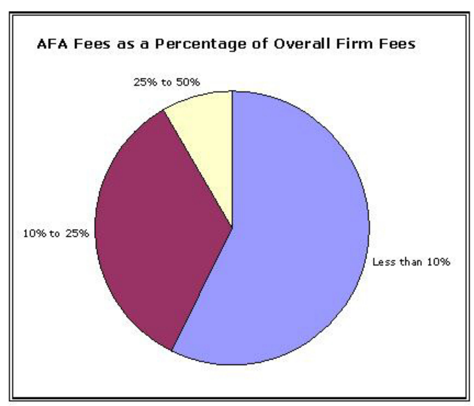
Practice	Rank	Rating Score
Environment	11 (tie)	1.8
General Corporate Representation	11 (tie)	1.8
Regulatory	11 (tie)	1.8
Commercial Loans and Financings	14 (tie)	1.9
Patent Prosecution	14 (tie)	1.9
Mergers & Acquisitions	14 (tie)	1.9
Antitrust	17 (tie)	2.0
Corporate Securities	17 (tie)	2.0
Immigration	19 (tie)	2.1
Real Estate	19 (tie)	2.1

**The rating score is the weighted average calculated by dividing the sum of all weighted ratings by the number of total responses.*

There was a three way tie at the top with **bankruptcy/financial restructuring, energy, and health care** – not surprising given the economy and, arguably, because these practices are more market focused. Also in the top ten were commercial litigation, ERISA/employee benefits, labor and employment, insurance defense, IP litigation, public finance, and white collar litigation. Finishing – again, not surprisingly – tied for last were real estate and immigration. Sixteen of the twenty practices were on the positive side of the average ratings – a clear sign of how well firms did in 2010.

Much has been said, written, and/or speculated about AFAs (alternative fee arrangements). It now even has its own acronym. We asked how alternative fee arrangements had affected the respondents' firms and then how much AFAs were as a percentage of overall firm fees.





Finally on the AFA topic, we asked about the level of experience with ten generally agreed upon AFA techniques (*1=considerable experience, 2=some experience, 3=little, if any experience*) – so the lower the average score, the more experience firms have with the approach.

AFA Technique	Rank	Rating Score
Rate discounts (not really an AFA, but many clients think it is)	1	1.2
Blended rates	2	1.5
Flat/fixed fee	3 (tie)	1.6
Contingent fee	3 (tie)	1.6
Capped fee	5	1.9
Partial contingency or success fee	6	2.1
Flat/fixed fee with shared savings	7	2.3
Phased fee (phase by phase)	8	2.4
Hold back	9	2.6
Defense contingency fee	10	2.8

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As could be expected, rate discounts clearly finished first (many clients think that discounting is the only alternative fee arrangement) followed by blended rates, flat/fixed fees, contingent fees, and capped fees in the top five. From these responses, we conclude that the more creative the approach, the less it is used.

As we had in prior surveys, we queried the responding firms as to the level of emphasis of 19 possible strategic/operational improvements in 2010 on the following scale (*1=high priority – have and are addressing, 2=know it needs addressing, but not a top priority, and 3=not on our radar screen*), so the lower the average rating score, the higher the priority in 2010. The responses are shown in the following tables.

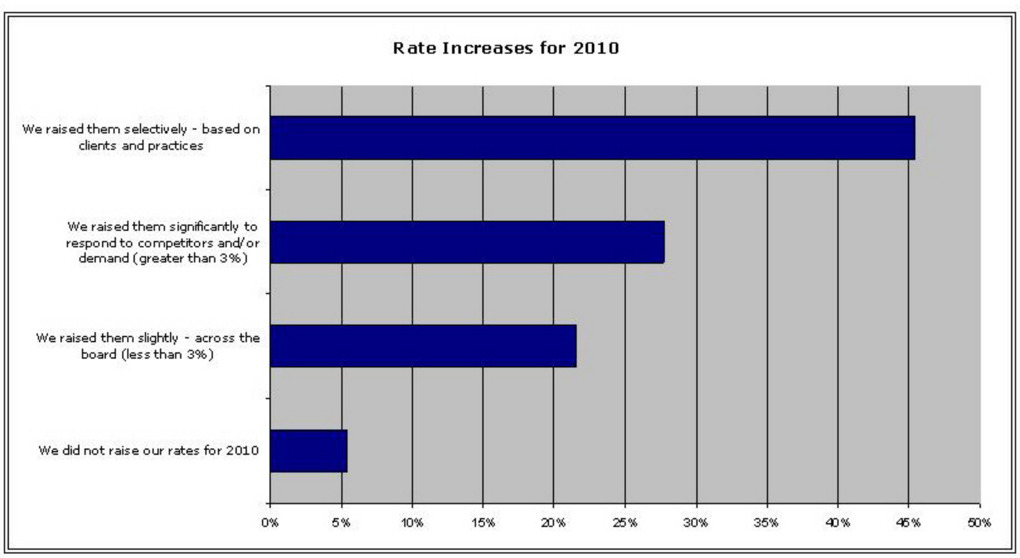
Strategic/Operational Improvement	Rank	Rating Score
Dealing with underproductive partners	1	1.3
Increased lateral hiring	2	1.4
Practice group management improvements	3 (tie)	1.5
Practice group planning	3 (tie)	1.5
Better strategic plan implementation	3 (tie)	1.5
Better associate training and development	6 (tie)	1.6
Strategic plan development/revision	6 (tie)	1.6
Website revision/improvement	6 (tie)	1.6
Industry focused marketing	9 (tie)	1.7
Regular, formal client feedback	9 (tie)	1.7

Strategic/Operational Improvement	Rank	Rating Score
Alternative fee approaches	11	1.8
Project management techniques/training	12 (tie)	2.0
Smaller mergers/acquisitions	12 (tie)	2.0
Revising partner compensation	14 (tie)	2.2
Revising the associate salary structure	14 (tie)	2.2
Revising partner structure – equity/income	16	2.4
Firm governance restructuring	17 (tie)	2.5
Balanced scorecard/performance management	17 (tie)	2.5
A large merger	19	2.7

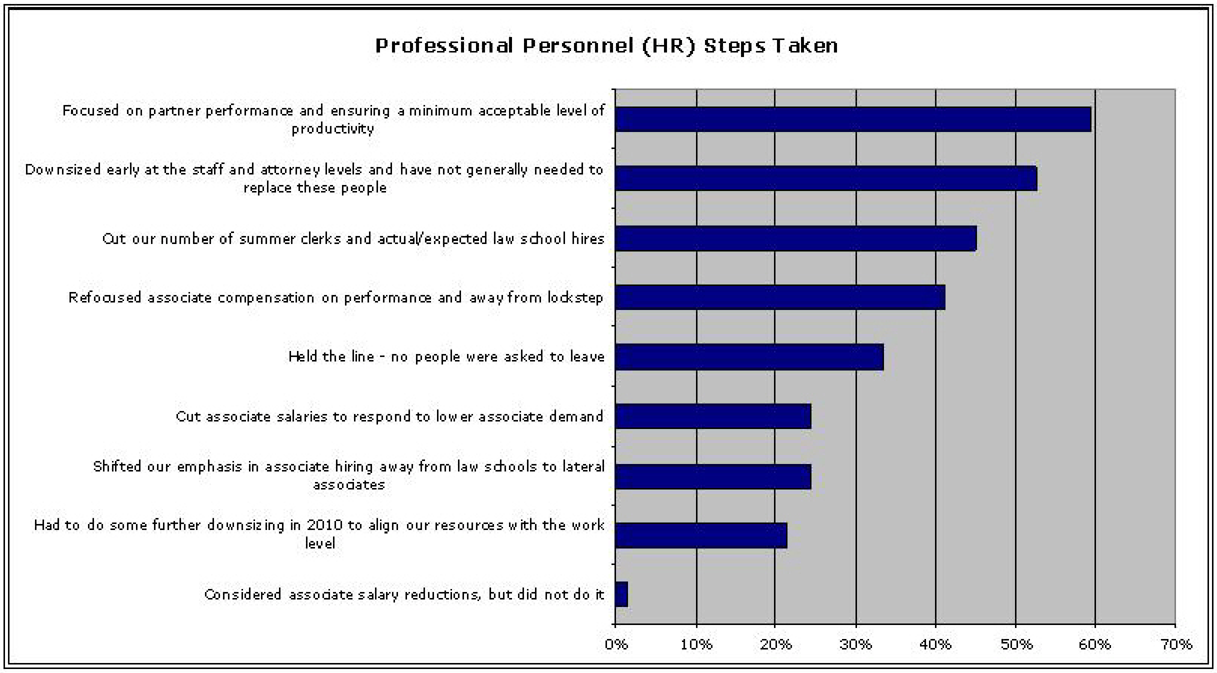
**The rating score is the weighted average calculated by dividing the sum of all weighted ratings by the number of total responses.*

The management emphasis in 2010 was clearly on those things that would have a tangible impact on the bottom line – and the focus was clearly on *"doing better with what we have"* than adding new things.

Finally with regard to 2010, we asked the responding firms what they did with rate increases last year. Very interestingly, 95% of the responding firms raised their rates in 2010 – only 5% did not – and nearly 30% raised them significantly. So, if you cut costs in 2009, held those cost cuts, maintained productivity, and raised rates in 2010, profits should have gone up – as they did.

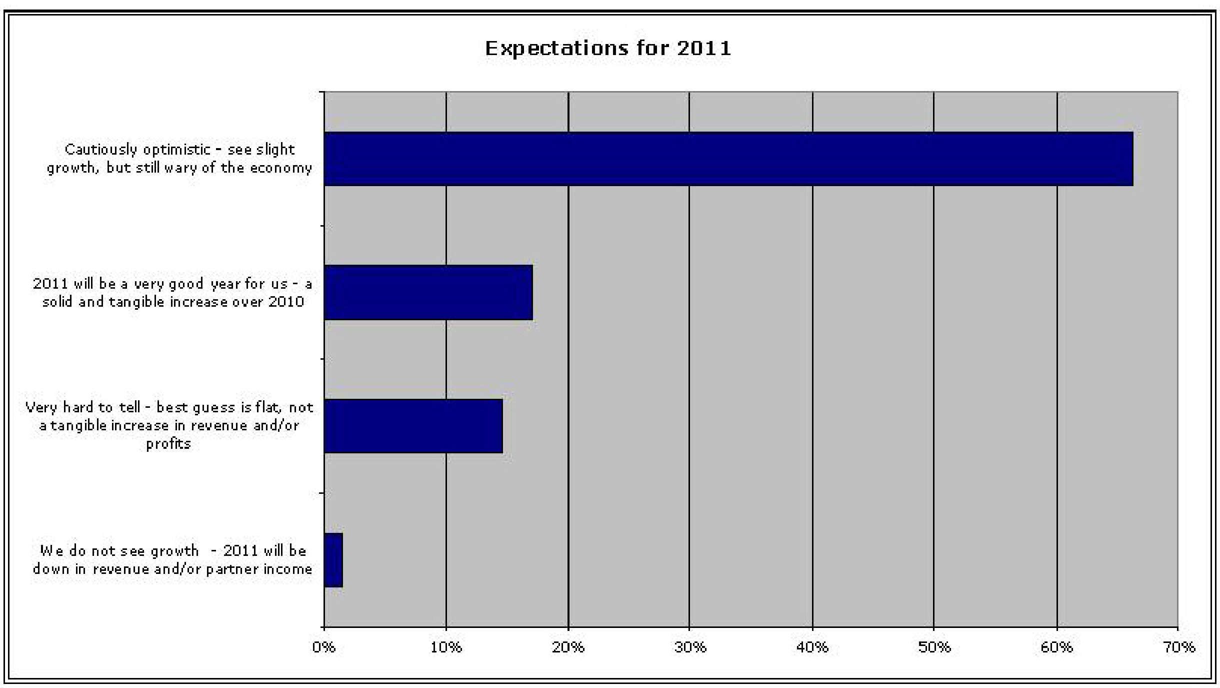


Because of the publicity given downsizing, delayed new hire starts, and a variety of other personnel/HR related actions taken in late 2008 and 2009, we asked the responding firms what actions they took – from nine choices. The top four responses were (1) focused on partner performance and minimum acceptable productivity, (2) downsized early and have not replaced those people, (3) cut summer clerks and law school hires, and (4) refocused associate compensation on performance.



EXPECTATIONS FOR 2011

On the crystal ball side of the survey, we first asked which of four scenarios best described the responding firms' expectations for 2011. The responses were both positive and cautious – as also could be expected, as no self respecting Managing Partner/CEO or Executive Director/COO is going to be overly optimistic at the beginning of a year. The bottom line is that 2011 will more than likely be very good for law firms – costs are still being watched, productivity is being managed, and rates are going up.



After the overall expectations question, we asked the responding firms to provide expected results for the same 20 practices we asked about 2010 results (*1=solid increase, 2=flat, and 3=down*) – so, a lower average rating score equates to higher performance expectations.

Practice	Rank	Rating Score
Health Care	1	1.3
Energy	2 (tie)	1.4
Commercial Litigation	2 (tie)	1.4
Commercial Loans and Financings	4 (tie)	1.5
General Corporate Representation	4 (tie)	1.5
Intellectual Property Litigation	4 (tie)	1.5
Mergers & Acquisitions	4 (tie)	1.5
White Collar Litigation	4 (tie)	1.5
Corporate Securities	9 (tie)	1.6
Patent Prosecution	9 (tie)	1.6

Practice	Rank	Rating Score
Regulatory	9 (tie)	1.6
Environment	12 (tie)	1.7
ERISA/Employee Benefits	12 (tie)	1.7
Insurance Defense	12 (tie)	1.7
Labor and Employment	12 (tie)	1.7
Public Finance	12 (tie)	1.7
Real Estate	12 (tie)	1.7
Bankruptcy/Financial Restructuring	18 (tie)	1.8
Immigration	18 (tie)	1.8
Antitrust	20	1.9

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Health care and energy were again among the first three finishers (along with commercial litigation). The responding firms were, on average, **optimistic on every single practice**, as any response below 2.0 is statistically positive. Moving up in the rankings for 2011 expectations over 2010 results were general corporate representation (from a tie for 11th to 9th), commercial loans and financing (from a tie for 14th to a tie for 4th). The rating scores were also trending much more significantly to a solid increase.

We also asked the respondents to rate the same 19 strategic/operational improvements relative to the level of emphasis they will receive in 2011 that we asked regarding management priorities in 2010 (*1=top of the list, top priority, 2=may be addressed, but not top priority, and 3=will probably receive no attention*).

Strategic/Operational Improvement	Rank	Rating Score
Dealing with underproductive partners	1 (tie)	1.5
Practice group management improvements	1 (tie)	1.5
Practice group planning	1 (tie)	1.5
Regular, formal client feedback	1 (tie)	1.5
Increased lateral hiring	1 (tie)	1.5
Better strategic plan implementation	1 (tie)	1.5
Better associate training and development	7 (tie)	1.6
Industry focused marketing	7 (tie)	1.6
Alternative fee approaches	9 (tie)	1.7
Strategic plan development/revision	9 (tie)	1.7

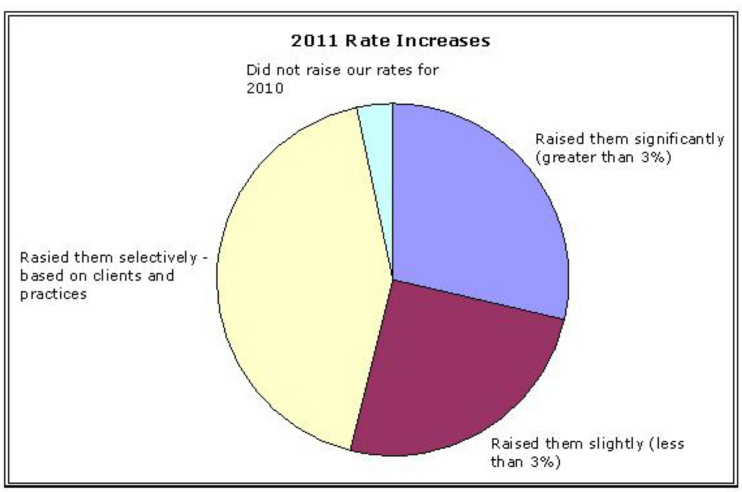
Strategic/Operational Improvement	Rank	Rating Score
Website revision/improvement	11	1.8
Project management techniques/training	12	1.9
Smaller mergers/acquisitions	13	2.0
Revising partner compensation	14	2.4
Balanced scorecard/performance management	15	2.5
Revising partner structure – equity/income	16 (tie)	2.6
Firm governance restructuring	16 (tie)	2.6
Revising the associate salary structure	16 (tie)	2.6
A large merger	19	2.7

**The rating score is the weighted average calculated by dividing the sum of all weighted ratings by the number of total responses.*

- Interestingly, six improvements tied for the top level of emphasis – **deal with unproductive partners, practice group planning, regular formal client feedback, better strategic plan implementation, and increased lateral hiring**.
- Bringing up the rear – the lower rankings – were a large merger (which always finishes last in these surveys), firm governance restructuring, revising the partner structure (equity/income), and revising the associate salary structure.

We commend the respondents. They tended to list – as higher priority improvements – those things that should have a tangible and strategic impact. The lower priority improvements tended to be internal initiatives that will have little impact on firm and practice results.

We also asked the rate question again looking forward for 2011 – *"what did you do with rates for 2011?"* The responses were very consistent – 97% either raised their rates across the board or selectively – 54% raised them across the board.



Finally relative to 2011, we asked about expected changes in staffing across staffing categories (*1=growth, 2=same number, and 3=decrease*). The responses are shown in the following table, along with the responses from last year's survey. The rankings stayed exactly the same, but the ratings clearly went up (from 1.76 to 1.63, where a smaller number means more growth). On average, growth is expected in all categories.

Staffing Category	2011 Rank	2011 Rating Score	2010 Rank	2010 Rating Score
Associates	1	1.3	1	1.4
Income Partners	2	1.4	2 (tie)	1.6
Equity Partners	3	1.6	2 (tie)	1.6
Of Counsel	4 (tie)	1.8	4 (tie)	1.9
Paralegals	4 (tie)	1.8	4 (tie)	1.9
Staff	6	1.9	6	2.2
Average Rating		**1.63**		**1.76**

**The rating score is the weighted average calculated by dividing the sum of all weighted ratings by the number of total responses.*

FUTURE LEGAL MANAGEMENT TRENDS AND CHANGES

It is always a bit risky to forecast the future. Remember the law firm prognosticators who forecast continuing dramatic growth as far as the eye could see – as late as 2008, right before the crash. But, we did want to gather the opinions of law firm managers on future issues in law firm management. So, we took 16 trends/changes that have been given play/space in the legal management media (whether we agreed with their viability or not) and asked the respondents whether they were relevant and would impact their futures (*1=will significantly impact our future, 2=some impact, and 3=little, if any, impact*).

Legal Management Trend/Change	Rank	Rating Score
Need for improved skills sets in attorneys (and non-attorneys) in project management, fee estimation, and related skills	1 (tie)	1.6
More legal work from larger companies to medium sized firms across the country	1 (tie)	1.6
Reductions in equity partners to those who *"truly bring in the bacon"*	3	1.9
Client insistence on AFAs – the billable hour will slowly die	4 (tie)	2.0
Increased mergers and acquisitions over the next five years	4 (tie)	2.0
De-leveraging of law firms (more partners and less associates)	6 (tie)	2.1
Increasing use of non-attorneys to support practice management, project management, etc.	6 (tie)	2.1
Restructuring work assignments and workload to meet varied lifestyle needs of attorneys and staff	6 (tie)	2.1

Legal Management Trend/Change	Rank	Rating Score
Restructuring the presumed to be outmoded private law firm business model	9 (tie)	2.2
Less market share to the large, multi-office, highly leveraged firms	9 (tie)	2.2
Declining value of and emphasis on law school recruiting	11 (tie)	2.3
Continued consolidation of larger law firms in concert with parallel creation of focused smaller boutiques	11 (tie)	2.3
More market share to the large, multi-office, highly leveraged firms	11 (tie)	2.3
The virtual law firm – everyone practicing from home – no real offices	14	2.6
Backroom research and/or document review done offshore (Mumbai, etc.)	15	2.7
Outside investment in law firms – as in the UK and Australia	16	2.8

**The rating score is the weighted average calculated by dividing the sum of all weighted ratings by the number of total responses.*

Remember, the lower the response, the more significant the specific trend is expected to be in the future.

- In general, the respondents did not view these trends or changes as being that significant (that is, the scores tended to cluster between *"some impact, but hard to tell"* and *"little, if any, impact"*) – only the first three had a rating of between 1 and 2, on the positive side of the mean.

- There was a tie for most significant – *"need for improved skill sets…in project management, fee estimation, and related skills"* and *"more legal work from larger companies to medium sized firms across the country."* Both of these are more current (and evident) than the other trends listed.

- The least significant in the minds of the respondents were *"outside investment in law firms – as in the UK and Australia"* and *"backroom research and/or document review being done offshore."* Those both seem to be further off in the future, so the respondents appeared to be less concerned.

CONCLUSIONS – WHAT DOES IT ALL MEAN?

While in many ways what this broad base of respondents had to say does speak for itself, we believe there are a number of conclusions that can be drawn from these responses (and what CEOs and COOs have been saying to us separately). These conclusions follow.

As Marketplaces Go, Legal Is Still a Very Good Place to Be

As commented on previously, the legal marketplace has remained strong economically.

- While there was considerable concern voiced on the future of law firms and lawyers as part of the financial markets meltdown (in late 2008 and the first half of 2009), those concerns did not pan out.
- Law firm managements successfully addressed profitability in 2009 with stringent expense control.
- 2010 saw continuing expense control, better addressing (at least partially) of the underproductive partner issue, and work returning to a number of practices that had been down. The end result of that was clearly shown early in the very positive results.

The legal marketplace is vibrant and good firms are doing quite well. In fact, we believe there are only two primary reasons for a lack of solid performance in a business law firm of reasonable size (15 to 20 attorneys and all the way up) – a mix of practices that is doing poorly all at the same time, or poor management and leadership.

Solid Management Is in Place in Most Multi-Practice Firms

The tried and true adage is that lawyers do not know how to lead or manage – actual results are clearly beginning to dispel that myth.

- The performance that many (or most) firms achieved belies that – those results could not have come about without true leadership and performance from law firms' chief executives.
- Most good law firm chief executives (all lawyers) have been wise enough to ensure that their chief non-attorney manager is both skilled and competent. As we said last year, these men and women deserve real kudos for their ability to grow profits in the midst of real capacity issues – the 2010 results again underscore that assertion.
- And, management/executive/policy committees are getting much better at setting policy and holding people accountable for performance. But, their positive development is clearly behind that of Managing Partners/CEOs and Executive Directors/COOs. The temptation to both micromanage and avoid pushing appropriate authority and responsibility to practice group leaders is overwhelming for many of these committees and their members.

The Big Firms Did Pretty Darn Well

The high quality mid-size firms have felt that they have and have had an opportunity to provide services of value to larger companies that they have not previously served (or served extensively) and that the larger firms are having greater problems dealing with the present market pressures. The former is a true, but the latter is not.

- Whether you look at the responses in this survey or review the AMLaw 100 (or the largest firms in the second hundred), it is evident that the large firms generally did very well in 2010.
- These larger firms hold some distinct market advantages – they have inherent name recognition for high ticket matters/cases; are generally better managed at the firm and, very importantly, the practice levels (although that gap is narrowing); and have genuine depth and breadth in high value practices.
- The large firms dealt with the market dislocation quickly – because they had to. They dealt with underproductive partners in 2009, while mid-size firms focused more effectively on that issue in 2010.
- And, large firms (again, because they have had to) tended to be more creative in the alternative fee arena.

It Is Realization, Not Rates

While it is true that most firms have continued to raise rates, the real measure to look at is realization, not rates.

- While it is financial suicide to not raise rates when competitors are, all firms know that rate freezes and rate discounting at the individual client level remains strong and prevalent.
- As one of the individual interviewees (at a large balanced business firm) said – *"40% of our current work has some type of fee discount or rate freeze."*
- So the pressure on rates remains very strong in the marketplace and, even more than before, billable hours clearly are not the true measure of firm, practice, or attorney performance.

Legal Management Media Has Overstated Market Changes

Since late 2008, the legal management media has overplayed the *"roiling"* in the legal marketplace and underplayed the continued professional and financial success of law firms. The American Lawyer's term *"the new normal"* tends to fit the concept of *"revolution"* rather than *"evolution."*

- When you take a couple of steps back and look at it, the idea of client pressure on fees is more of a pendulum swinging back to equilibrium, than a revolution.
- Clearly, the 6% to 8% annual raise in rates was not sustainable– clients' prices were not rising at that rate. And, associates' salaries could not have continued rising at the rate they had been either.

A Major Opportunity Missed to Fix Raw Material (Associate) Purchasing

A law firm's raw material is its young associates – their development allows the Firm to survive and long term client relationships to be maintained. The economic dislocation in 2008 and 2009 presented an opportunity to fix the perceived problems (runaway associate salaries, clients' negative views, associate entitlement mentality, etc.).

- Many firms did move positively to more directly link associate compensation to performance through uncoupling compensation from class years, basing it on necessary attorney skill levels, and tying bonuses to tangible results (not just hours).
- But, very few firms lowered associate salaries to a level more commensurate with their value (and to give them *"room"* to develop). So, at high end firms the irrational salary levels remain – and the rumor is that they are about to start going up again – truly a self inflicted wound.
- While it is true that law school hiring is way down, the salaries paid for law school graduates at the largest firms tend to cascade through all firms – so, if salaries go up again at high end firms, most firms will probably – again - follow.

The Opportunity for Mid-Size Firms to Obtain More Work for Larger Companies Is Real

As can be seen from the survey responses, there is a belief that high quality mid-size firms can obtain more work from larger companies – usually the exclusive preserve larger firms.

- This belief is becoming a reality – the anecdotal evidence and examples are compelling.
- We believe that this opportunity will exist for mid-size firms for at least the next few years.
- But, the opportunity is not that of the *"bluebird of happiness"* flying through the window – mid-size firms will have to increase their depth and breadth in the right practices, ensure high quality in all that they do (which implies higher quality in some of what they are now doing), move more positively to deal with those who are not producing (and, for some, stop using culture as an excuse for not producing), and effectively market the value they can provide to potential clients.

In Many Cases, Current Firm Strategies and Plans Do Not Reflect Market Conditions

The development of most law firm strategic plans predates the economic dislocation – they were built on assumptions that no longer ring true. And, many firms that knew they had to update and/or revise their overall firm strategy or strategic plan put that effort on hold – both to save costs and to avoid giving the impression of wasteful spending.

The problem is that the plans they are supposedly executing are flawed (e.g. – assuming growth in size and leverage will continue unabated) – if their assumptions are wrong, one can assume that the plans are too.

The Basic Business Need for Growth Has Not Gone Away

Even though many law school professors would eschew the idea, the private practice of law and law firms are capitalistic entities. And, like all capitalistic entities, long term growth is essential (recognizing that growth in a law firm can be defined as something other than the number of attorneys).

- The very positive results shown earlier are the result of *"managing what we have, rather than something new and/or improved."*
- It is evident – from the survey – that the focus on growth is returning – but, from a different perspective (i.e. – rather than *"bigger is better,"* it is now *"better is better"*). Thus, law firms are recognizing that strategic growth is a better place to be than growth for growth's sake.

- The survey results focus more on lateral growth than growth via mergers. While we believe lateral growth should always be a strategy (under the *"best athlete available"* theory), substantive growth can only come through the acquisition of critical groups or the acquisition of or merger with another firm. And, we believe law firm mergers will be going up, perhaps dramatically, in 2011 – in spite of responses to the contrary in the survey.

RECOMMENDATIONS – WHAT SHOULD FIRMS DO IN 2011 AND BEYOND?

Considering what was said in the surveys, as well as the above conclusions, we have developed a series of recommendations for what law firms should do. We have tried to keep them short and to the point.

- For the next couple of years, **focus on those strategic/operational improvements that provide tangible benefits and will impact the bottom line** – these include ensuring acceptable performance across the partner group; improving practice group management effectiveness, leadership and management (through training and coaching), and planning; website improvements; better associate development; and, importantly, effective implementation of firm and practice strategies.

- Get out ahead of the alternative fee arrangement issue by **providing and demonstrating true value to clients** – including determining (proactively) how a firm's billing can best meet the needs of their clients and remembering that it is not lower rates or discounted fees that clients are looking for, it is value.

- **Deal with the need for project management skills in creative ways** (not merely by sending a number of attorneys off to a three day seminar) – including adding non-attorney financial people to be part of the team in major cases and matters responsible for ensuring effective project management.

- Consider **revising the Firm's and/or the practices strategic plans to reflect the present and expected market conditions** not what the markets were prior to 2008 – and ensure that these plans and strategies are understood firmwide or practice-wide so they can be successfully implemented.

- As part of Firm and practice strategic plan execution, **use well crafted metrics to measure and monitor achievement** and report these metrics widely throughout the Firm.

- ***"Get back in the game"* with prudent and strategic investments in growth** – people, practices, and services, as all successful businesses must grow to survive and firms and especially their successful practices must get back on the growth curve to remain competitive.

- **Pay attention to the associates group and ensure development and retention** through effective training and development programs, incentive based compensation (pay for what it is you want to see from associates) and the provision of solid information on the benefits of partnership (not just money) and what it really takes to get there.

* * * * *

This completes our view of the present marketplace, based on the January 2011 survey, as well as continuing interviews with law firm management.

Smock Law Firm Consultants serves a wide range of law firm clients on national basis in six key areas of practice – strategic planning, strategy execution, practice group management, firm mergers and combinations, high level economic counsel, and resolving vexing strategic management issues. Our four partners – John Smock, John Sterling, Peter Giuliani, and Joe Walker are clearly the most experienced *"first string"* serving the legal marketplace.