fairfax
INSIGHTS

Strategic Priorities for 2024

Each year, we look ahead and identify the key strategic and management issues that we believe will need to be top of mind for law firm leaders during the coming year. While year-end results are still being released, it looks like 2023 turned out to be a better year for firms than many leaders expected at the beginning of the year. There were certainly economic headwinds, and some firms needed to manage aggressively through those, but on balance we head into 2024 with more optimism than we did a year ago.

The legal industry continues to see more rapid change than in the past and change will continue to be a theme for 2024. Competitive pressures, technological advances, and societal and demographic pressures are all contributing to an accelerated pace of change. Key areas for focus in the coming year include growth, paying top performers, moving forward on the potential applications of AI, evaluating the firm's position in the segmentation of rates, and putting the return to office discussions to bed.

Growth. Growth is an evergreen topic but one that continues to come more into focus. The benefits of scale are coming into increasing focus, including market profile perspective, depth of core practices, ability to provide adjacent specialty practices with sufficient depth, and ability to invest in talent, technology and other strategic initiatives.

We saw an uptick in mergers in 2023 compared to the prior 3 years. And 2024 has started off with a bang, with 17 mergers already effective or announced in the first month of this year. The majority of firms have at least considered merger as part of their growth strategy, In the past, it was not uncommon for firms to express a high degree of commitment to their independence or only consider combinations where they would be the larger of the two firms. However, this mindset is gradually shifting, in part due to the limited growth options available in the market. As a result, we are seeing more flexibility from firms who might not have been open to a merger of equals or even being acquired than in the past.

In addition to growth via merger, we continue to see a high level of lateral partner movement, including significant lateral groups, and expect this activity will continue in 2024. Lateral growth requires a commitment of time, capability to invest, and ability to effectively integrate the new team.

Having a clear sense of the firm's desired competitive position and an understanding of the potential paths to achieve that position are the critical foundations of a growth strategy (see The Great Growth Race).

Paying Top Performers. The increase in lateral partner movement has put significant pressure on partner compensation across all segments of the legal industry. Lateral partners are often paid a premium to move, and attracting high performing laterals with significant books of business can require firms to stretch their compensation ladder. At the same time, firms are laser focused on keeping their existing top performers. And younger high performing partners are increasingly impatient with the historic "slow up/slow down" approach inherent in many compensation systems, and expect to be paid in accordance with what they are delivering today.

As a result, many firms have added levels to the top end of their compensation scale, and increased both the size of the bonus pool and the size of individual bonuses to pay partners for sustained and outsize current year high performance. Bonus pools of 10% or more are increasingly common, particularly among large firms.

Firms with level/unit systems are also recognizing performance by advancing high performing partners more quickly through the levels. This requires being willing to move partners who are underperforming their tier down more quickly than in the past, which can be a difficult change for firms.

These pressures will continue in 2024, and we expect to see more firms adapt their compensation systems from both an offensive (growth) and defensive (retention) perspective.

AI and Pricing. Generative AI and large language models are quickly gaining traction in firms although clearly still in the very early stages. In our interviews with the clients of law firms we hear significantly more interest in how AI might be used both in-house and by outside counsel to reduce the cost of legal services. It may well be that large corporations will drive the adoption of generative AI, and law firms will need to adapt.

2024 will be a year of testing AI for both internal and client facing applications. This will require an investment of firm resources and of course must be done within a strong risk management framework. But ignoring it or forbidding it is not likely to be a successful approach for firms.

Rate Segmentation. We have seen healthy hourly rate increases over the last several years in response to both high demand (2020-21) and inflation (2022-23). This has served to continue to create separation of billing rates among segments of the market. The leading firms are now charging rates for entry-level associates which exceed partner rates in many regional firms. The by product of this rate segmentation is that clients are considering their selection of outside counsel even more than in the past, and being very selective about work that goes to higher rate firms.

Law firm leaders need to think about where they want to be positioned in the market and how their rates and pricing align with the firm's capabilities and brand, In other words, rates need to reflect the work the firm is actually doing. Pushing rates too high for price sensitive services is rarely successful. At the same time, pitching for bet-the-company work as a low cost provider can also be a challenge. At that level clients are looking for experience, scale and often brand, rather than price.

As the pricing for legal services continues to shake out, we will see more firms de-emphasizing price sensitive areas that don't support the firm's rate structure, which likely results in shedding some clients or service areas. Of course, these decisions create opportunities for other firms who are well positioned to take on that work.

Return to Office/Flexible Working. 2024 needs to be the year we stop agonizing about return to office policies. Many law firms were adopting flexible working policies even before the pandemic, and they are here to stay. There are clearly some challenges that have come with remote work over the last few years, but it has also created opportunities for firms. The challenges come in the form of impact on culture and perceived reduced commitment to the firm, among others. Firms are particularly concerned about lawyers who may be doing the billable work but are not otherwise investing in their own career development or making broader contributions to the firm.

On the positive side, remote/hybrid work has allowed firms to provide more flexibility for working parents, attract talent in locations where the firm does not have a physical office, and potentially reduce space costs.

Firms need to figure out how to make training and mentoring work in a hybrid environment, as well as maintaining appropriate levels of both productivity and investment time (e.g., business development and contributions to the firm). There is no one-size-fits-all approach, so each firm needs to determine what works with their practice and culture.

The year will no doubt bring unexpected turns and opportunities for law firms. But making sure you are considering and addressing these areas should be at the top of the list.

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