



## A Look Back, a Look Ahead ...

As we begin 2018 it is a good time to reflect on the past year and anticipate the coming year. Here are just a few of our observations on the legal industry in 2017 and predictions for key themes in 2018 which warrant preparation and action.

### A Look Back at 2017

Overall, 2017 was a relatively stable year for the legal industry, with continued market forces impacting law firms, but few revolutionary events. We anticipate that year-end financial reporting will reveal that average law firm financial performance showed modest gains in 2017. Throughout 2017 demand for legal services from large law firms continued to be challenged, with fee pressure from clients, increasing competition from new service providers, the efficiencies that come from better application of technology, and a slowdown in M&A activity.

While firms continued to manage expenses aggressively, 2017 expenses included the full year impact of 2016's associate salary increases without a proportional increase in revenue, moderating profit growth. And as has been true for the last several years we find that the average performance of the industry does not tell the whole story as performance is far more variable than in the past. Some firms will see double-digit growth in profits, while others may see double-digit declines. Firms with year-over-year declines in profitability are vulnerable to partner losses and instability.

We also saw continued consolidation in the legal industry in 2017. Law firm mergers in the US were at their highest level since 2001, with 65 mergers completed in 2017. Much of the uptick in mergers was attributable to a high level of cross border mergers, with 19 such mergers in 2017. Law firms have continued to look to geographic and practice expansion as a way to remain competitive. Lateral partner activity remains high as well, although the low success rate for laterals remains a challenge for many firms. In fact, we've seen some firms invest in laterals but with subsequent departures of some of those laterals, along with other turnover at the firm, end up without any material gains in lawyers and profit.

Finally, mirroring the trends in society more broadly, 2017 brought the acceleration of a focus on gender issues in law firms, reflecting renewed concern over the number of women partners, gender pay gaps, discrimination and harassment. Firms are just starting to address the impact of these issues and more are likely to emerge in the coming year.

### A Look Ahead to 2018

While 2017 did not present revolutionary change for most law firms, 2018 will see renewed competitive pressures and market turbulence. Maintaining market share and financial performance in 2018 will require both solid management of the fundamentals, as well as action in implementing key strategic changes.

**Managing fundamentals.** Firms must continue to pay attention to the fundamentals in 2018 – a clear and differentiated strategy, a focus on clients and strong financial management. The current competitive environment and relatively flat demand in the legal market leaves little room for firms not minding the basic elements of success - aggressively developing clients and business, eliminating excess capacity, maintaining efficient operations and addressing succession and retirement of senior lawyers. In addition, firms must also manage against and respond quickly to unanticipated internal challenges – loss of a major client, lawyer defections, office shrinkage, etc. Recent dissolutions of once successful firms reflect the need for firms to remain vigilant in avoiding client and lawyer losses, and if necessary, taking quick action to close offices or cut staff if required.

**Diversity in firm leadership.** In addition to continuing to focus on increasing gender and racial diversity among lawyers and staff, firms now also need to place a greater emphasis on developing women and diverse firm members into top leadership roles. It is no longer enough to simply hire women and diverse lawyers and staff - they must be given opportunities to succeed and in a workplace that is free from harassment. The vast majority of law firms continue to struggle with underrepresentation of women and minorities in the top management of firms. We believe that 2018 is the year that firms

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must and will address this shortcoming.

**Strategic growth.** Much of the uptick in mergers last year and in earlier years was driven by a recognition that many firms must continue to build depth and breadth in core practices and markets in order to compete. Of course, not every firm needs to grow at a fast rate, but for those who believe it is an effective way to implement their strategy, merger will continue to be an attractive option in 2018. A key success factor in identifying and executing truly accretive mergers will be an ongoing focus on strategic priorities and avoiding investments of time and energy in growth which does not offer an opportunity to materially improve the firm's market position. For firms pursuing growth via laterals, the low success rate for laterals will remain a challenge. Firms will need to adopt a strategic approach to both hiring and integration to reduce the otherwise inevitable and expensive churn and be prepared to take quick action when laterals do not follow through in providing the contributions and value promised at hiring.

**Embracing change.** While we have seen external forces impact the legal industry, from changes in the way clients view the value of their outside lawyers, to the growth in non-traditional competitors (e.g., virtual firms, outsourcers, Big 4 accounting firms), to the potential for technology and artificial intelligence to replace some of what lawyers do, all of these forces have mostly nipped at the edges of traditional law firms. Further, while the economics of law firms have surely been tested in recent years as growth in revenue and profits have slowed, the legal industry as a whole remains a very profitable endeavor for law firm partners. The profitability of the legal industry is one of the things that makes it attractive to new entrants and a target for disruption. And the reluctance of firms to change creates an opening for some of those new entrants to reinvent the model. Firms who do not examine their business model are at risk of falling behind over time. Successful firms in 2018 will encourage their lawyers to be innovative, to be flexible and to embrace rather than resist change. See our [recent Insight](#) for more thoughts on this topic.

**Risk management.** Most firms have robust conflict and client acceptance processes in place. But risk management in law firms today goes far beyond conflict clearance. Firms need to have proactive plans in place to reduce malpractice claims. They need to reduce or eliminate the potential for rogue partners whose behavior can reflect badly on the firm (and create financial risk). They need to protect against lawyers and staff misusing firm or client funds. And perhaps most significantly, firms need to have robust cybersecurity protocols in place to protect client data and to ensure business continuity. Trust and informality is not an effective approach to risk management in 2018.

2018 begins with optimism. Firms who focus on the fundamentals, have a clear and executable strategy, and address these emerging issues of importance, should be well positioned to succeed.

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