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BIGLAW 2017: A LOOK AHEAD

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Compared with the seismic geopolitical events of 2016, BigLaw's year was relatively tame. However, those external events (predominantly the Brexit vote and Donald Trump's surprising victory in the U.S. presidential election), coupled with other global macroeconomic issues, are likely to make 2017 more interesting, and perhaps more volatile, for the legal industry. The "Great Shake-Out" that we noted in last year's forecast (BigLaw 2016: A Look Ahead) shows no signs of abating and, in fact, is probably accelerating. And while profits continue to soar at the elite firms, the view from the top bears little resemblance to what is happening further down the line. Even those at the top may start seeing some changes that could profoundly affect their compensation systems and cultures in the years ahead. While BigLaw's future seems far less uncertain than it did only several years ago, the road ahead is far from clear.

1. The global demand for legal services remains strong, but the supply side of the equation continues to evolve. Last year, we noted that the demand for legal services was neither flat nor contracting, but that BigLaw was continuing to give up market share to three different competitors:

- Corporate legal departments
- New market entrants
- The Big Four accounting firms

These trends persisted in 2016, and we expect they will continue to affect the market for years to come. Over the past two decades, in response to these incursions by competitors as well as macro issues affecting the pricing and delivery of legal services generally, many firms have shed their less profitable practices and focused their efforts on legal work that is not easily "commoditizable" or susceptible to being outsourced. So far, "bet the company" work remains mostly the purview of BigLaw firms, but the new market entrants will not be content to feed on rote assignments and will continually seek to work their way up the pyramid to more complex projects.

2. Brexit and the Trump effect. The Brexit vote sent shock waves through the industry, especially U.S. firms that invested heavily in London offices. Just as firms began processing the implications of Brexit, Trump's election complicated matters further. As with the other industries affected by these two events, it remains uncertain which practice areas will ultimately benefit or be disadvantaged:

- Some commentators believe that Brexit will increase demand for corporate, M&A and regulatory advisory services in the long run, but there is speculation on whether the U.S.- or London-based firms will be better situated in the short term.
- Similarly, the Trump administration is expected to create significant opportunities across a wide swath of practice areas, such as antitrust, trade, immigration, tax, bankruptcy and healthcare.
- The expected rebound from 2016's relatively sluggish year for the capital markets, coupled with the existing stockpile of investment capital, has created optimistic outlooks for corporate and real estate practices, which are buoyed by the new administration's stated intentions of creating a more favorable business climate.
- Conversely, the anticipated loosening of environmental and financial regulatory restrictions could have a negative impact on those practice areas.

Conventional wisdom is that in times of uncertainty, the legal industry ultimately benefits. Needless to say, all will be watching both events closely.

3. Lateral partner hiring remains critically important, and is accelerating among the elite firms. As we noted last year, law firms essentially have three ways to grow revenue and/or address important strategic needs:

- Substantially improve their existing lawyers' abilities to develop business and/or cover critical practice needs
- Merge
- Hire laterally

Option 1 is quite challenging for obvious reasons, and Option 2, even if properly effectuated, remains culturally impactful and a high-risk approach to strategic growth. The lateral partner market continues to be the most viable and expedient option for law firms to enhance or maintain growth and profitability. While some commentators have attempted to question the effectiveness of lateral partner hiring as a growth strategy, it is unlikely that today's law firms could have achieved their current size, breadth of practice, office dispersion, revenue, brand power and profitability without it. We believe lateral partner hiring will continue to play the key role in effectuating growth.

Instead, rather than question this historically successful growth strategy, firms would be better served examining and improving their hiring and integration process (see our most recent Lateral Partner Satisfaction Survey, which showed once again that firms that do a good job integrating their lateral partners will more likely reap the anticipated benefits of such hires). Firms that excel at lateral partner hiring have a tremendous competitive advantage over those that do not.

They:

- Have a better grip on the types of laterals they want and the strategic needs they will fill.
- Are better at evaluating their practices and assessing their cultural compatibility.
- Understand what laterals seek in a new firm.

As firms continue to increase the professionalization of their management team (discussed below), we believe firms that fail to place a significant emphasis on lateral partner recruiting expertise are making a serious error.

Lastly, 2016 was something of a watershed year in terms of movement by partners among the elite firms. Any remaining notion that it is simply too "unseemly" for the very top firms to poach from one another will continue to fade, and those elite firms will continue to target top partners at other elite firms who can solve their strategic objectives.

4. The gender pay gap. In September 2016, we released the results of our 2016 Partner Compensation Survey. As reported in our Survey, male partners reported average compensation of $949,000 vs. $659,000 average compensation for female partners. This 44% difference in compensation is slightly lower than the 47% difference reported in our 2014 Survey. There has been much discussion among commentators regarding the reasons for this gender gap. While male partners also reported significantly higher originations than female partners ($2,590,000 vs. $1,730,000), and originations are generally thought to drive compensation, it still begs the question as to why male partners originate so much more business on average than female partners. Some question whether men are actually generating more business or simply better at getting credit for doing so. Given the extent of pay disparity that exists in virtually every industry, this issue will clearly receive more attention in 2017.

5. Mergers will continue, and rainmakers at weaker firms will continue to move to stronger firms. Merger activity slowed down slightly in 2016, at least with regard to larger combinations, while a number of large firms continued to acquire boutiques. As we noted last year, many firms that have been unable to improve themselves in key areas, or to achieve their perceived optimal size, will continue to pursue a merger or acquisition of a sizable boutique. We continue to remain concerned by merger activity that involves the combination of two underperforming firms, and acquisitions of firms that have already seen many of their top performers leave prior to the consummation of the merger.

Rainmakers at weaker firms will continue to trade up to stronger, more stable and more profitable platforms. Partners who were formerly hesitant to do so out of a sense of loyalty to their original firm can no longer justify staying put solely out of a sense of obligation, especially with such significant amounts of compensation and capital at stake (often millions of dollars over the long term). The risk is simply too high. Notwithstanding this movement, we are not suggesting high profitability is dispositive of the quality of a firm. There are excellent, high-performing firms throughout the AmLaw 200 (and beyond) whose profitability is more a reflection of their historical focus or geographic location than of their leadership, competence or long-term viability. We believe strongly that success comes in many flavors and that there is no single right size, strategy or level of PPP.

6. Cybersecurity and technology. Technology will continue to play an important role in BigLaw's growth, especially in areas related to cybersecurity, privacy and data breaches. Firms are increasingly developing "go to" crisis management resources for clients with regulatory issues and litigation exposure associated with data breaches, and firms themselves are assessing the implications and exposure related to breaches in their own networks. In 2017, we anticipate that the more forward-thinking firms will assert brand leadership over these issues and separate themselves from the pack.

We also noted last year that the use of new technologies is changing the competitive landscape, with regard to both historical staffing models and the type of work being performed by BigLaw. There have been a number of advances in artificial intelligence that are expected to significantly impact the delivery of legal services, especially those related to contract analytics. Notably, unlike in the previous two decades, corporate lawyers seem to be leading litigators in experimenting with these new technologies. Firms expect to make significant investments in technology to keep up with these changes and stay relevant.

Although there is no shortage of tech firms seeking to break into the legal industry, law firms will have to exercise caution deciding in which companies/technologies to invest their time and money, since many companies and technologies will not be long-term survivors. This renewed focus on technology harkens back to a period 30 years ago when law firms began implementing computers and word processing solutions on an enterprise scale. Poor technology choices mean not only the potential for millions of wasted dollars, but the possible loss of market share.

7. Continued professionalization of firm management. Over the past several years, there has been heightened demand from firms for chief pricing officers (CPOs) with expertise in analytics and profitability analysis. The need for these CPOs stems from the recognition by firms of the need for a more business-like analysis in the pricing of their services, especially following the introduction of alternative fee agreements (AFAs) such as flat fees, success-based fees and auction-based fees during the early 2000s. It is unclear to us whether AFAs are increasing in use, as previously thought, and they may even be decreasing (statistics are hard to come by as firms' pricing models interrelate with their business development activities and are extremely proprietary). We suspect AFAs suffer from:

- Process entanglement.
- The difficulty of predicting contingencies.
- The inherent simplicity and advantages of time and material billing.

Notwithstanding all the discussion surrounding AFAs, law firms have discovered that clients don't always want them or the background work needed to analyze their potential implementation. That being said, law firms will need to continue to be responsive to market demand for AFAs, and having a CPO who understands this process is clearly an advantage.

Similarly, we see increased demand from firms to hire focused business development leaders – dare we say professional sales people – for firms willing to experiment with changes to the traditional "seller-doer" model of generating legal work. Other managers making upwardly mobile headway include lateral hiring professionals, often former or current partners or lawyers in the firm, who have significant experience and are personally facile in the complex aspects of hiring lateral partners. The "professionalization" of BigLaw management will likely continue in the years ahead, as billion-dollar enterprises can clearly benefit from having MBAs and/or other subject-matter experts to help navigate increasingly complex market forces.

8. Alternative staffing models will continue to thrive. BigLaw clients want high-quality legal services delivered at a price that is commensurate with the complexity of the work. Increasingly, clients are turning to alternative legal services providers and alternative staffing models to augment their own in-house legal teams and expect their law firms to do the same. The demand for project attorneys, staff attorneys, career associates and other non-partner–track or interim legal professionals continues to grow because law departments and law firms can expand and contract their teams as needed. The use of flexible staffing allows an organization to virtually scale and maintain greater control over the work done, and the demand for this market is expected to grow by more than 20% per year over the next 5–10 years.

9. On-shoring of back office services continues as pressure to manage costs persists. The recent rise in associate salaries has put additional, unwelcome pressure on firms, especially those below the elite tier, as they continue to try to keep up with the Joneses (or, more accurately, the Cravaths and Davis Polks). The on-shoring of back office services continues to flourish and will remain an element of BigLaw's quest to manage costs and expenses. The movement of these back office services to lower-cost cities, as well as the location/relocation of staff attorneys, project attorneys and other personnel to those cities, continues to be a win-win for both the law firms and individuals involved.

10. Smaller equity partner ranks and associate classes. It has never been harder to make partner at BigLaw, and post-recession trends of smaller partnership classes remain likely to continue indefinitely, although there is some evidence that more non-equity partners and counsel are being made due to more limited equity partner opportunities. Associate classes generally remain smaller than in prior generations, as the pyramid approach to BigLaw continues to evolve. While every generation questions whether the succeeding generation of associates has the same "drive" to make partner as they did, we believe Millennials remain every bit as motivated as their predecessors, but perhaps are simply more realistic about their chances. Law firm leaders do not speak with one mind on this issue, but a fair number acknowledge that, compared with previous generations, today's associates are:

- Much more knowledgeable about the industry.
- Have better skills and insight about technology.
- Have a better understanding of their career options.

They lament that often it is the talented associate who is choosing to leave the firm rather than the firm choosing to part ways with the associate.

Firms at all levels also continue to manage out partners who are no longer productive on their current platforms. We note that being managed out is not inherently negative. Partners with practices in the millions of dollars can find themselves in situations where those practices are no longer consistent with the firm's increased profitability or strategic focus. In those situations, it's in everyone's best interests for those partners to move to firms that value practices of that level and type.

11. Firms have grown increasingly comfortable with the revised utilization of real estate. As we noted last year, law firms, although typically slower to act than other "Class A" office occupants such as consulting firms and financial services firms, are making changes to their utilization of real estate. Office sizes keep getting smaller, and both the real estate and legal industries are watching lease renewals carefully. Most new spaces have only two or three office sizes, usually 90-150 square feet for associates and about 225 square feet for partners, and we know of at least one major international firm that has taken the single-size office plunge. Recent trends include an emphasis on social and tech-oriented communal areas to give firms a modern feel, as they seek to compete for top Millennials. Other than in London, "hoteling" has not yet caught on, though firms continue to evaluate that option. Locations outside traditional downtown business districts are being considered more often, and lawyers, like their clients, are doing more work from home and remote locations. While some firms still care about "face time," most are focused on delivering high-quality and cost-effective work with less focus on how or where it gets done. We believe the trend toward smaller and different footprints will continue.

12. Leadership. The generation of leaders who engineered the rise of BigLaw are now well into their 60s and 70s, and many are on the cusp of retirement, if not already retired. 2016 saw a number of BigLaw's most powerful chairs pass the torch (in many cases, quite eagerly) to a new generation of leaders who face challenges their predecessors could not have imagined 20 or 30 years ago:

- Never has the business climate been more competitive or less forgiving, requiring the new generation to find new ways to cut costs and grow revenue while maintaining the cultural glue so critical to holding the firm together.
- The task is daunting, but the rewards remain high for those who succeed.
- Profitability is at an all-time high, but its distribution is uneven.
- The elite firms continue to thrive, and a number of other firms have made remarkable climbs up the ladder. But for every firm that has risen, it seems as though at least one or two are running in place or have lost their way.

We hold the long view that this increased level of competition will ultimately make the industry stronger, and the winners and losers will be sorted not by market forces, but by their leaders' reactions to and, more importantly, anticipation of, those forces.

ABOUT JEFFREY A. LOWE

Jeffrey A. Lowe is the Global Practice Leader of Major, Lindsey & Africa's Law Firm Practice and the Managing Partner of the firm's Washington, D.C., office. He is the author of the biennial [Major, Lindsey & Africa Partner Compensation Surveys](), the most comprehensive efforts ever undertaken to explore partner compensation and satisfaction, and the co-author of the [2014 Major, Lindsey & Africa Lateral Partner Satisfaction Survey](). He is regularly quoted by leading business and legal publications such as *The New York Times*, *The Wall Street Journal*, *The American Lawyer* and *Law360*, and his articles have been published in the *D.C. Legal Times*, *New York Law Journal*, *National Law Journal*, *Law Firm Partnership & Benefits Report* and *Texas Lawyer*.

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ABOUT DANIEL R. HATCH

Daniel R. Hatch is a Managing Partner of Major, Lindsey & Africa and founded the Southern California Partner Practice. Dan has advised on some of the most significant lateral partner transactions of the past 11 years, gaining a reputation for professionalism and discretion. Prior to joining Major, Lindsey & Africa, Dan ran Home Depot's West Coast legal department, and was named one of California's "Top 20 Lawyers under 40" by the *Daily Journal*. His placements have repeatedly been listed on *The American Lawyer's* annual short list of the top lateral partner moves worldwide.

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