

## WHAT IS HAPPENING IN THE NORTHEAST OHIO LEGAL MARKET, WHAT IS GOING TO HAPPEN AND WHAT DOES IT ALL MEAN?

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This monograph presents the results of a series of Smock Law Firm Consultants (SLFC) interviews with Managing Partners and Executive Directors of Cleveland based law firms (both in-person and by phone - eight firms in total).

- It is similar to efforts (and resulting monographs) from the same type of interviews we conducted in the Chicago and New York markets in late spring and early summer.
- A very straightforward process was used. John Smock contacted firms in the Cleveland legal market prior to a scheduled trip to Cleveland. We wanted to know three things - how law firms were doing in 2014, what the interviewees saw as prospects for the remainder of the year, and their view of longer term issues.
- We asked for thirty minutes of their time, promised anonymity, and previewed this monograph to the interviewees in draft form.

This monograph is organized in the same way as the interviews - what is happening in 2014 and prospects for the rest of the year, then the interviewees' view of longer term issues. Also, we have put in our two cents, relative to what we think the interviewees had to say means, and what firms should do about it.

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

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

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

- We have had a spectacular first six months in 2014 and the second half also looks exceptionally strong.
  - Our strengths include significant increases in the mergers and acquisitions and private equity practices.
  - Environmental has also picked up dramatically.
  - And, IP is "on fire" (actually, all the firms interviewed with IP practices reported solid growth).
- We will grow about 5% - but flat profits per partner, as a result of investments we have made.
- We are in a sweet spot now, we are comfortably growing revenue - not just this year, but over the last few years.

- Definitely it is a much more positive picture than last year at this time – it has been a very good year.
- Our Cleveland office is flat, but our other offices are up dramatically (and we are growing in those places) – these results justify our decision, over time, to diversify beyond NE Ohio.
- The big change in 2014 is that all of our people are consistently busy – there are no pockets of overcapacity, like we have seen over the last few years.
- All practice groups are busy – our revenue is up dramatically without adding attorneys (revenue per lawyer has taken an enormous jump) – we do not see a falloff in this level of work.
- All of our transactions focused practices are up dramatically.
- Our fixed fee work (as a % of our overall work) has picked up dramatically and we are supporting it with non-attorney resources to assist in pricing decisions and managing projects.
- The private equity money that has been on the sidelines is starting coming into play.
- We have invested in marketing/selling training and revised our expectations for partners in this area. That investment is now bearing fruit – a lot of our people are out there meeting with clients and potential clients and it is working.
- Ohio has some real advantages now – a business friendly administration and tax advantages (e.g. – no state estate tax). We are more of a place to be, than a place to leave from.
- There are positives and areas of potential for firms in NE Ohio.
  - The breadth, scope, and number of companies located here and doing business here is significant – there are lots of clients/potential clients that we can serve.
  - The businesses that are here are staying here.
  - The need for competent, effective legal services in NE Ohio and the state remains high.
- And, Cleveland has had a pretty good recent run of positive publicity – the Republican National Convention selection and, of course, LeBron returning to the Cavaliers.

Not all of the comments were positive, as shown following.

- While it is currently strong for litigation in 2014 (commercial litigation, employment, financial, and product liability), transactions are down (deal flow is just not what we expected).
- There is still a good bit of fee pressure – but we have shifted to other staffing models (e.g. – contract attorneys) and learned to live with those pressures.
- There has been a shift in leverage over the past few years. A higher percentage of partners and income partners makes for a lower percentage of associates – the future leaders of the Firm are just not coming up through the ranks.
- The largest firms appear to be suffering from considerable fall-off in headcount in their Cleveland office – but that does not necessarily mean work has dried up, it is a function of their strategies (i.e. – to get as much of their work out of NE Ohio as they possibly can).

- The former market leading firms are having issues.
  - Cleveland is no longer their center of gravity.
  - They are losing people (often, very senior people) and not promoting people (i.e. - their partner promotions are in other offices).
  - And, their rates have gone up dramatically (greater than 5% this year) - making midsize firms even more competitive for larger company work.
- Our revenue is flat - clients are still putting pressure on fees and rates. It is a grind.
- Banks (particularly for loan work) are behaving like insurance companies - lots of rules (on what can be charged or not) and bill auditing.
- Northeast Ohio is a stable market, but not a "hot" one. This is not where you invest in growth strategies.

### Longer Term Issues

We also asked the Cleveland interviewees about those longer term issues that they will have to deal with.

- Our areas of emphasis are shifting - we are building on (1) industries we serve (and want to serve) and (2) an overall firm client service focus - these are our two key growth strategies, not mergers.
- We are paying much closer attention to metrics and our partners are beginning to see why that is important.
- We are taking an active approach to identifying merger candidates - we will not grow in Northeast Ohio, but we are sure looking hard in other locales.
- It is still a flat market here (at best) - our growth will have to come from outside Cleveland.
- We see an opportunity to go up market and do higher value work for larger clients.
- The Cleveland market is a "zero sum game"
  - To get more work, you have to steal it from someone.
  - The economy here is ok, but it is never better than ok.
  - The medical market (due to the Cleveland Clinic and others) remains strong.
  - But, Cleveland will never be a "dot com" or technology center.
- While alternative fees remain important to some clients, it is apparent that the larger companies' and clients' intensity of interest in this approach has fallen off.
- There are no real major changes apparent - the national legal market is not seeing any earth moving trends. We have to focus on being absolutely the best at serving our clients' needs - if not, they will go elsewhere.
- We expect the economy will get stronger and stronger over the next three years - unless there is a significant terrorist attack.
- While most clients still expect it (and try to reduce the hourly rate), the billable hour will eventually die, and be replaced by fixed fees for full cases/matters or pieces of cases/matters. In preparation for that, we have to come up with ways of estimating the costs of the projects we do, charge a fair price, and ensure we make a profit.

- Law firms need to retool and reorganize to be more efficient and competitive – probably not unlike what the accounting firms had to do.
- The respect that outside counsel used to receive from clients has eroded – it is now a relationship managed by chief financial officers and outside counsel are clearly “vendors,” not “trusted advisors,” as in the past. That takes a lot of the enjoyment and satisfaction out of what we do.
- Now and in the future, a successful firm and its partners will have to focus on what they do best and make sure that clients understand the value they bring to the table.
- The legal market will continue to get better over the next few years – more akin to the standard historical model, transactions growing and fueling litigation, but considerably less premium work than the years preceding “the crash.”
- There will be continued consolidation – multiple practices and offices spread the risk and provide a stronger, deeper footprint to take to the clients.
- The first half of 2015 is already cooked (it will be very good) – but, a lot of “ifs” out there beyond that.
  - The stock market could come down dramatically.
  - Interest rates could rise and probably will.
  - Clients could go back into their foxholes and delay most important legal work.
- Law firms will need to operate quite differently in the future
  - Legal project management is a skill set needed by business law firms and firms need to address how to do it – “we are hiring a non-attorney to do that now.”
  - Project (case/matter) planning is becoming more and more critical. Objectives and benefits need to be understood by both attorneys and their clients.
  - Continued investments in technology are and will be required – “in terms of technological capabilities, clients are getting way ahead of outside counsel, you have to match client capabilities.”
  - There will be much more profitability analysis by case/matter attorney, practice, etc. – you have to manage to good financial results – “then you have to do something about it.”
- Increased pressure on performance and efficiency will help clearly delineate the winners and losers – and, the winners will get the good clients, get and keep good attorneys, and the losers will ultimately go out of business.
- Underperforming partners are still an issue – and always will be. Knowing who to try to rehabilitate into becoming a producer and who to give up on are very difficult decisions – now and in the future – for law firm managers.
- Northeast Ohio firms are looking for mergers (or, really, acquisitions) – but, they are not looking to merge with each other – “why double down in a flat market?”

### **Smock Law Firm Consultants’ Comments**

Following are our comments (and recommendations) based on what the Cleveland legal market interviewees had to say.

- The takeaways from these interviews are reasonably straightforward.

- With some exceptions, 2014 is shaping up as an excellent year for business law firms in Northeast Ohio (actually that is also true nationally, based on what we hear in other cities).
- People/practices are busy, most firms are ahead of plan/budget, and partner income will be up dramatically – across the board.
- In fact, if you look at law firm performance (perhaps best expressed in partner income) over the past few years, the “*great recession*” of 2008-2010 could be viewed as a “*blip*” on the radar screen, rather than the supposed “*sea change*” stated by law firm management pundits.
  - Actually, both are true. Yes, the “*great recession*” changed the rules of the game and put clients back in the driver’s seat – but, it slowed the increase in rates, it did not reverse it.
  - Law firms adjusted well to these changes, listened to what clients said, and kept on raising their rates – so a short term earnings hiccup became part of a longer term pattern of growing partner income.
  - And regardless of increased partner income, the “*pressure on fees*” is still an everyday fact of life for Northeast Ohio law firm managers.
  - So ultimately, these results present a “*good news/bad news*” scenario – in other words, yes it is considerably more competitive out there (and that trend appears to be a lasting one), but partner income continues to (on average) go up.
- When one considers the Cleveland interviewees’ view of the future, it certainly includes the need to focus on improvements that better manage cases/matters, address the needs of specific industries, and ensure individual performance that leads to Firm (and partner) profitability. We believe that those priorities are generally the right ones for Northeast Ohio and, for that matter, beyond.
- Our thought is that it is very hard for a law firm to go wrong when it focuses on **both growth and profitability** – and both should be part of Northeast Ohio firms’ strategies.
- Nationally, most law firms are not growing in terms of the number of timekeepers. Those who leave are not being replaced and, generally, the work is being distributed to those who remain. In the short term that is a positive, but not for the longer term.
- We have suggested to a number of our clients and friends that they make a solid effort, over the next fifteen months, to build firm profitability as follows.
  - First, charge the Executive Director (COO) with a thorough review of the Firm’s expenses. We have found that a level of unnecessary expenses has crept back into some firms operations. One of the Cleveland firm interviewees did do that in the last year with very, very positive results.
  - For longer term profitability, we suggest that every effort be made to make the practice team concept – as full business units – work (most firms fall way short in this area).
  - Improve present client focus through formal client follow-up, client service planning, and other ways of improved client responsiveness is, we believe, the best short term strategy to increase revenue.
  - Finally, most firms need to take a step back, review their processes, and make long term improvements in the way they deliver and support the delivery of legal services (i.e. – reengineering firm processes).

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

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

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