

Legal economics and professionalism

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The new legal economy

Partners in US law firms are anxious about their economic prospects, with good reason. After a decade of economic expansion, experts recognise that the economy of 2001 is in a "slowdown", if not the beginning of a recession. Compared to ten years ago, lawyers in private practice today are working harder than ever just to stay even, as is much of the rest of the American work force. The factors that give rise to this problem are not abating. Support staff overhead costs continue to rise as demand for English language-skilled, technology-oriented support staff increases with not only the growth of law firms, but the growth of other "knowledge businesses" as the result of our shift from a manufacturing to a service economy. Expenditures on information technology are exploding as are marketing costs. At the same time, intense fee competition has leveled billing rates, and in some cases has even reduced or discounted them.

Many lawyers attribute these changes to a lingering, detrimental effect of the 1990/91 recession. However, that simply is not the case. The newly competitive, mature marketplace of the legal profession of the 1990s was totally predictable for years before its emergence, and if anything, that recession served only to accelerate its arrival.¹ Other professions and service industries (accountants, investment banks, brokerage houses) that have undergone this maturation process (shift from excess demand to oversupply) before the legal profession can be instructive in predicting the future. Some of those characteristics are as follows:

Industry consolidation, characterised by increasing size of service providers, driven by merger. This is how the Big Eight accounting firms became the Big Five, and how today's large investment

banks and brokerage houses emerged. It is how the megafirms of today, some with 1000 or more lawyers, grew out of the much smaller firms of the past. Lateral acquisitions and mergers fueled the growth of major US law firms in the 1980s.²

Brand name recognition often accompanies size, and frequently commands premium fees.³ Big Five accounting firms enjoy brand name recognition, as do major brokerage houses. Major law firms are just beginning to enjoy public brand name recognition, and they are achieving it in sophisticated business circles, due to the disproportionate focus of both the legal and business press on developments at large law firms.

Client sophistication results in smarter shopping for and use of professionals. Today, high-level transactional legal work is being ceded on the basis of RFPs (Requests for Proposal), competitive bids, and even online reverse auctions over the Internet. In the legal profession, the growth of in-house law departments has led to considerable change in the relationship between lawyers and clients.

Price competition is predictable in a marketplace where client sophistication is increasing. There is tremendous price competition in the auditing side of public accounting, and in the discount brokerage houses. Price competition emerged in the legal profession in legal clinics, insurance defense practice and, increasingly, is occurring in business-oriented legal services.

Expenditures on marketing and business development are increased in competitive marketplaces. Law firms spend less than 2% of revenues on marketing, advertising, promotion and business development.⁴ That percentage can be expected to

increase, in the future. And if marketing expenditures do not produce increased revenues, they simply intensify the squeeze on profits.

Another factor is the significant incursion of the traditional legal services marketplace by "non-traditional" service providers. Foremost among the ranks of invaders are the accounting firms, particularly the Big Five. Not only do accounting firms practice more tax law than do law firms, they also are entering other areas of business-related legal practice, hiring lawyers to do so. Through their litigation support capabilities they are apparently attempting to pre-empt big ticket litigation in the United States.⁵

Other "non-traditional" providers include labor, environmental and employee benefits, consulting firms (hiring lawyers with those specialties to serve consulting clients), banks and insurance companies (hiring lawyers for estate planning and administration), independent paralegal firms (practising in Florida — serving public clients directly without ownership or supervision by lawyers), and finally foreign law firms, hiring US lawyers to handle US matters which historically and traditionally have been referred out to US law firms.⁶

Law firm responses

Law firm response to the new marketplace of the 1990s has been varied as the profession seeks to navigate the "sea change". Some law firms "hunker down", continuing operations as always and hoping for the good times to return, earning less money each year. Eventually, the pain becomes so intense that either such firms dissolve or those lawyers capable of making more money elsewhere (eg, those "net exporters" of business within the firm with portable clients)

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depart for firms offering greater earnings opportunity, intensifying the economic problem for those remaining behind.

Other firms overreact, for example by drastic cost-cutting focused on associate lawyers, paralegals and staff, rather than the real problem, which usually is too many underproductive partners. Paring partners who do not control clients almost always positively affects the profitability (average income of remaining partners) of the firm. Much of the work done by partners in US firms is capable of delegation to associates, generating greater profits for those partners generating the work, while reducing fees paid by clients due to the lower billing rates of associates.

It is in these two categories of firms — those “hunkered down” and those “overreacting” — that the abuses cited by the press most often occur — embezzlement, padding of hours, overstaffing, overbilling, overcharging disbursements, and otherwise putting the firm’s (or lawyer’s) interest ahead of those of clients and the public.

Finally, there are firms that have taken a considered, longer-term view, by accepting a degree of immediate economic sacrifice (avoiding some of the short-term pressure on hours and billings), while also conceiving a strategy to improve profitability in the future. This is done through planning for growth, targeted marketing, geographic expansion, cultural adaptation to the new economic realities of law practice, image-based differentiation and identification of other possible sources of competitive advantage. A law firm can be economically successful while fulfilling its professional responsibilities and not only encouraging its individual lawyers to do so, but in some cases requiring them to adhere to the fundamental tenets of professionalism.

A model for the profession

There are plenty of successful law firms that have maintained standards of professionalism despite economic pressures of the marketplace.

Consideration of common characteristics of firms that appear to have achieved economic success without sacrificing professionalism reveals the following attributes:

The firm is driven by long term, not short term, vision. Pursuit of short-term profits is a problem common to American businessmen, no less to lawyers. Short-term profit maximization frequently requires compromise of professional values, placing interests of the firm above those of the client or public.

The economic goal is profit improvement, not maximization. For almost all law firms, profit improvement can occur without sacrificing professionalism, when viewed over the long term. Short-term profit maximization almost always requires a sacrifice of professional values.

Everyone in the firm can articulate shared values other than profitability. Client service, mutual respect, work and service quality, efficiency, continuous improvement, provision of value and the like should be identified and articulated as firm goals.

There is leadership, and it never compromises on professionalism and integrity. Leaders need to reiterate continuously commitments to professional values, act accordingly, and never to sacrifice professionalism for profit. Violations of professional ideals need to be identified and rectified immediately, with client best interests always in mind. Demonstrated commitment to professionalism by leaders will induce others in the firm to think and act similarly, and will attract lawyers and staff committed to those same values.

A true client focus is maintained through continual communication, making the firm “easy to do business with”. This client focus can be demonstrated to the point of meaningful differentiation from other firms, through “partnering” initiatives toward integrating the firm into the client’s business in a meaningful and valuable way. This enables lawyers to reassume the counseling role that has been abdicated in large part in the past two decades.

There is continual reinvestment in training, technology, and other means of enabling the firm to serve clients better. Training is important because the only meaningful difference between law firms is people. Training should encompass an element of legal ethics and professionalism, whether such training is substantive, skills, or management oriented. Technology acquisitions should increase efficiency and reduce costs to the firm and fees to the client. “Win/win” pricing scenarios should be pursued.

Everyone is accountable both to each other and to the firm, for quality, professionalism, economic performance, client satisfaction, sharing of resources, and communications. Teamwork replaces individual effort and/or autonomous performance as the standard by which success is measured.

There is a coherent strategy that everyone understands and which is a source of future competitive advantage. Management must conceive, communicate and help implement differentiation strategies to assure future success, sufficiently appealing to invite active participation in their implementation at all levels within the firm. Strategies should focus on practice mix, targeted market segments, geographic “reach”, image or culture that will make the firm a likely choice of desirable clients, in the future.

Economic expectations are realistic. After decades of double-digit growth in lawyer incomes in many law firms, the 1990s were especially disappointing to some who expected those increases to continue indefinitely into the future. Management must communicate the fundamentals of firm economics broadly, ensuring that everyone understands fundamental economic dynamics of the practice, and what reasonable earnings can be expected. The reinforced message that profit maximization is not an institutional goal facilitates effective adjustment of unrealistic expectations.

Finally, there is a focus on core competencies (specialties) and relationships with referral sources, suppliers, and even other law firms are

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created to meet client needs outside the firm's expertise. In other words, the successful firm does not overextend itself in self-interested pursuit of short-term profit.

Conclusion

The new legal economy has resulted in the business failure of a significant number of major US law firms, and many more smaller ones. Economic survival requires effective management and good business practices.

Properly conceived and implemented, such practices need not interfere with professionalism, and arguably they are necessary to it. In many respects, the greatest threat to professionalism is the lawyer or firm with an unprofitable practice, under increasing economic duress.

It is there where temptations to compromise independence (creating conflicts of interest), breaches of client loyalty (including preservation of client property/trust accounts), or overreaching in the pricing of legal services (gouging) are likely to occur.

Clients, lawyers and the public all benefit when law firms are operated profitably with the application of management values and principles that enhance the ability of the lawyer to serve the client competently and efficiently, maintaining the highest standards of professionalism.①

Fellowships for young Australians

Applications are now open for the innovative leadership program, the Vincent Fairfax Fellowship.

Managed by the St James Ethics Centre, the Fellowship is a program which supports the development of Australians seeking to carry out their roles in society with integrity.

individual projects

Fellowship provides for full participation in a program covering 10 weeks during an 18 month period and includes individual projects (of an applicant's own design), in a country of choice in the South East region.

Participants are also asked to travel to remote Australian locations where they gain insights into these challenging environments.

For more information, see the website at www.ethics.org.au or contact Antoinette Simon on (02) 92999566 or fax (02) 92999477.①

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Ward Bower will be appearing at the World Masters of Law Firm Management on 30 August in Sydney. For more information, go to <http://www.lawcouncil.asn.au/gps/worldmasters.html>, or contact the GPS Section Administrator on (02) 6247 3788 or gerard.oneill@lawcouncil.asn.au to register your interest in receiving a brochure for this event.

1. See Bower, Ward, "The Big Picture", Report to Legal Management, Altman Weil Publications, Inc., Newtown Square, PA, December, 1986, p. 1.
2. See, generally, Galanter, Marc and Palay, Thomas, *Tournament of Lawyers*, University of Chicago Press, 1991.
3. See Haigh, David, "The Power of the Brand in Professional Services", International Law Firm Management, Euromoney Publications, Ltd., London, March 1995, pp. 16-18.
4. Survey of Law Firm Economics, Altman Weil Publications, Inc., Newtown Square, Pennsylvania, 1995, p. I-14.
5. See "New Competitive Threats for Law Firms", Report to Legal Management, Altman Weil Publications, Inc., Newtown Square, Pennsylvania, Vol. 21, No. 7, April 1995, p. 1.
6. *Ibid.*

APLA position papers on insurance premiums

If you're arguing about whether litigation is to blame for the rising cost in insurance premiums, the Australian Plaintiff Lawyers Association has two position papers which may assist.

Issued earlier this year, the position papers outline the arguments against blaming litigation, instead pointing at the insurance industry itself.

"The recent crisis in the industry is due to a number of factors," one of the paper's states.

"These include excessive cost cutting and acceptance of poor insurance risks during the intense competition for market share, decline in investment returns due to the global economic slowdown and steep rises in the cost of reinsurance on the global market."

For copies of the papers go to www.apla.com.au or contact the Law Society on 89815104.

Asylum seekers detained too long: Law Council

The Law Council of Australia has welcomed the Federal government's review of some aspects of their mandatory detention policy but says they haven't gone far enough.

LCA President Tony Abbott says detention without trial should only be necessary for a limited period.

He says the Council has expressed its concerns to the government.①