Law.com Trendspotter: 2021 Could See Law Firms Ratchet Up the Profitability Pressure on Partners

In the ongoing quest to remain profitable, law firms are starting to get tough with partners—even rainmakers—who have grown accustomed to operating inefficiently.

By **Zack Needles**

The Trend:

Of the many lessons the global pandemic has taught law firms, one of the most important is that additional profits can be uncovered if you *really* want to find them.

In 2020, really wanting to find profits often meant cutting costs that at one time were regarded as off-limits. This year, however, that will be harder to do, which could force firms to get tough with partners—even rainmakers—who have grown accustomed to operating inefficiently.

The Driver:

Back in December, we noted in this column that law firms will face challenges this year in trying to retain the level of profitability they enjoyed during a 2020 that forced them to make a number of drastic, but in many cases unrepeatable, cost reductions.

In addition, with the pandemic still very much in full swing, clients are likely push back on attempts by firms to increase profitability through significant rate increases.

With all of that in mind, this year is likely to see a number of firms pay stricter attention to how much it's costing them to service even the biggest books of business.

The Buzz: >> Clients appear to be in no mood for major rate increases in 2021.

James Jones, a senior fellow at the Georgetown Law Center on Ethics and the Legal Profession and lead author of a new report on the state of the legal market in 2021, told Law.com's Andrew Maloney last week he was "dubious" firms could boost rates at the same level they did last year—about 5%. The average annual rate increase for firms since 2008 has been about 3%, he said.

Jones also pointed to a recent Thomson Reuters survey of more than 200 legal departments that found about 89% said holding down outside counsel costs was one of their highest priorities for 2021. He noted that corporations have significantly increased personnel whose job is to oversee outside counsel agreements.

According to Reuters' Legal Department Operations Index, about 57% of companies had people in those roles in 2019. In 2020 that number shot up to 81%.

"So, given the economic uncertainties and enormous pressure that companies are under, I would be surprised if they sit still for a 5% increase," Jones said.

In a recent piece for ALM's Mid-Market Report, Roger E. Barton, managing partner of New York City-based Barton LLP, noted that a McKinsey & Company study showed that, from 2007 to 2012, standard hourly rates increased 3% per year, but the percentage of rates not collected doubled from 8% to 16.4%.

"This suggests that even as firms attempted to increase profitability through raised rates, clients pushed back by applying pressure for discounts, write-offs, and write-downs," Barton wrote, adding that this post-Great Recession phenomenon does not bode well for firms counting on rate increases to carry them to higher profitability in 2021.

"Firms that depend heavily on increasing rates for their growth are going to suffer during a time when clients are looking to cut costs and derive more value from the services they are receiving," he wrote.

Indeed, as Law.com's Dan Clark reported last week, among the 223 legal departments that responded to a June 2020 Thomson Reuters survey, 89% indicated that controlling cost on outside counsel has been a high priority during the pandemic.

>> As we noted previously, cost-cutting is going to be a more difficult — and potentially more delicate—process this year.

"I think the challenge that we're going to have in 2021 is the very sharp expense reductions that we saw when we went into lockdown. Those expense reductions—they're not going to repeat, and we're going to see our expense numbers rising again," Michael McKenney, managing director of Citi Private Bank's Law Firm Group, told Law.com's Maloney last week. "So that margin expansion that we saw is unlikely to repeat."

>> Just as Law.com's Dylan Jackson recently reported that law firms will likely to have a low tolerance for unproductive partners in this economic environment, there is reason to believe some firms will also look to ding unprofitable partners—even those who are plenty busy.

As Law.com's Maloney reported last week, firms are focusing more on profitability when setting and evaluating partner compensation right now, some legal market observers say, putting a focus on realization rates, frequency of discounts and the degree of leverage.

"That's the biggest change that's going on," said Tom Clay, a legal management consultant at Altman Weil. "It's not easy by any stretch, but with billing services to calculate this, and firms getting more sophisticated, this is getting more popular and is going to grow over the next five years."

Still, Clay said plenty of firms are calculating profitability but not publishing the data because they've had "incredible pushback" from lawyers with large books of business but that aren't necessarily as profitable.

It remains to be seen whether pandemic will force the issue at more firms, but Jeffrey Lowe, global practice leader for Major Lindsey & Africa's law firm practice and managing partner of its Washington, D.C., office, told Maloney he's seen some progress on that front recently.

"I can tell you it was always a frustration among the managing partners that we dealt with—some of the very successful partners didn't care about what their book was and what profitability was. In their minds, they had a $10 million practice, and they wanted to be compensated as such," he said. "And management finally learned how to go back to them and say, 'Yeah, it's a $10 million practice, but it costs us $8 million to service."