

## THE NEW YORK LEGAL MARKET 2014 UPDATE - OPINIONS, THE NEAR TERM OUTLOOK, AND OUR COMMENTS

Gary B. Fiebert, Partner

This monograph is a result of a series of in-person and telephone interviews of law firm managing partners, executive directors, and chief financial officers conducted by two of our partners - Gary Fiebert and John Smock - in a small, cross-section of law firms in New York City.

- This follows a similar project that we conducted a few weeks earlier in Chicago.
- In both New York and Chicago, we took advantage of previously scheduled meeting in each city and parlayed them into a series of meetings with law firm leaders to assess their views of the present and future outlook of their local legal market through the first few months of 2014. We followed this up with a few telephone interviews with other firms.
- As a result, this monograph is based upon a small number of separate interviews - while not statistically significant, it represents a solid and insightful response from a good cross-section of firms.
- Our questions were straightforward - we asked the New York firms how they were doing through the first five months of 2014, what the interviewees saw as prospects for the remainder of the year, and what suggestions they would make to their fellow law firm managers.
- This monograph is organized in sections that answer those questions and also includes Smock Law Firm Consultants' comments on what we heard.

The sample of firms that were able to accommodate our schedule represented a broad cross-section of the market ranging from a 100 lawyer firm all the way up to more than 1,600 lawyers in multiple offices.

### How Is the New York Legal Market Doing in Early 2014?

The firms we spoke with all had good to very good 2013s and most, if not all, were cautiously optimistic going into 2014. Now, after five months, that optimism has held and has been supported by generally excellent results.

- *"People that were not busy in 2013 are busy in 2014. While we could use a couple of large cases, our overall sense, supported by the numbers, is that we are busier in 2014."*
- Our transactional practices came back last August but *"the litigators could be busier."* New York real estate has shown signs of increased activity as has M&A and bankruptcy activity (which surprised us a bit).
- Another firm said that *"we have seen 2014, thus far, to be episodic. Real estate experienced a big uptick in 2013 and that has continued while litigation has been steady, but under-utilized. Our corporate practice started 2014 stronger than 2013 but is also still under-utilized."*

- One firm said they are seeing 2014 performance bouncing around a bit between good and bad months. *"We had some large litigation matters come to an end and have not yet seen the next big thing."*
- While another firm told us that the year is going very well with time recorded in 2014 at the highest levels in five to six years. Litigation has stayed busy and the transactional practices have caught up to their prior utilization levels.
- *"We were able to expand our representation with institutional clients and expand the client base."*
- A larger firm said that 2014 is a "good news" story. The firm has been pleasantly surprised at the YTD performance. They are ahead of an aspirational budget with activity levels strong with more high level matters in the door. *"All departments are busy and we have already replaced two of three big matters that closed late last year."*
- And yet, another firm told us that while all the metrics in terms of hours worked, billings and rates were strong so far this year, collections have been slower than they would like.
- Firms are still seeing fee pressure from clients and this pressure is lowering fees and realization. Clients are clearly viewing legal services more as a process and a commodity. On the transactional side, financial transactions are driving firms' performance including real estate finance, financial regulatory work, and related areas.

### **Prospects For the Rest of the Year and Beyond**

The interviewees expressed a generally optimistic assessment for the balance of 2014 and into 2015 (*"we are bullish on the balance of the year"*). They believe the market will continue trending up slightly with modestly more activity – essentially, more of the same. There was broad consensus that clients want quick, efficient responsiveness with no bells and whistles in an effort to lower and control their legal spending.

- One said that *"our expectation is cautious optimism with the final results for 2014 dependent upon the last four months of the year. Unless we get the one or two big cases we need, we expect 2014 to be only flat to up slightly over last year."*
- Associate hours are continuing stronger than partner hours with partners showing more available capacity. Several firms added that there is *"not more that can be done on expenses but you cannot ignore them – they require day-to-day diligence."*
- However, the past five years were filled with angst and some roller coaster rides. As a result of the year-to-date performance, firms are hiring again, but remain skittish about the balance of the year.
- The middle market focused firms are fighting for business that has essentially become commoditized. Firms are fighting for *"shelf space"* and *"referrals."*
- Another firm added *"we are cautious in our thinking and are concerned about the talent wars – there are a fair number of partner defections in the marketplace."*
- Another firm added that *"we have no short term indication of any slowdown in activity. Our biggest short term challenge is insufficient capacity in the senior associate ranks."*

## The Interviewees' Sense of the New York Legal Market

We have separated the comments we heard that directly related to the firms we spoke with from their comments on the broader New York legal marketplace generally. As we look at the comments on the broader New York market rather than firm specifics, we see that the perspective is more determined by size, with the larger firms showing more confidence and believing that is also true of their peers while the mid-sized firms still display a lot of caution and skittishness as they look at the market.

The range of views we heard follows:

- The general consensus we heard is that the New York legal market is generally better in 2014 with revenue growth and cost containment contributing to the improved margins at larger firms.
- Firms with multiple offices continue to be challenged with softness in many offices requiring other, stronger offices to make-up the slack. A single office firm provides better accountability for everyone.
- We sense that the big, highly regarded transactional firms are pulling away in the market. The comparative data on margins seems to indicate that premiums and performance fees are having an impact on those larger firms. In effect, a smaller group of firms is getting a larger proportion of the transactions.
- There appears to be broad consensus that there is no more low hanging fruit for cost containment. Managing expenses remains important, but expense control is not a strategy for growing revenue and profit.
- The current focus on reengineering and law project management has resulted in more fixed fees, but this is much more of a long term trend than a short term "quick fix."
- Overall, the loss or flattening of demand in the marketplace has been and continues to be a critical driver of strategy.
  - A firm told us that they "suspect that the impact will be over a longer term with the result that many firms will be smaller and more focused. On the other hand, in an environment like this, you need to take some risks and be more proactive."
  - One firm suggested that "further declines in realization are likely to result in more year end headcount reductions across the marketplace."
- Several firms added that middle market clients are more sensitive to price and are looking for value. They expect more in service.
- A few of the larger firms we spoke with said that they "see a greater and increasing split between the haves and have nots of the industry."

## Priorities for the Future

We asked the interviewees what are the legal marketplace issues that they believe law firm management must address in the longer term.

- All firms reported that they are striving to continue to expand work with existing clients (i.e. - cross-selling and cross-serving other parts of the firm).
- One firm stated that "we still have to run this place like a business. This change is here to stay."
- We were told that law firms "must be actively out in the marketplace - public speaking, speaking with clients, providing CLE programs to clients which makes the firms 'user friendly' - we cannot do enough of this. You cannot be visible enough." Another firm said that they are emphasizing a client service mentality and client service management skills at every level.

- Another firm said that they believe the New York financial markets will again create financial products that will cause financial missteps in the financial markets yielding another round of problems and related litigation.
- One firm candidly admitted that *“when we look at the future horizon, we sense that that horizon keeps moving. It will be much harder for many firms to be ‘full service.’ We constantly look at our office space in New York to find opportunities to shrink our commitments. Absent the ability to do something dramatic, we suspect it will be harder to grow in the future.”*
- Another firm told us that it is *“critically important that we keep the right people happy. Younger partners are our building blocks for the future.”*
- The evolving market has resulted in the 2,200 hour target being reset to 1,800 hours. This means that firms will have to look at headcount again.
- A few firms said that law firms will need to be able to support more national and global work with the risks greater in doing that for the mid-sized and smaller firms.
- A few firms also reported that the lateral market continues to deteriorate with more new hires unable to meet the expectations of their new firms. *“We have become quicker on pulling the plug and even more cautious on new additions.”*
- Several firms acknowledged that *“management must continue to have a disciplined approach towards dealing with underproductive partners.”* And another added that they will continue to emphasize basic *“blocking and tackling”* as opposed to a major shift in strategic direction.
- A few firms also said they are seeing more competition as larger firms continue to sell *“down market”* to smaller clients.
- We heard a few firms report that they are focusing on real revenue growth, not just billing rate increases. *“We also continue to manage our expenses in a responsible way.”*
- A key issue is the continuing war for talent, especially at the partner level.
- Another firm said they are *“looking at preserving the firm’s culture as a means to retain talent and continue to reinforce the strategic direction of the firm. This issue is exacerbated as we also are focusing on diversity issues.”*
- *A few firms told us that they believe the future will see an increase in smaller, more narrowly focused firms; more fixed fees. But great lawyers will always be able to get business” so maintaining quality is critical.*
- Many firms reported that their technology is becoming better utilized.
- Several firms acknowledged that *“we have only began to see the impact of technology on the profession.”*
- A few firms also told us that talent recruiting and retention are key issues. Diversity is a plus but not a driving issue. *“We see ferocious competition for talent and for clients. We are also addressing succession planning at management levels for both attorneys and C-Suite executives.”*
- One firm also pointed out that *“another key issue is space utilization and our requirements for the future.”*
- A few firms added – looking at the future – that another looming issue is the possible change in the tax code mandating accrual accounting for law firms.

## Smock Law Firm Consultants' Comments

- The generally positive view of the 2014 market reflects what we have been hearing across the country in cities and firms of all sizes.
  - About this same time last year, we sensed that the mood had shifted from optimism to pessimism. Last year, firms began expressing concerns about making the budget targets – but following the strong finish to 2013, and the year-to-date results in 2014, this does not appear to be the case this year.
  - While there is still a lot of caution being expressed it will probably be a very good year – in New York and elsewhere.
- In view of the greater levels of uncertainty and skittishness at the smaller mid-sized and small firms, we are somewhat surprised to see so little merger activity among and between firms in the New York market.
  - Many of these New York firms tell us that their independence and desire to maintain their existing cultures are what keeps them out of the merger market for law firms.
  - We also recognize that “*in-market mergers*,” especially in a market like New York – are extremely difficult to execute well. Law firm partners and managers frequently feel they know too much about their colleagues across town and focus on their “*warts*,” rather than the benefits that might come out of a combination.
  - While tough to do, such in-market combinations, if done correctly, are potentially very productive and rewarding to the resultant entity. So, there could very well be some New York in-market mergers in the next couple of years.
- If there is in fact an increased number of high quality potential laterals (always with “*books*”) in the market, then that is a rational strategy/approach to growing, improving depth, and also improving a firm’s DNA by pursuing laterals.
  - But, the national average hit rate for lateral partners remains at 25% or less, so the professional, reputational, and financial risk in hiring laterals is significant.
  - And, law firms continue to do a generally terrible job of integrating lateral partners into their firms and, as a result, never come close to achieving the benefits for which the lateral acquisition was made in the first place.
  - We believe that solid practice team planning and execution may be a better and less risky way to grow a bottom line than bringing in “*laterals with books of business*.”
- We commend the firms’ foci on profitability. It is not the amount of money you bring in the door that counts, it is the amount of money that you distribute to your partners that is critical.
- All in all, we see a healthy legal marketplace in New York – certainly the AmLaw 100 firms based here are doing well and the next tiers’ firms are also doing well.
- Looking further ahead, we also see good years in 2015 and 2016 for law firms and their transactions and litigation practices. If the economy does not crash, neither will the legal marketplace. If you could buy stock in law firms, it probably be a much better bet than most publicly traded companies.

\*

\*

\*

\*

\*

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 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 the firm and practice levels; (2) **strategic plan implementation and execution** 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; Weston, CT; Long Island, NY; and suburban Detroit and our staff is also in suburban Chicago. Our breadth of knowledge on the New York City market is based on our many experiences there, both in a consulting capacity for Gary Fiebert, John Smock, and Peter Giuliani, as well as Gary's twenty years of service to three NYC based law firms as Executive Director/COO. If any of these issues have hit a responsive chord with you, give us a call. We would welcome the opportunity to speak with you about them.