

# UNDERSTANDING LAW FIRM ECONOMICS

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**GOODWIN**

# State Of The Industry – An Overview

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## *Current Environment*

- Economy has stabilized since the recession, business has improved for law firms and there is cautious optimism within the industry.
- Overall demand for legal services is basically flat and growth is expected to be modest for several years.
- Transactional practices have been very strong in recent years, while litigation has stabilized.

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## *Current Environment*

- Clients are shifting work from law firms to in-house legal staff.
- Clients have not given back concessions achieved in 2009.
- Clients are more likely to view legal services as a commodity. Less "cutting edge" work. Lawyers tend to think that what they do is unique. Impact on what can be charged.
- Historically, the vast majority of legal work was priced based on the number of hours attorneys worked on the matter.

# State Of The Industry – An Overview

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## *Current Environment*

- Billable hour is not dead, but there is more fixed fee/fee cap work and more budgets are being required.
- Tension between historical desire for attorneys to bill a lot of hours and the need to stay within budget.

# The "New Normal"

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- Clients have higher expectations and have become more sophisticated buyers of legal services.
- Clients demand value, cost certainty and efficiency from their law firms.
- There are more non law firm options for legal services (legal process outsourcers for discovery work, Big 4 Accounting Firms).
- General Counsel are consolidating legal work among fewer firms.

# The "New Normal"

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- Firms need to re-engineer work processes to become more efficient in the delivery of legal services, as clients want more for less.
- Firms need to re-evaluate their recruiting, leverage and staffing models to reflect the changing environment in which they operate.
- Firms need to communicate with clients around fees, value and matter management.

# Why Law School Hiring is Down Among Large Law Firms

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- Law school hiring is still an essential pipeline for talent and firms have gradually increased the size of their summer classes in recent years.
- Demand for bright individuals at UC Berkeley School of Law will continue.

**BUT**

- Law firms are not growing as fast (or at all) since the recession.

# Why Law School Hiring is Down Among Large Law Firms

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- The traditional leverage model of big firms has eroded, reducing demand for junior attorneys.
- Some clients are unwilling to pay for first and second year associates' training.
- Law firms need to reduce the cost of delivering legal services to remain competitive.



# Revenue Metrics

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- Attorney headcount
- Average billable hours per attorney
- Average rate billed
- Billing realization – two components
  - Pre-negotiated discounts
  - Write-offs
- Billing and Collection Cycle

# Billing Realization

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- Clients have become empowered to ask for price concessions. Recognize that law firms are competing for work to a greater degree than ever before.
- Balance of power between client and law firm has shifted.
- Ability to improve "pre-negotiated discounts" is limited.
- Law firms can/must find ways to reduce write-offs.

# What is Goodwin Doing to Address the Decline in Billing Realization?

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- Most firms are devoting considerable resources to this issue.
- Matter Budgeting
- Project Management Training
- Client Communications Training/Awareness Raising Effort

# What is Goodwin Doing to Address the Decline in Billing Realization?

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- Re-engineering work processes to become more efficient in the delivery of legal services.
- Firms that ignore these issues will become less competitive.

# Law Firm Structure – Goodwin

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- **Management Committee** – Chairman, Managing Partner, Business Law Department Chair, Litigation Department Chair, Chief Operating Officer
- **Executive Committee** – includes Management Committee and eight other partners with three-year terms
- **Major Practice Group Heads**
- **Office Chairs**
- **Chief Operating Officer**

# How Do Law Firms Fund Themselves?

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- Cash Flow From Operations
- Partner Capital Contributions
- Debt

# Compensation Systems – Partners

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- Lock step
- Quantitative/Formulaic
- Quantitative and Qualitative – Most firms including Goodwin
- Allocations Committee
- Open versus closed compensation systems

# Compensation Systems – Associates

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- Mostly market driven
- Geography – impacts compensation at some firms, but not at others
- Base Compensation and Bonus Components
  - Base is usually lockstep
  - Bonus depends on quality and billable hours



# Advancement — Making Partner

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- Two tier v. one tier structures
- The time to partnership has generally lengthened, and the process has become more exacting across the industry.
- Increasing pressure to grow profits per equity partner to help ensure partner retention and attract lateral partners. This results in a smaller number of advancements to equity partner in a flat market.
- Business development has become a much more pressing concern

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