LIFE WITHOUT GROWTH?

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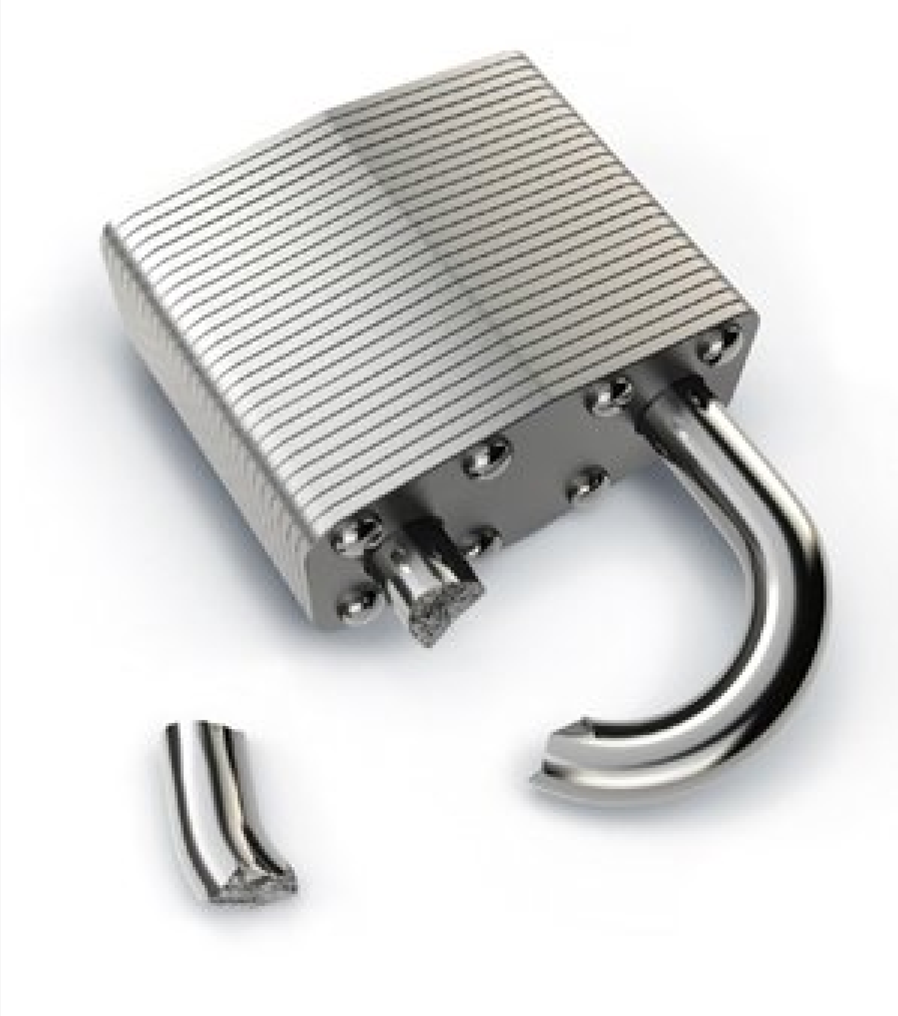

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Now that times are quieter, will Iberia's law firms end their obsession with growth? Easier said than done, as many argue that current partnership models require growth. Stress lines are already appearing as law firms try to contemplate the years ahead.

The recent end-of-year reporting by Iberia's major law firms has suggested that growth is flat. But despite the poor economic outlook, income has not fallen as dramatically as could have been expected. Law firms are counter-cyclical; it is tempting to say they are able to ride the storms of both the good and bad times.

Dig deeper, however, and experts are suggesting, almost five years into the downturn, some of the traditional perceptions and very foundations of the law firm model are increasingly being tested.

Big is beautiful

Unlike the global UK law firms, which have significantly reduced lawyer numbers, including partners, to maintain the all engulfing profits-per-partner, it seems that the Spanish and Portuguese law firms are following another rhythm altogether.

Far from preventing or quenching the thirst for growth, the downturn appears to be reinforcing the trend. Rumours persist of various proposals to merge well-known regional and national law firms, incorporating Madrid, Barcelona and Lisbon, plus other regional offices, into the same firm.

Across Iberia, "growth", expressed financially by turnover and not profitability, has always been the Holy Grail – and it is not difficult to see why. Increasing, year-on-year, income is seen as a sign of effective management, and size is a symbol of success – safe, solid and respectable.

Even against the background of very difficult market conditions in Barcelona – as investigated in this issue's Barcelona Special Report – a number of Madrid law firms have, or are looking to, further expand in the city. Plus Lisbon law firms report, off the record, that they have been approached to join potential large mergers across Iberia.

And size is seen as providing many benefits, such as a wider range of services or having a suitable balance of practice areas, avoiding relying on one speciality. At the start of the slowdown, Dutilh Abogados, who were highly respected in private equity, for example, grew rapidly into a much larger full-service structure, Vialegis Dutilh, following growth in Madrid and a merger in Barcelona.

There is also the perception in the Iberian market that being big is important for reputation, if only to appear higher, or not to slip down, the law firm size league tables.

Growth remains the dominant mantra, according to one Madrid Managing Partner: "What is my message to the firm if we are not growing? At the end of the day, isn't growing the firm my job, and if I am not doing that, what am I doing?"

Financial logic

In fact, Professor Mitt Regan of Georgetown Law School and other law firm experts say that there are some difficult challenges for what is now being called "the traditional law firm model", many that cannot be easily resolved.

Increasing size does not of course mean increasing profitability. Doubling in size with the same leverage means increasing costs in proportion to income, without even one euro more of profit. There are no real economies of scale in law firms.

Regan argues that the boom years of legal services only served to mask, and to some extent exacerbate, the cracks appearing in the law firm façade. At a time of economic uncertainty, this has only served to emphasise the major challenges ahead.

Up-or-out

Current approaches to recruitment and career management rely on the "up or out" model – what US lawyers call the "partnership tournament" –the ultimate trophy of those making the lifestyle sacrifices required to make partner. Not everyone gets to be partner – not everybody is good enough. But it is the possibility that motivates the best people, and the need to satisfy that which is driving growth.

A four partner, 16 associate, firm wanting to promote a young star to partner, while maintaining the same leverage and profitability, requires a 25 percent revenue increase and the need to grow the assistant pool by four.

The calculation will be different depending on the expertise level, and leverage, of different types of legal services; but a certain level of partnership promotion will be required to feed the machine. With expectations of zero growth, it is clear to see why some are predicting that "up or out" has its limits.

"I have recruited an exceptional group of young lawyers," one Managing Partner told Iberian Lawyer, asking to remain anonymous, "and am now having sleepless nights wondering how I can provide them with the career opportunities I promised."

Many firms are therefore looking at creating different career paths, such as the "pre-partner" positions of Legal Director or Of Counsel. Others are helping potential partners to grow their business by providing sales training to show the potential and ability to build a sustainable and profitable practice, or, as two major Iberian law firms have done, coaching and mentoring programmes for potential partners. This is seen as a win-win – assisting those with the ability and motivation to make partner, plus the chance to discover, sooner rather than later, who may lack the business development skills currently required by partnership.

Plus, even at the most senior level, "partner performance" is on the agenda: individual partner plans, with annual evaluations, are becoming a must, a reminder that even once partnership is achieved, remaining in such a profitable role cannot be taken for granted.

Generation Y

Aside from the current shortage in partnership places, the "up or out" approach has already caused huge challenges for the traditional law firm model. Research suggests that the new generation of young lawyers, Generation Y as they are known, value a work-life balance and see this as being at odds with being partner.

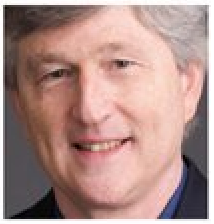
For Michael Bossone, Special Adviser to the Dean at the University of Miami School of Law, and one of the world's leading experts on dealing with the new generation of lawyers, one must look beyond the negative stereotypes and embrace the opportunity their new approaches bring. "Young lawyers are very comfortable with the opportunity that new technology brings to legal practice and, beyond that, they are willing to embrace new ownership and management approaches," he says.

At a time when new legal services models are being explored, such as legal process outsourcers (LPOs) etc, often with fixed share owners and not a partnership structure, Generation Y are ideally suited to populate them.

New pricing models

"Clients now want to pay by outcome – whether they got the solution they needed, and not by inputs – the time the law firm spent."

Professor Mitt Regan, Georgetown Law School



But the growth of alternative providers of legal services has in part been driven by the need, in a buyer´s market, to explore more flexible pricing models.

At a recent meeting at Universidade Católica Portuguesa in Lisbon, members of Iberian Lawyers' In-House Club reported that paying law firms in terms of the hours worked is quickly becoming the exception – saved only for the most expertise areas of law – rather than the rule. Commentators would again see this as a major threat to the traditional law firm model. More than a simple change in calculation, the move away from the billable hour is catastrophic, argues Regan.

During the boom times, the billable hour enabled firms to grow in size and profits each year simply by increasing their hourly fees. And if the client is paying per hour, and fees are increasing annually, then there is no motivation to be efficient, far from it – the longer a piece of work took the more the client would pay.

"Clients now want to pay by outcome – whether they got the solution they needed, and not by inputs – the time the law firm spent", says Regan. "This is a 'solution' model that requires a new conversation - what is the problem that you have as a client and the value the law firm provides by solving that."

With such new approaches, coming as they do within such a competitive market, it is easy to see how the shoe is now well and truly on the other foot – it is the clients who are now driving the agenda. The law firm carries the risk of delivering to a pre-agreed budget, and working efficiently becomes the key concern.

A bright future

Aside from the challenge of making new partners, efficiency and reducing lawyer costs at all levels, primarily salary, are another major challenge.

Many Spanish and Portuguese firms have now frozen salaries and held back bonuses, but reducing pay and benefits for junior lawyers is, for some, a step too far. With such pressure on reducing fees, and keeping costs low, the harsh reality has been that partners themselves are carrying the burden in the shape of reduced profitability.

That could be about to change. So while many are predicting a new wave of mergers over the coming 12 months, some law firms are now talking openly about the need to reduce pay and benefits to junior lawyers.

"We all knew that the salary wars were illogical, but how to reverse that? It is like the arms race, and nobody wants to be the first to disarm as we think we may lose good lawyers," says a Madrid Managing Partner.

Time will tell whether the thirst for growth, which appears stronger than ever despite the economic downturn, will help overcome the current challenges to the traditional law firm or is simply storing up even more problems for the future.

The longer-term seems to look less problematic. However there are a wider range of law firm approaches available plus junior lawyers willing and able to embrace them, new business models and ways of working.