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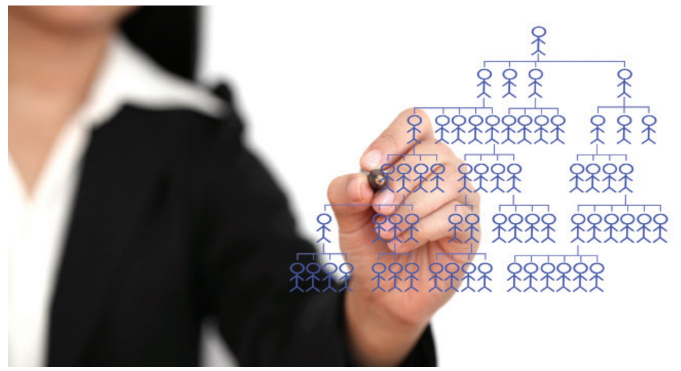
Size Matters: Managing the Mid-Size Firm For Success in Any Economy



BY RONALD H. SHECHTMAN

When I became managing partner of Pryor Cashman about six years ago, I sat down with a number of legal recruiters to discuss a strategy for partner acquisitions in certain practice areas. The firm was then only slightly smaller than we are now—125 lawyers, most of us based in New York City, and a handful in Los Angeles. After my presentation to one legal recruiting firm, the grande dame that heads that firm announced that mid-sized law firms had no place in the legal marketplace and would not survive, even with the top talent she acknowledged we had.

Her pronouncement certainly had some currency at the time. Mid-sized firms had been declared dinosaurs, and many in New York City, particularly, had merged themselves out of existence.

The Legal Landscape

When the landscape changed in 2008, however, all of the givens about the law firm business model were suddenly and critically at issue. Leverage, expansion, rate inflation and the very cost model of large firms came under scrutiny. Not surprisingly, the characteristics of many mid-sized firms returned to vogue, and law firm experts and consultants began preaching a sermon that managers of mid-sized firms had long espoused.

Leverage was dangerous on the downside, as large firms could not cut enough fast enough to reduce the drag of bloated professional payrolls. Not only did the work that supported that workforce decline, but clients began to push back on the staffing models that they considered excessive or overly costly.

Mid-sized firms had missed some of the boom because they did not have the dollar-driving force of enormous leverage. But when work contracted in the current recession, they avoided much of the pain of reducing their associate workforce. Moreover, as clients adopted a more focused, value-driven approach to purchasing legal services, and increasingly rejected excessive and overly costly staffing models and rate structures, mid-sized firms were suddenly able to use their existing, leaner staffing model to compete for business that larger firms no longer controlled.

Before 2008, large firms had grown their rate structure past the $1,000 threshold for some partners' hourly rates. Annual rate increases of 5 percent or greater were not uncommon, and the crush of business allowed management to reject significant rate adjustments or alternative arrangements. These firms had also created new compensation models for associates, paying out more money in rates and bonuses than ever before. Starting in 2009, the same minds raced to right-size and pay associates according to their talent and productivity.

It was not merely a Gordon Gekko phase, but reflected the need of these larger firms to finance vast global expansion. Mergers, new offices in new places around the world, and get-'em-at-any-cost lateral recruitment (cf., Dewey & LeBoeuf) expanded financial pressures in what would soon emerge as a shrinking market.

Mid-sized firms by definition avoided significant expansion, steering especially clear of the costs of adding new offices and the attendant administrative expenses. Their client base was not tolerant of the fee inflation that large firm clientele seemed to take for granted. Cost containment was therefore an absolute priority for mid-sized law firm management. It was often the only means to reconcile their lower rate structure with the demands of paying partners at a level sufficient to keep them on the mid-sized ranch.

Lessons and Opportunities

Thus, the recruitment of quality associates at mid-sized firms must be based on attractions other than wages; fortunately, the leaner structure of the mid-size firm also creates opportunities that would rarely be available at a large firm. Because of the lesser leverage of mid-sized firms, there is less of a pyramidal structure and a greater opportunity for an associate to make the rank of partner. When associates join the firm, they are working side-by-side with partners, usually immersed in many matters. One mid-level litigation associate who came to our firm from an AmLaw 10

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firm told me that he had worked on more cases in his first four months with us than he had in over four years at his previous firm. Our associates are also encouraged and mentored in business development and incentivized by commissions to originate business. We have been successful in the attraction and retention of top-level associate talent precisely because we are different from the larger firms.

These differences have afforded mid-sized firms a competitive edge in the new, post-2008 world of law firm economics. My firm has thrived and reached record revenues during this recessionary period. We are recruiting successfully the best lateral talent that we have ever seen.

Although the latest era in law firm evolution may prove mid-sized firms to be advanced evolutionary creatures, they still remain an endangered species. Those that have disappeared share a number of characteristics that should be amber lights to the management of all mid-sized firms.

Over-reliance on a small base of clients or even a single industry leaves a mid-sized firm vulnerable to a sudden loss of a client or a deep downturn in a particular industry on which the firm has been dependent for its client base. Similarly, over reliance on a small base of originators leaves a firm vulnerable to either defections or retirements of only a few members. At Pryor Cashman, for many years, no client has accounted for more than 5 percent of our business. Over half of our partners originate over $500,000 annually, and about a third originate more than $1 million. Unless both the client base and pool of originators have breadth and depth, a mid-sized firm is especially vulnerable.

The key to our success at Pryor Cashman, and I suspect to the success of other mid-sized firms that have survived and thrived, is the creation of an entrepreneurial culture that enables a broad base of partners and even associates to build practices. This entrepreneurial culture's by-product is an extraordinary collegiality that encourages cross-selling. So many partners are engaged in business development that each appreciates the help that another offers in bringing in a matter in another discipline. Our busiest and most successful partners are the first to offer and lead an effort of another partner to bring in an important new matter.

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Thus, the mid-sized firm that encourages and supports an entrepreneurial member to pursue and advance business development is a Mecca to so many lawyers who have begun to realize their potential in business development. The mot du jour that I hear from lateral recruits looking for a different platform is "siloed." They are frustrated that they cannot get the support to land new business from others in their firm because they function only within their own siloes. They also cannot get out of their own silo to do other work and grow their practices as they aspire to. Neither their firm's rate structure, nor its bureaucracy, helps them create new business possibilities where fee alternatives or discounts are required for new and smaller clients.

Large firms may have little interest in new business that does not depend on leveraged staffing or that requires alternative fee structures or discounts. One recruit from a large firm told me that it took him 90 days to get a response to a request for a fee modification for a client of his that had sent a number of matters to him and his firm.

So we are in a time of great opportunity for mid-sized firms to compete for work that was not in play for them before this recession. Mid-sized firms can realize meaningful profits from a business model that depends on cost containment. And mid-sized firms can compete for top legal talent at the associate and partner ranks because of the opportunities they offer for advancement and business development.

But this "new day" for mid-sized firms does not remove the risks that they face when they become dependent on too few clients or too few originators (or too many originators who are finishing their careers). The survival and security of the mid-sized firm depends on a culture that makes the word "entrepreneurial" more than a website tagline. Management must be dedicated to the advancement of entrepreneurial talent inside the firm and the recruitment of laterals outside who can use the mid-sized firm platform to grow significant new business and who can keep the firm growing younger. That is an endless and tireless endeavor, but the continued viability of a mid-sized firm depends upon it.

That recruiter who told me that mid-sized firms cannot and will not survive stated conventional wisdom of the prior decade. But we know that conventional wisdom has a way of being turned on its head. Indeed mid-sized firms have survived and many, like Pryor Cashman, have surely thrived. We will survive and thrive as long as we understand how and why we are and must be different from the large firms to which we are often compared. And truly, there is little comparison.