Rethinking the pyramid

What is the new business model for law firms? **Tony Williams** investigates

For the best part of 25 years up to the financial crisis law firms had a pretty typical pyramid structure. Equity partners were at the top; next came non-equity partners, then senior associates, associates and finally trainees. The pyramid envisaged annual growth in lawyer headcount and a steadily increasing number of equity partners who enjoyed increasing levels of income.

After the financial crisis of 2008/9 such growth came to an abrupt stop. Firms had to reconsider their needs as demand slumped. There was a significant level of staff redundancy and partner exits. However, in a large part, these adjustments only amounted to pruning (in some cases hard pruning) of the traditional pyramid. The pyramid remained in place as firms waited for the return to "normal".

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Lawyer surplus

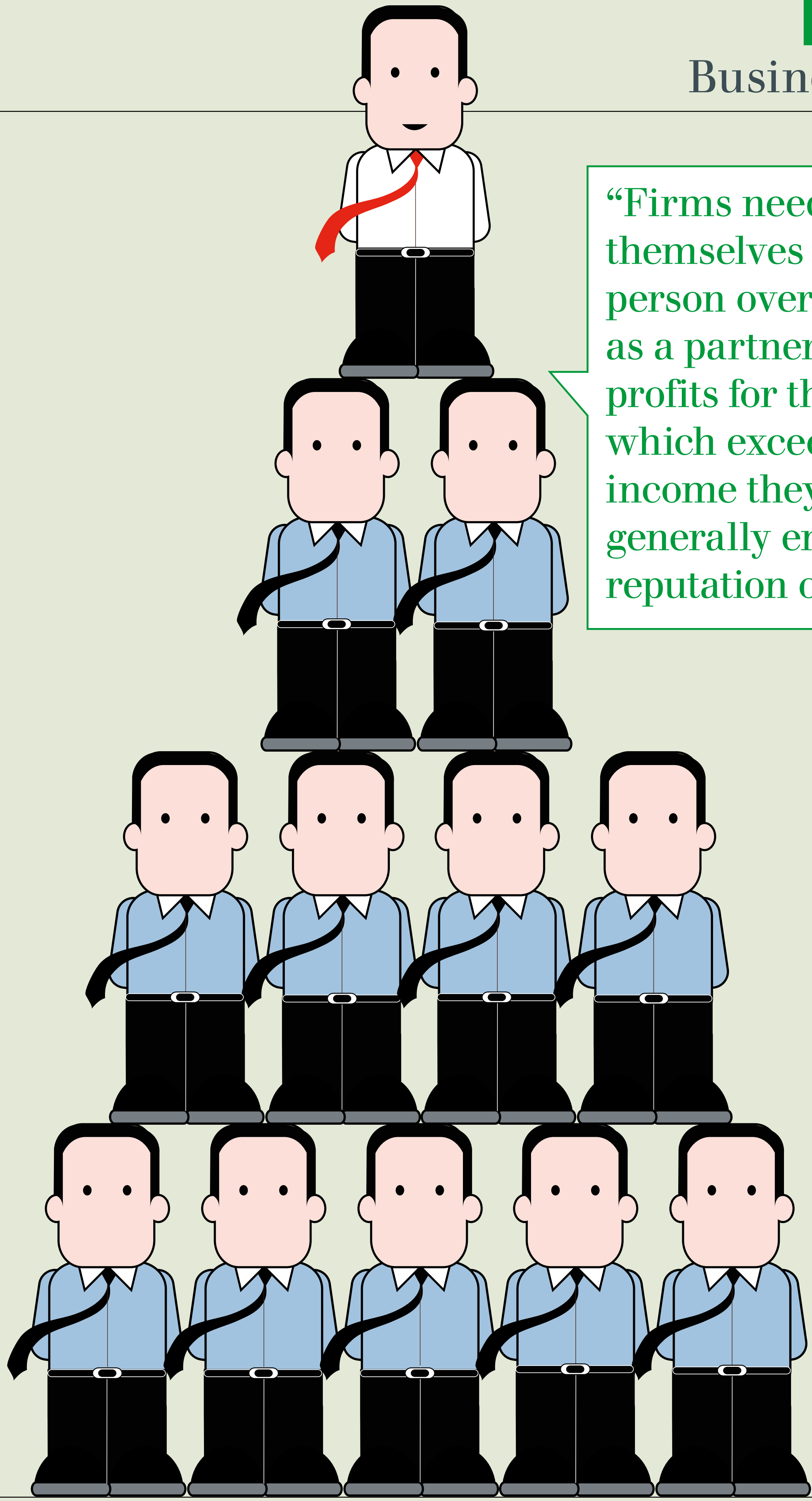
As that recovery has proved elusive and as clients have been demanding a better service at a lower cost, firms need to think again. Royal Bank of Scotland in a recent report suggested that there is a 5% oversupply of lawyers in the UK. This may be a conservative figure, especially in some badly hit sectors such as residential and commercial property or in certain areas of the country where activity levels have been very low. However, the answer for firms is not just to prune their pyramid by a further five or more percent but to comprehensively and methodically re-examine their business model so that it is fit for purpose in the new environment.

They need to ask themselves some difficult and searching questions. Especially in an era of alternative business structures it may be worth standing back and asking: if I was building my business today what shape would it look like and then how do I get my existing firm closer to that model? This may appear to be unrealistic but in a rapidly changing market you need to understand what your competitors could do and what new entrants will do.

Food for thought

- ***Equity partners***
  Being a good lawyer, in itself, may not be a reason to give or maintain equity partner status. Firms need partners who will profitably grow the business, maintain and enhance client relationships, develop clients for other practice areas and offices and develop and mentor their teams. Firms need to ask themselves will this person over their time as a partner produce profits for the firm which exceed the income they receive (to allow for investment) and generally enhance the reputation and standing of the firm. If not, then to award equity status is likely to be dilutive to the other partners. This imposes a high bar for granting or keeping equity status.

- ***Non-equity partners***
  What is such status seeking to achieve? Is it a proving ground for younger partners before they are awarded equity? If so, should there be an up or out policy after, say, three years? Alternatively, is it as status for key skills the firm needs but where the case for equity is not sufficiently strong? If so, how many do you really need? And, are non-



> "Firms need to ask themselves will this person over their time as a partner produce profits for the firm which exceed the income they receive and generally enhance the reputation of the firm"

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Business models

equity partners preventing work being pushed down to more junior lawyers, thereby robbing them of much needed experience and increasing the costs (and reducing the profit) of providing the service to the client?

- ***Associates***
  What is the career track for associates, how long will they stay, what type of work should they be doing, how should they be developed, how specialised do they need to be? With clients increasingly scrutinising the manning of their matters they are unprepared for lawyers to learn on their job.

- ***Trainees***
  How many trainees should a firm take? Given they often qualify four years after being accepted how can you predict your future needs? Is it appropriate to pay their law school costs? Are you choosing the right candidates and what return do they provide to the firm?

- ***Contract lawyers***
  Is it sensible to have arrangements to contract lawyers when needed rather than have a large, permanent staff which is often underused? Can we transform some of our fixed cost into a variable cost and thereby improve profitability? Can we get contract lawyers (including partner-level lawyers) of the right quality and level of motivation?

- ***Paralegals***
  With law schools producing far more students than training contracts available, can we use this well trained and relatively cheap source of labour effectively? How will we recruit and train them, do we want some to become trainees and can we take them on a short-term basis as our work flow fluctuates?

- ***Legal process outsourcing/onshoring***
  Should we consider cheaper means of production either by our own offices in cheaper parts of the country (as Herbert Smith is doing in Northern Ireland) or should we outsource work to India or other lower cost centres? Can we do a similar exercise with our back-office functions?

- ***Technology***
  To what extent can technology move to the front of our business? Will intelligent drafting and project management tools enable us to deskill significant parts of our product and how then should the product be priced? How much will such technology cost and how effectively will we use it?

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- ***Training***
  What training programmes do we need and how should they be delivered? How do we get lower skilled staff able quickly to provide higher value services while improving service delivery and minimising our risks?

Conclusion

None of these questions are easy. But, in an environment of sustained pricing pressure from clients, an anaemic economic recovery, and patchy and unpredictable workflow, firms need to ask very searching questions if they are to deliver the service their clients want at a price the client is prepared to pay while producing sufficient profit to fund further investment and provide sufficient rewards to attract, retain and motivate the right lawyers.

The answers may necessitate fundamental change in the structure and operation of the firm. Such change will be difficult given that the traditional model apparently worked well for so long. But leaders who are ducking these issues are putting the future of their firms at risks.

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