Continuity / Succession

Tuesday 31 October

14:30-15:45

Case Study

Legal Advice Worldwide & Co ("LawCo") – based in Lawrovia - An everyday story of a law firm we all know well

Information on LawCo

Strong financial performance but…

- Following a sharp initial slowdown in early 2020, the firm had a successful two financial years despite the uncertainty caused by Covid. In the financial year 2022 (which follows calendar years) the turnover increased by 15% and profitability by 6% (it is now at a margin of 37%). 2023 is currently well below budget on all fronts.
- In parallel, the average partner billable hours were up by 10% to 1,430 hours (as partners converted their commuting and international travel time into billable hours – this has continued). Performance is polarising however, five partners increased their billings to over 2,200 billable hours while three have fallen below 1,000 hours.
- Partners are feeling nervous about the future. For 2023, the finance director is predicting a rise in costs (due primarily to increasing Associate salaries plus also introducing a new IT system) and a potential fall in profit and partner income. Given the current geo-political and economic uncertainties, some major transactions are on hold and everyone is feeling stronger pressure on fees.

Firm overview

- John Law, a very well-known litigator in Lawrovia, founded the firm 40 years ago. Historically, the firm's reputation was built upon John Law's personal relations with the leaders of three major domestic family-owned conglomerates who still pass the firm all of their legal work. John remains personally very close to the families, sitting on their various Boards.
- Over 40% of LawCo's revenue comes from the top five clients (John Law is the sole relationship partner for all five) and over 70% from the top 50. Many of these clients work with one partner and practice only. With over 5,000 "active" clients partners are advising a large number of smaller clients with either low or no profit.

- The partners are getting increasingly frustrated with the increasing costs of business services ("too many people who are just not good enough"). Business development is a constant frustration ("they don't seem able to complete the simple tasks such as client pitches and the directory submissions"). They also complain about the Conflicts Team as it is increasingly "finding" conflicts that prevent partners taking on new matters, especially in litigation.

"Transition" from John Law as founder

Two years ago, a litigation partner, Sue Often, became only the second Managing Partner of the firm, after the founder John Law. She was "nominated" by John and there was no vote. John has always been Sue's mentor.

Historically and because of John Law's reputation as a litigator and arbitrator, the firm's brand "stands for" dispute resolution. Given John Law's role in the firm until recently, and Sue's elevation to Managing Partner there is a general expectation among the older partners that a dispute resolution partner would 'always' be the Managing Partner. There is a feeling that the firm is still dominated in leadership terms by litigators, but this is not reflected in revenue which is mostly generated by Corporate.

John Law is revered by the older partners who are keen for him to remain a partner. A group of younger partners, however, see him still having more influence and drawing more income than is warranted by his current role and contribution. (Also, John Law has a daughter, Mary Law, within the Dispute Resolution team. Some feel that her fast promotion into a Senior Associate role is due to her father's influence rather than her ability – she is not partner material some think.)

John's long tenure as the firm's Managing Partner was marked by deference to his decisions on everything in the "back office" – Finance, BD, HR, IT, etc. Everyone assumed everything was fine in those areas and there were very few ripples or other reasons to think otherwise. The professional side of management was handled by John along with the practice group heads, who were all of roughly the same vintage as John himself. Partner meetings were infrequent. Strategic discussions never occurred.

John takes an active role and appears to still make many of the decisions with various heads of business support still looking to him for decisions and bypassing Sue.

Sue is facing a very different situation. Everyone expects her to run everything behind the scenes as smoothly as John seemed to do, but with the change from John to Sue, and the firm's current circumstances, partners of all ages are expecting Sue to address the challenges. At the same time, there are private conversations among some of the partners who seem to have a sense that Sue is not so much John's successor as his deputy.

Remuneration – Supporting a collegial approach?

The firm prides itself in being a meritocracy, and partners say that the profit-sharing approach is one of LawCo's major strengths. As John Law summarised during his last meeting as Managing Partner: "The lock-step is the foundation of our culture and our support for each other as partners".

Currently the partners share profits equally based upon their position within (what they describe as) a "lock-step model". Partners are automatically promoted one band a year until they reach the top of the bands after 10 years. Points are awarded for each band with a range of 5 points on the bottom band and 50 points at the top. Partners contribute capital in the same percentage as they share in profit.

As founder, John still gets a special "Founders Share" of the equity with 75 points more than anyone else. John also has a 'deemed' capital contribution equal to 50% of the value of the firm based on EBITDA for the last three years before retirement. Upon retirement capital is repaid within 30 days. John "jokingly" said to Sue that he had run the numbers and he would be mad not to retire within 2023. Sue has no idea how the firm would pay John.

Four of the oldest partners are in their late 50's and John Law (who is in his late 60's) has said he is keen to start a political career. The firm does not have a retirement policy, which is permitted under local law.

There is increasing agreement that the contributions that partners are making are increasingly out of step with the lock-step model. However, there is no consensus around any new approach. After attending a recent IBA law firm management conference, Sue Often now believes that the remuneration system should be changed and that partners should have annual goals against which they can be appraised (which she believes should include financial targets).

Sue was frustrated when she shared her thinking with John Law who responded: "With increased revenue and record profits in 2022, I can't see any reason why we would want to change our pure lock-step approach".

The firm is growing in size and the financial results in 2021 and 2022 were better than expected. In general, however, most partners have had lower remuneration. It is hard to know why, everyone appears to have been working harder.

When Sue spoke to the Finance Director they told her that it is hard to know the real financial situation of the firm. In general, partners are not good at recording their time (saying that time-keeping is less relevant now that the major clients are working on a fixed fee and retainer basis). Also, the Finance Director has said that he is frustrated that partners are not invoicing on time nor chasing unpaid bills.

Each Partner has their own preferred approach to pricing. There are agreed standard rates – which are the same for every partner – but some are regularly offering 20% discounts. Partners are also regularly writing-off recorded time which they say clients will not pay. There are concerns that many of the fixed-fee arrangements may be unprofitable, the reality is that without proper financial analysis nobody knows. Given the lock-step system, there is no particular incentive to manage work efficiently.

LawCo rejoices in a culture which the partners describe as "collegial", it is clear that partners enjoy their work and also spending time together. In part this has been due to the *laissez faire* (or hands-off) approach to management, which one partner described as: "We leave every partner to develop their own practice with their own clients and nobody here tells you what you can or cannot do". Sue has started to understand that while some aspects of this culture are highly positive, unless they can start to hold each other accountable the firm will never "professionalise" and deal with "under – performance".

Sue is increasingly worried that the hard work and financial success of the mid-level partners is not being recognised, especially with older lawyers (including John) taking a much larger share given how the lock-step works. She was also surprised when a recent conversation with a possible lateral partner ended abruptly when she shared likely earnings following the move – the mid-level partner earnings are falling behind the market.

Falling behind the competition

There was a huge shock to the system last year when the firm no longer appeared in the directories in the number one slot for dispute resolution. The other practice groups and individuals within those practice groups are decently ranked but there are no number ones.

Two corporate partners left last year and a lateral hire into litigation decided not to join. Sue also heard from Tom Jones, the rising "PE" star of the M&A/Corporate team, that he has had an offer to move to a competitor firm with a 30% higher income. He has told Sue he would prefer to stay, although with four young children who will be going to university he is clear that money is a key motivation.

A number of very good associates have left to join competitor law firms at a time when hiring junior lawyers is particularly challenging. The firm has increased salaries, in line with competitor firms, but that appears to have made no impact.

After a recent partners meeting, a group of younger partners cornered Sue in the corridor, sharing their concerns that "the firm has lost it's way". Despite Sue becoming Managing Partner with an agenda of "modernisation and growth", they told her that no progress is being made – "nothing has changed – John is still in charge and you aren't doing anything".