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2014 LEGAL MARKET REPORT – CHICAGO

by

Smock Law Firm Consultants

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THE CHICAGO LEGAL MARKET IN EARLY 2014 – OPINIONS, THE NEAR TERM FUTURE, AND OUR COMMENTS

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This monograph is a result of a series of in-person and phone interviews of law firm managing partners and executive directors in Chicago – in-person and following that by phone.

- I had a breakfast scheduled for downtown Chicago for Tuesday, April 22nd and decided to stay downtown and use that time to speak to representatives of Chicago based law firms and assess their view of the present and future status of the legal market through the first three and a half months of 2014.

- We contacted our clients, friends, and contacts in the Chicago legal market and I filled my schedule for that day (six firms) and followed up with two phone interviews with other firms. So, this monograph is based on eight separate interviews – while not statistically significant, a solid response on short notice by Chicago-based firms.

- Our questions – we wanted to know how law firms were doing in the first three plus months of 2014, what the interviewees saw as prospects for the remainder of the year, and what suggestions they would make to their fellow law firm managers. This monograph is organized in sections that answer those questions and also includes Smock Law Firm Consultants’ comments on what we heard.

There is one important caveat – although we have clients and friends in firms of all sizes, our consulting work in Chicago (and nationally) is focused on the larger medium sized law firms. The Chicago firms who were willing to work me into their schedule were all medium sized Chicago-based law firms – so, the foci and opinions of the midsize firms are reflected in this monograph.

How Is the Legal Market Doing in Early 2014?

Our findings on 2014 results follow.

- The majority (but, not unanimous) of the firms we spoke to had a reasonably good 2013 with a strong fourth quarter that led into 2014. So, the stage was set for a solid 2014. And, that trend has continued. The firms we talked to are having a very good to outstanding year in 2014. And, general comment is that their people are very busy (“across the firm, everyone is extremely busy – not the practice spottiness of recent years”).

  - Transactional attorneys are seeing “the best deal flow in years,” even without many of the strategic buyers coming strongly back to the market. “A good bit of money is still on the sidelines.”

  - Commercial real estate in Chicago – as a legal practice and as a market – has “come back with a vengeance.”

  - And, prospects are considered to be good for litigation, because increased transactions lead to a increased business disputes.
• **Client pressure on fees, rates, and costs remains very strong**, but most firms feel that they are better at dealing with it and anticipating how to deal with it, than a few years ago.

• The areas of **management focus** have shifted a bit and law firm managers in Chicago state that they are focusing more on practice team performance, improved client relationships, and profitability – areas that do and can have an impact on profitability.

• It is clear to the people we interviewed that **non-performing partners are still on the chopping block, particularly in the larger firms.** “There are a lot of resumes on the street – particularly from the less profitable practices in the large firms – and some are very good and would fit with us.”

• The Chicago firms we talked to report they and other Chicago firms are getting an ever increasing number of calls from firms based outside Chicago suggesting mergers (or acquisitions, masquerading as mergers).
  
  - It seems that the center or locus of these calls is from the larger Ohio-based firms – as one Chicago Managing Partner said, “when will the Ohio firms satisfy their Chicago hunger?”
  
  - Chicago law firm managers recognize that any firm planning to be a Midwestern regional firm or a super regional firm needs to be in Chicago – “it is hard to portray yourself as covering the Midwest bases, if you are not in Chicago.”
  
  - **Chicago remains a legal destination market** and while there are hotter markets out there now (e.g. – Houston and Pittsburgh – both primarily a function of the national energy play), Chicago is still viewed as a very positive place to have an office and resources.

• While these “let’s merge” calls have been increasing, there is a general belief that recent acquisitions (in the past few years) by out of town firms (both larger and mid-size ones) have had their problems. Rumors have it that partners have left (possibly one of the causes of the increased resumes on the street) are the out of town firms are having a difficulty integrating their Chicago colleagues and that “it is very difficult to manage Chicago from outside Chicago.”

• The Chicago firms we spoke to all underscored the fact that they are not really growing (a situation which mirrors most law firms). In fact, they stated a pride in being able to get more revenue (and, thus, profitability) with less attorneys. “We learned the value of lean in the recession.”

**Prospects For the Rest of the Year and Beyond**

The interviewees voiced the following 2014 prospects and near term considerations.

• Given the positive results to date in 2014 and the general uptick in late 2013, the interviewees were quite positive/bullish on the prospects for the near term legal market – they think 2014 will be very good and 2015 will be even better.

• The midsize firms we spoke to felt that there was a decided trend of general counsel of larger companies trying out midsized firms for various matters and cases.
  
  - “There is a heckuva lot of work that we can do for larger companies between the ‘bet the company matters’ and the commodity work.”
  
  - This is certainly something that we have heard a good bit nationally, but it appears to be case-by-case and company-by-company, rather than a tsunami of interest.

• A few of the interviewees brought up the inherent conflict between rising rates and client pressure on legal costs.
- They felt that the larger Chicago based firms – particularly in 2014 – have been very aggressive in raising their rates (some well in excess of 5%).
- The midsize firms were less aggressive – but, like most law firms, they raised their rates.
- The interviewees who brought this up did so in the context of “something has to give,” if the rates keep going up and client pressure keeps going up.
  • There is a positive view of available high quality laterals and the opportunity to bring those laterals into midsized firms in Chicago – either to grow a practice or practices or upgrade partner DNA.
  - That is something we also hear widely and are always a little skeptical. To ensure that you get good laterals and keep them, midsize firms have to have (1) a solid and repeatable due diligence process and (2) a defined and effective process for integration.
  - We do not see either or both very often.
  • The independent law firms in Chicago appear to be staying the course vis-à-vis their independence. They have not heard – from their perspectives – compelling stories from the firms that have called them that would cause them to seriously consider a merger. They fear ineffective integration and a loss of independence and freedom.
  • Some concerns were voiced regarding younger partners in the various independent Chicago firms.
    - They do not seem to be stepping up – actively or aggressively – into leadership roles at Chicago’s firms. “Our management keeps getting older and older.”
    - There were also questions as to whether “the really good” work is available in the Chicago marketplace that the young aggressive partners in these firms can go out and get and build a strong position in their firms – as it was for the current senior partners.

**Interviewee Recommendations**

The eight firms and their representatives were asked to make recommendations for the Chicago legal market. The following are their suggestions – although we need to point out that not everyone we talked to offered recommendations.

- Some felt that a key strategy for Chicago firms had to be beefing up the key practice areas of importance to clients. “Our clients want depth in the practices important to them, not necessarily breadth of practices.”
- Clients have upped their expectations as to what they expect from outside firms, so law firms need to put more time and effort into relationship management. Clients want to hear from their attorneys; they want training, when it is appropriate; and, all in all, they want a closer relationship. They want to give more work to fewer firms – the ones they feel closest to and they do not want to be charged for each and every little thing.
- The most important skill that firms need to expand is that of planning – from planning individual cases and matters (so that they meet client needs/expectations and are profitable) to strategic planning at the firm and practice level. Better strategic pricing is also seen as part of an improved planning skill set.
- Chicago firms need to focus on marketing their younger partners. The market already knows about the visible senior partners – but, it is the younger partners (both litigators and transactional attorneys) who are the future of their firms and who should be more visible and, ultimately, well regarded in the marketplace.
• Most firms need to be sensitive to the impact of partner compensation on partner behavior. Law firm management needs to reward what is important to the firm and its clients and that is not always individual performance. For instance, “if partners can make more money by not sending work to other partners and associates, then they will hold onto that work, whether it serves the client or not.”

Smock Law Firm Consultants’ Comments

Our comments, based on what we heard in the interviews follow.

• The positive view of the 2014 market (“everybody is busy and volume is up”), reflects what we are hearing in other markets across the country. About this time last year, the mood of firms shifted from optimism to pessimism, but that is not the case in 2014. Last year, law firms were worried about making their budget – but this year that does not appear to be the case. **It will probably be a very good year – in Chicago and elsewhere.**

• We are somewhat surprised that there has not been an in-market merger of similarly size and/or focused firms in Chicago.

  - There is a very good argument for a couple of midsized firms to get together to achieve that depth and increased capability they feel that their clients want them to have – they do not need to sign up as the Chicago office of an Ohio firm to get it.

  - We do recognize that in Chicago – like any market – people will often know too much about the firms they compete with. While they may listen to the siren songs of Ohio firms, they already know the “warts” of their fellow Chicago firms.

  - It is tough to do an in-market merger – but as proven in certain other jurisdictions, potentially very productive.

• If there is in fact an increased number of high quality potential laterals in the market, then that is a rational strategy/approach to growing, improving depth, and also improving a firm’s DNA. But, the national average hit rate for lateral partners remains at 25% or less, so the professional, reputation, and financial risk in hiring laterals is significant. And, law firms continue to do a generally terrible job of integrating lateral partners into their firms and, as a result, never come close to achieving the benefits for which the lateral acquisition was made in the first place.

• We commend the midsize firms’ foci on profitability and planning mentioned previously. It is not the amount of money you bring in the door that counts, it is the amount of money that you distribute to your partners that is critical. Only measuring activity (billable hours, working receipts, etc.) does not measure the costs of that work. We believe that solid practice team planning and execution may be a better and less risky way to grow a bottom line than bringing in “laterals with books of business."

• All in all, we see a healthy legal marketplace in Chicago – certainly the AmLaw 100 firms based here are doing well and the next tiers’ firms are also doing well. 2014 should be a very good year. And, Illinois businesses need competent legal counsel – most believe that state and local government will try to solve their enormous fiscal problems out of the hides of successful businesses.

• **Looking further ahead, we also see very good years in 2015 and 2016 for transactions and, thus, litigation. If the economy does not crash, neither will the legal marketplace.**
Smock Law Firm Consultants is a focused strategic management consulting firm serving law firms (our primary industry concentration), other professional service firms, and commercial entities. We help law firms address and resolve those issues that have a major impact on a firm’s near term success and its long term direction and focus. We have seven key areas of practice – (1) **strategic planning** at the firm and practice levels; (2) **strategic plan implementation and execution**, in essence, helping clients do what they said they would do; (3) **mergers and combinations assistance**, helping identify, negotiate and implement combinations; (4) **practice team/group management**, helping the practice team concept achieve its potential; (5) **law firm economics**, helping our clients improve profitability and deal with longer term financial issues; (6) **operational excellence**, improving both the effectiveness and efficiency of firm operations (both the front office and the back office); and (7) **strategic management issue resolution**, assisting in resolving a variety of issues of vexing management concern.

We are “on the cloud” and our four partners are based in Lake Forest, IL; Weston, CT; Long Island, NY; and suburban Detroit and our staff is also in suburban Chicago. We know the Chicago market well and John Smock has practiced strategy consulting in Chicago since 1983.