fairfax
INSIGHTS

Secrets of High Performing Firms

Over the last decade, we have seen an increase in differentiation among law firms – from financial performance to scale and growth, to practice mix, to the clients that firms serve and the work they perform.

For context, the number of AmLaw 200 law firms with Profits per Equity Partner over $2 million increased from 21 firms in 2010 to 67 firms in 2021. Forty-one of those firms exceeded $3 million in Profits per Equity Partner in 2021. Revenue growth also accelerated, with 52 firms over $1 billion in revenue in 2021, compared to 17 in 2010. While 2021 was certainly an extraordinary year for the legal profession, we have seen this acceleration of revenue and profit growth throughout the last decade.

While some of the elements of differentiation among firms are based on factors like geography and history, others are driven by actions firms have taken to change (or preserve) their competitive position. Based on our work with high performing firms, we see four broad themes that drive superior performance.

1. Strategic Focus

Strategic focus is typically the most significant driver of firm performance because it is the one that results in higher value work and thus higher effective billing rates. While all the profit drivers are important, billing rates deliver the most significant financial performance differences between firms. There have always been billing rate differences between firms, but in recent years the high to low spread in law firm billing rates has become even more dramatic. There are firms at the top end of the market where the billing rates of junior associates are higher than the billing rates of most or all the partners at other firms.

Of course, clients are not going to pay premium rates for all their legal work. High performing firms focus on practices and sectors where they are able to compete for large and complex matters because they have differentiated themselves and are a leader in the space. These areas of differentiation are, necessarily, different across high performing firms so there isn't a single practice or sector that guarantees high performance. For example, some firms have benefited from being in Northern California in the early stages of the growth of the technology sector and doubled down on that sector (and ridden the inevitable business cycles). Other firms developed expertise working with private equity firms or hedge funds as they became more dominant players.

The corollary of practice focus is determining what the firm will not do. High performing firms identify services and practices that are not a strategic fit and either exit those practices over time or limit the practices to what is required to support their core practices.

2. Deep, Cross-Practice Client Relationships

Research shows that clients who are served by multiple practice areas of a single firm drive significantly more revenue than those served by only one practice. In addition, when clients turn to a firm for more than one area of expertise, particularly on a single matter, it tends to be more complex, and as a result supports higher effective rates. Finally, clients served by more than one partner in a meaningful way are stickier than those where the relationship is held by a single partner, which is increasingly important in this era of partner mobility.

High performing firms focus on developing cross practice client relationships, and in particular ensuring that partners are incentivized to proactively pitch as a team and organize as teams on client matters. This includes not only compensation incentives but also partner performance metrics which capture cross practice contributions.

3. Targeted Growth

As we and others have said many times before, growth for growth's sake can be dangerous. Many high performing firms are fast growing firms, but they make strategic investments in growth. This means identifying practices, sectors, and geography where they need to build depth and focusing lateral partner or merger discussions in these areas. They are selective in bringing in lateral partners and conduct due diligence to ensure potential additions are a cultural, quality, and financial fit. While no firm is perfect, this approach results in a higher success rate for lateral partners, and enhanced profitability.

Strategic growth also means making investments to acquire desirable talent who would not likely make a lateral move without financial upside. This can include being willing to pay a short-term premium if the firm believes the partner will be accretive to the firm's strategy and profits over the medium and longer term. It also can mean making investments in talent that may not pay off in year one or two but will position the firm to capture a particular aspect of the economic cycle when the opportunity arises, such as investments in a bankruptcy practice in advance of a potential downturn. It also means continuing to bring in strong talent when the legal market is ebbing, to take advantage of opportunities that may not otherwise be available.

4. Consistent Performance Expectations and Disciplined Performance Management

High performing firms generally have performance expectations for lawyers and staff which are clearly articulated and understood. This doesn't mean that firms manage only to billable hour targets – in fact high productivity is more often a byproduct of the level of work the firm is performing and the client service expected of the firm. But clarity around expectations allows the firm to actively manage performance with a focus on retaining the highest performers.

High performing firms are disciplined about performance management at all levels. Productivity, profitability, and revenue generation are key quantitative components, but client service, contributions to firm and practice initiatives, investments in skill advancement, and other qualitative contributions are critical as well. Firms recognize there will be some level of natural attrition in a leveraged model and aim to retain the highest performers. However, they are also careful to provide the opportunity for all lawyers to develop a strong foundation through training and mentoring, targeted work allocation, and coaching. In the law firm segment, it is understood that the "associate deal" means that partnership elevation may be a reach, but that those who do not achieve partnership will be not only be prepared, but assisted, in finding an appropriate role outside the firm. Of course, this also results in a strong alumni base.

When it comes to partners, high performing firms do not try to solve underperformance through compensation. Simply reducing compensation rarely results in strong performance the following year. Coaching or other guidance may be helpful, but at some point, the partner may be more successful elsewhere. High performing firms are typically much quicker to amicably reach this conclusion than other firms.

Not every law firm aspires to be a high-profit firm, but many do aspire to be higher profit. Aspects of the 'secrets' we have outlined here can be applied across the industry. As law firms face potential economic headwinds, these approaches become that much more important.

Washington

Principal: Lisa Smith
lisa.smith@fairfaxassociates.com
202.365.4180

California

Principal: Kristin Stark
kristin.stark@fairfaxassociates.com
415.215.9294

London

Principal: Julia Hayhoe
julia@jhayhoe.com
+44 7747 024249