

# MID-SIZE LAW FIRM REPORT

ISSUED 03.31.14

INDUSTRY FOCUS

## A Glass Half Full or Half Empty?

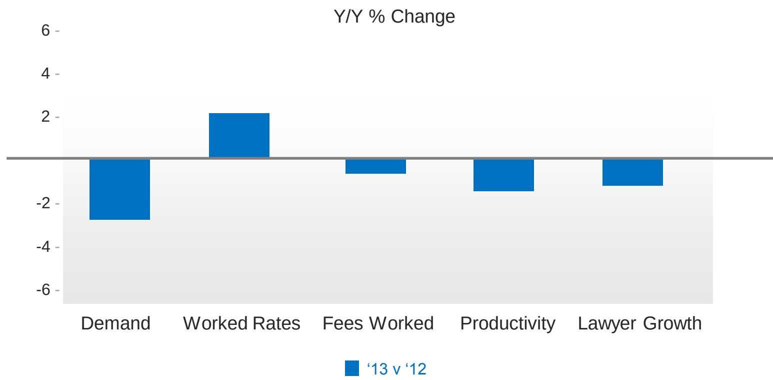
### The Challenging Market for Mid-Size Law Firm Services[1]

Since 2008, all law firms have struggled with the economic downturn and the challenges of adjusting to a new buyer's market in which clients have increasingly demanded more efficiency, predictability, and cost effectiveness in the delivery of legal services. Mid-size firms[2] have certainly not been immune to these impacts, though the challenges and opportunities that the current market presents for them may be somewhat different from those of their larger firm counterparts.

**Chart 1** shows the key performance measures for mid-size firms in 2013. As can be seen, the overall demand for the services of mid-size firms declined by 2.7 percent from 2012.[3] This contrasts with the performance of large firms, where demand growth was essentially flat.[4] Worked rates[5] for mid-size firms increased in 2013 by 2.1 percent, showing an upward trend also reflected in the rates of large firms.[6] By contrast, however, fees worked[7] (which may indicate future demand) by mid-size firms declined by 0.7 percent in 2013, during the same period that fees worked by large firms were growing.[8] Productivity was down during 2013 for all firms, with mid-size firms experiencing a decline of 1.5 percent, more-or-less in line with that of large firms.[9] As to lawyer growth, mid-size firms declined by 1.2 percent (presumably a good result in a time of declining productivity), while large firms continued to grow despite productivity challenges.[10]

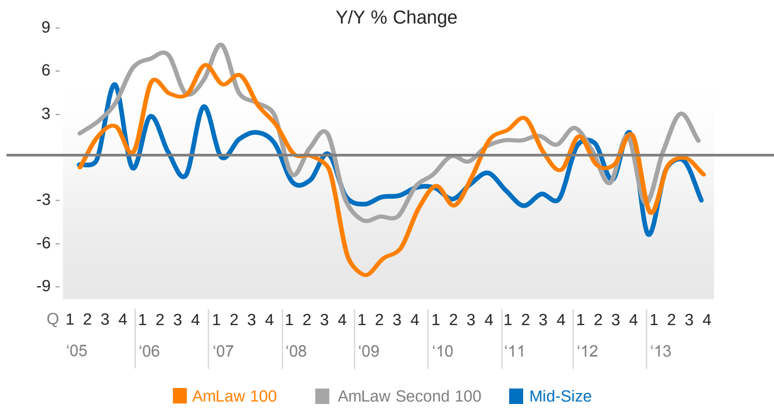
Looking back over the past several years, there are two distinct ways in which the mid-size firm market might be said to have performed somewhat better than the large firm market. First, as shown in **Chart 2**, demand growth in the mid-size market has been noticeably less volatile than the market of either AmLaw 100 or AmLaw Second 100 firms, even through the worst years of the economic downturn. Although the highest growth rate achieved by mid-size firms since 2005 (4.4 percent in Q3 2005) is lower than the highest growth rates of the larger firms (6.7 percent for AmLaw 100 firms and 7.1 percent for AmLaw Second 100 firms), the lowest growth rate experienced by mid-size firms (-4.5 percent in Q1 2013) was about the same as that seen by AmLaw Second 100 firms (-4.6 percent) and considerably better than the rate experienced by AmLaw 100 firms (-8.3 percent). Overall, during the period from 2005 through 2013, the demand growth rate in AmLaw 100 firms varied by 15 percent and that for AmLaw Second 100 firms by 11.7 percent, while demand growth in mid-size firms varied by only 8.9 percent.

1 | Key Performance Measures of Mid-Size Firms[11]




Source: Thomson Reuters Peer Monitor

2 | Demand Growth from 2005 through 2013[12]




Source: Thomson Reuters Peer Monitor

1 Thomson Reuters gratefully acknowledges the participation of the following persons in the preparation of this Report: James W. Jones, Senior Fellow at the Center for the Study of the Legal Profession at the Georgetown University Law Center (lead author); Mark Medice, Senior Director, Thomson Reuters Peer Monitor; and Jennifer Roberts. Data Analyst, Thomson Reuters Peer Monitor.

2 This report uses the term "mid-size firm" to refer to law firms that are outside the AmLaw 100 and AmLaw Second 100 categories. The average mid-size firm in this analysis has 142 lawyers.

3 The "demand" for services is measured by the total number of billable hours recorded by firms in a particular category.

4 Demand for services among AmLaw 100 firms declined by 0.8 percent from 2012 to 2013, while AmLaw Second 100 firms experienced a slight growth in demand of 0.4 percent.

5 "Worked rates" refers to the negotiated rate as determined by the matter value.

6 The worked rates of AmLaw 100 firms grew by 3.4 percent in 2013, while the rates of AmLaw Second 100 firms increased by 2.7 percent.

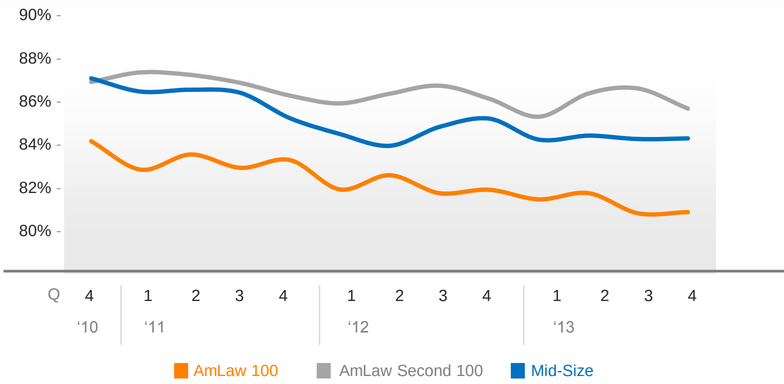
7 "Fees worked" refers to what is worked by a specified timekeeper during a period of time.

8 Fees worked by AmLaw 100 firms grew by 2.5 percent in 2013, while fees worked by AmLaw Second 100 firms grew by 3.1 percent.

9 The productivity of AmLaw 100 firms declined by 1.5 percent in 2013 (the same as mid-size firms), while AmLaw Second 100 firms did somewhat better with a decrease of 0.8 percent.

10 "Lawyer growth among AmLaw 100 firms increased by 0.8 percent in 2013, while AmLaw Second 100 firms grew at a rate of 1.2 percent.

## 3 | Collected Realization against Standard Rates[13]




*Source: Thomson Reuters Peer Monitor*

The second way in which mid-size firms have "out performed" some larger firms in recent years relates to realization rates. As indicated in **Chart 3** (which tracks collected realization against standard rates for each of the past four years), mid-size firms have performed equivalently to AmLaw Second 100 firms and noticeably better than AmLaw 100 firms.

Looking forward, mid-size firms may well benefit from some of the changes that have occurred in the overall market for legal services, while being challenged by others. On the benefit side, mid-size firms (as well as AmLaw Second 100 firms) are clearly advantaged by client focus on efficiency and cost effectiveness and by the increasing willingness of clients to "disaggregate" or "unbundle" matters, both litigation and transactional. Indeed, in one recent survey of 207 corporate chief legal officers, 40.5 percent indicated that they had shifted work to lower priced outside law firms in the preceding 12 months.[14] The ability of smaller firms to take advantage of these shifts has been greatly enhanced in recent years by substantial advances in available technology, advances that have allowed smaller firms to "punch above their weight" and compete more effectively with their larger firm counterparts. It must also be said that smaller firms often exhibit a flexibility in responding rapidly to client needs that can be more difficult for larger organizations.

## Challenges for 2014

As for challenges, mid-size firms face the constant question of whether they are "big enough" to serve their selected markets effectively. This is not a question about economies of scale,[15] but rather about whether a given firm has sufficient "bench strength" to handle the types of matters that it might realistically expect to attract from clients in the new market environment. The answer to this question will, of course, vary widely depending upon the types of practices and clients that an individual firm has, and every firm must make the determination for itself. It is an important issue, however, as mid-size firms seek to better position themselves to take advantage of increasing client willingness to move work "down market."

Another challenge confronting mid-size firms somewhat more urgently than large firms -- at least for the moment -- relates to technology. While changes in technology in recent years have leveled the competitive playing field, allowing mid-size firms (as noted above) to "punch above their weight," those same technology innovations have hastened the commoditization of legal services, particularly at the lower end of the market. In recent years, we have seen ever more sophisticated search engines that have transformed electronic discovery and document management, vastly improved contract drafting software that has made clients more self-reliant, game theory based applications to assist parties in negotiations and in resolving disputes, and sophisticated expert systems to guide clients through decision making processes in complex regulatory and other situations.

This is not to suggest that lawyers are going to disappear, but it is becoming increasingly clear that ongoing technology advances will significantly impact what lawyers are asked to do by their clients in the future. And, unfortunately, it is likely that the segment of the market to be hit first by these changes will be mid-size firms.

## So, from the standpoint of mid-size firms, is the glass half full or half empty?

Again, the answer will vary from firm to firm. For those firms that are able to focus strategically and genuinely address the concerns of clients for more efficient, predictable, and cost effective services, the opportunities presented in the current market environment will undoubtedly outweigh the challenges. That will require, however, that firms be willing to rethink the basic organizational, pricing, and service delivery models that have dominated the market for the past several decades. Unfortunately, such transformative change will not be possible in all firms, and for those that cannot adjust to the new market realities, the glass is probably half empty.

11 This analysis includes all timekeepers and billable hours.

12 This analysis includes all timekeepers and all matter types (billable + contingent).

13 This analysis include only lawyers.

14 Altman Weil, Inc., *2013 Chief Legal Office Survey: An Altman Weil Flash Survey*, Nov. 2013, at p. 10.

15 Peer Monitor studies have confirmed that, over a certain minimal size, there is a very weak relationship between profits per partner and firm size, as well as overall margin (*i.e.*, profit as a percentage of revenue) and firm size. There is also a very low correlation between firm size and office count with expenses per lawyer or with expenses as a percentage of overall firm revenue.