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More Complex than Greed

By William D. Henderson

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Dewey & LeBoeuf, an amalgam of two storied New York City law firms that merged in 2007, has died. Understandably, this has prompted a lot of soul-searching among lawyers. One storyline that will attract many followers is that large law firm lawyers, long viewed as the profession's elite class, have lost their way, betraying their professional ideals in the pursuit of money and glory. This narrative reinforces that lawyer-joke mentality that lawyers just need to be become better people.

And that narrative is wrong. Yes, we all need to become better people, but that still won't begin to cure the larger structural problem affecting large U.S. law firms. At its core, Dewey's collapse has less to do with individual moral failings than with aging organizational structures that worked remarkably well for over a century, but now, for a variety of reasons, inhibit law firms' ability to adapt to a changing legal marketplace.

Many law firm leaders recognize this problem, yet they struggle to communicate it convincingly to partners who have become rich under the existing model. The economics are compelling. Between 1978 and 2003, legal services as a percentage of the nation's GDP increased from 0.4 percent to 1.8 percent. In the mid-2000s, average profit per partner shattered the $1 million-per-year barrier and kept climbing. This pattern of getting a bigger slice of a bigger economic pie continued right up until the collapse of Lehman Brothers in the fall of 2008.

Prior to 2008, the economic fortunes of Big Law were integrally tied to economic opportunities created by technology, globalization, and Wall Street finance. To deal with the increasing complexity, clients needed more sophisticated and specialized legal services. The vast majority of those services were only available, however, through a highly labor-intensive, billable-hour model. So clients paid the going rate, and Big Law became more profitable by steadily increasing rates and hiring enough lawyers to keep up with demand.

Because of these rapidly rising profits, firms had little incentive to improve efficiency or innovate. The downside for law firms was always off in the distance. By steadily growing and increasing the number of specialized lawyers, the firms were slowly shifting bargaining leverage to clients. Further, the lack of innovation encouraged the entry of nonlawyer entrepreneurs who saw huge profit-making opportunity in automating, streamlining, and outsourcing the work formerly done by expensive law firm associates.

When the credit markets seized up in the fall of 2008, large corporations had to quickly cut expenses. At that moment, many in-house legal departments woke up to their ability to successfully bargain over price with the nation's largest and most prestigious law firms.

Decades of success have not prepared Big Law for a rigorous battle over market share. These firms primarily sell the time of individual lawyers, not access to proprietary products or know-how developed and owned by firms. As a result, the power in virtually all large firms resides with rainmaker partners. If these lawyers leave, their clients tend to follow.

This reality dramatically limits the strategy options of law firm leaders, such as former Dewey & LeBoeuf chairman Steven Davis. At most large law firms, the top priority is to attract and retain a large stable of partners with strong client relationships in lucrative practice areas. Firms that successfully pursue this strategy have a large profit pool for distribution to their rainmakers. The high profits keep these lawyers under the same large tent and, in a crude sense, make the firm economically stable.

In recent years, reliance on this simplistic business model has been growing. Since 2000, partner movement between large firms has increased by 50 percent, increasing the cost of acquiring and retaining talent. According to data collected by The American Lawyer, Dewey & LeBoeuf turned over more than a third of its partnership in the four years leading up to its collapse. Among the nation's largest firms, these types of figures are common. During the same period, ten firms took in more than 100 lateral partners, and seven lost more than 100 partners to rival firms. Thirty years ago, the movement of a single Wall Street partner was relatively rare. Now it occurs almost daily.

Among Big Law insiders, the critique of Dewey & LeBoeuf is that it paid too much for the partners it attracted and retained. That is almost certainly true. Yet, even though it may be possible to play the lateral partner game well, the game itself is in severe tension with the new competitive landscape. A loose confederation of rainmakers may cover the high operating expenses of an international law firm, but it generates limited synergies for clients. In the years to come, a conservative billable-hour model will be increasingly outflanked by a new generation of legal entrepreneurs who are reengineering, streamlining, and productizing many old-line legal services.

Large law firm partners tend to be skeptical that new entrants with new models pose a legitimate threat to their firms. But the threat is already here, and it's taking shape in the form of well-financed, legitimate companies with professional management teams.

A good example of this is Axiom, which was started by a former associate from a white-shoe law firm and is financed by private equity interests on both Sand Hill Road and Wall Street. Axiom provides less-expensive access to talented lawyers, typically alums of the nation's leading law firms. But Axiom lawyers operate through a leaner structure that emphasizes process innovation, and like other industries, an increased use of tools and technology. Axiom's model also includes the deployment of seasoned business people—including former partners from places like McKinsey & Co—who help legal departments reengineer how legal services are bought, managed, and delivered. Not surprisingly, Axiom is getting very good at anticipating what corporate clients want—the firm grew 60 percent last year and now employs nearly 1,000 lawyers across three continents.

Another good example is Novus Law, a legal services firm that specializes in electronic discovery, which is the fact-gathering phase that precedes trial in every litigation matter. The primary product of Novus Law, which was founded by two MBA nonlawyers, is an Underwriters Laboratory–certified work process that has engineered out much of the time and drudgery that would otherwise fall to law firm associates. Novus Law prices e-discovery exclusively on a fixed-fee basis. And on every dimension—cost, quality, and time delivery—appears to be objectively better than Big Law.

Axiom and Novus are only two examples of a new generation of legal entrepreneurs who are positioning themselves to profit at the expense of the old law firm model. To hold onto market share over the long term, Big Law is going to have to reallocate some of it profits and massive brain power toward the development of similar products and services that focus on some combination of better, faster, cheaper, or more predictable.

Ironically, many of the lawyers who are thriving the most under the lateral model—selling their time for $1,000 an hour and feeding work to a large cadre of junior lawyers—are the major roadblock to a more competitive future. Unless these lawyers are willing to share risk toward the goal of developing a new source of firm-specific competitive advantage, Big Law won't be able to turn the corner.

When discussing the predicament of large law firms, Richard Susskind, one of the world's preeminent consultants for professional services, has opined, "It's hard to tell a room full of millionaires that their business model is broken." The unfortunate implication is that, in the coming years, several more storied firms are likely to go the way of Dewey & LeBoeuf.

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