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Deciphering AmLaw Profit Reports

Ahhh, my good friend and favorite BS Detective (see my Post #530 on Howrey) is at it again and this time translating for us, the reality behind the news in today's repots on the AmLaw 100 profit picture. So . . . let's all take a closer in-depth look at the latest AmLaw 100 data:

Back in Black

The Am Law 100's partner profits jumped 8.4 percent last year as revenues rose and firms slashed their lawyer ranks.

By Robin Sparkman The American Lawyer May 01, 2011

After watching partner profits sink in 2008 (down 4.3 percent) and crawl back into positive territory in 2009 (a mere 0.3 percent increase), The Am Law 100 collectively exhaled last year as profits per partner jumped a healthy 8.4 percent.
(Actually, they didn't have a "healthy" increase at all, as the article goes on to say. The reports of a rebound are greatly exaggerated).

Firms heeded Obamaphile Rahm Emanuel's advice and didn't let the economic crisis go to waste. They cut overhead, principally by trimming head count at all levels, and reined in expenses. (Lavish retreats in exotic locales gave way to pedestrian events at the home office.) As the economy revived, the country's highest-grossing firms were able to convert modest revenue gains into profits thanks to their prudence. Here are a few other key stats from our rankings:

Gross Revenue. The Am Law 100's revenue jumped 4 percent last year, in effect making up for the 3.4 percent loss it posted in 2009. Firms benefited from the nascent recovery in capital markets and M&A. And even with clients' demands for discounts, firms were able to increase their "productivity" or hours worked and raise rates. Still, in "Drop the Scissors", the top officials at Citi Private Bank's Law Firm Group write that rate increases in 2010 "were roughly half the size of the annual rate in_creases in the boom years prior to 2008."

It's also critical to note that much of The Am Law 100's revenue growth came from two giants—DLA Piper and Hogan Lovells, a pair of vereins whose worldwide revenues are being included in The Am Law 100 for the first time, because of a change in our methodology. Leaving out those two anomalies, The Am Law 100's average revenue went up a meager 1.4 percent.
(This is the "real number" and it is nothing to get excited about, not only because it is small....but because it is not evenly distributed among firms. Overall, the year was stagnant for most firms.....assuming that 1.4 % in itself is not stagnant!)

Head Count. Firms continued to trim their lawyer ranks. The Am Law 100's attorney head count fell 2.7 percent in 2010 (or 3 percent if you exclude DLA Piper and Hogan Lovells). This was the biggest drop since we started ranking law firms almost 25 years ago. Equity partner head count alone slipped 0.9 percent last year, after dropping 0.7 percent in 2009.

(There were exceptions, of course. Quinn Emanuel Urquhart & Sullivan's total head count jumped 14.8 percent, and its equity partner ranks grew 22 percent—the biggest increases on The Am Law 100. Moreover, the spike in equity partner head count didn't weigh down the litigation powerhouse's PPP, which jumped almost 16 percent last year.)
(If you cut the numbers of partners who share in the pool faster than the size of the pool shrinks, you report "gains". It is ridiculous to claim that is an "improvement" in operating performance.)

And after a rather puzzling rise in 2009, nonequity partners at The Am Law 100 got the ax, too. Nonequity partner ranks fell by 1.7 percent last year as firms took a hard look at partners who didn't have their own books of business or whose salary creep over the years suddenly didn't seem worth the expense.
(This is not puzzling at all. Many of the reductions in equity partner headcount were from "de-equitization" of equity partners, which then in some cases were followed the next year by discharge or retirement, a two step process that is achievable in a way that direct dismissal of an equity partner may not be under the partnership agreements of many firms. In addition, many lateral entry partners are now brought in on a two step process as well, having to "prove up performance" before they become full equity stakeholders. This makes it easier to address mistakes in hiring, as equity partner dismissals are often more difficult. In 2010 the lateral hire market was the slowest in a decade.)

Revenue Per Lawyer. Not surprisingly, the cuts in head count and the modest uptick in billing rates led to a 4.4 percent increase in RPL for an average of $807,330.
(This is a bit more complicated, but with many headcount cuts occuring at the lower associate levels, and fewer hires of new graduates, more work was done by more senior, higher billing rate attorneys, so that the firmwide average billable hour simply cost more.....a hidden rate increase for the client base.)

Profits Per Partner. The rigorous cost cutting also led to a surge in profits, with Am Law 100 firms reporting an average PPP of $1,366,695. A few firms had spectacular PPP growth. Take Alston & Bird. The Atlanta-based firm posted a 33.7 percent increase in profits (the highest on The Am Law 100) because of a 6.7 percent reduction in head count and a 3.6 percent increase in revenue in part due to its work defending Toyota Motor Corporation in unintentional acceleration–related claims across the country.
(It is difficult to drive an enterprise to success through cost cuts. And cost cuts were availed of aggressively in 2008 and 2009 and it didn't make the difference. Some of the savings were not felt until later periods, so that might explain a small part of the improvement. But the real increase is through splitting the profit pool with fewer people. If one were to look at Net Operating Income from the enterprise, a much more valuable and relevant metric, it is inescapable that as enterprises most of the firms are generating much smaller profit pools than they were in 2007. That should be the number to look at for comparability, not PPP. The firms as enterprises have not recovered, have not improved their operating efficiencies, have not addressed the fundamentals essential to responding to client demands for better service at a lower cost.)

The rich also got richer last year. Once again, if you take out Hogan Lovells and DLA Piper, The Am Law 50 posted a 1.8 percent growth in revenue. Compare that to The Am Law 51-100 firms, which grew their revenues only an average of 0.3 percent. Traditionally, these firms bill at lower rates and have a smaller market share of the highest-end corporate work.

But The Am Law 51-100 were far more efficient at cutting costs. While PPP for The Am Law 1–50 jumped 5.7 percent over 2009, it rose a whopping 9.7 percent for The Am Law 51-100. The spike in profits was largely tied to head count reductions, as the bottom half of The Am Law 100 cut their equity partners at a rate that was nearly five times that of The Am Law 1-50.
What does this mean going forward?
(This is not a cost cutting driven outcome. This is "population cleansing". This is desperation, pure and simple.)

Strategic lateral hiring will be more important than ever. Firms are now willing to shell out once unheard-of amounts ($5 million, anyone?) for partners with lucrative practices and portable clients.
(This could be a very dangerous development as to the stability of partnerships, as any compensation for a partner that is out of balance with the firm they go to must ultimately be reduced to be consonant with what their partners make, or their partners must make what the newcomer makes for the same performance. This can promote lateral departures as much or more than it attracts candidates. It may put greater pressure on shifting income from the middle tiers of partners to pay the upper tier newcomers, and consequently chase them out of the firm in a search not for premium compensation, but only fair compensation. And without that middle tier, there is no firm.)

Concurrently, firms that can clearly and, perhaps, ruthlessly, shed lower-performing practices are more likely to see their efforts pay off. Firms that don't make these hard choices—well, there's no harm in being third-tier, right? Just don't try to recruit any big rainmakers.
("Lower performing practices". This is a bizarre statement. What matters is contribution to "profit", not the billable rate that is charged. While it is true that such practices will "dilute" the PPP figure, that figure is not the be all and end all metric of financial performance. Many of the so called "lower performing practices" are steady performers that help a firm to have a balance and regularity to their cash flow, which is what keeps a firm alive. The partners in such groups may make less money than their comrades in "higher performing practices", but so what? If people are fairly paid for their contributions, and satisfied that is so, what is the problem?)

The nature of equity partnership has changed. After two years in a row of easing senior partners into retirement, deequitizing underperformers, and outright firings, surviving equity partners may feel like the firm they grew up in has changed forever. While PPP may grow, the downside of losing your colleagues is a fraying of partnership bonds and alliances, which can have long-term repercussions.
(The short term repercussion is already on stage, "front and center". There is a clear understanding that any culture that values something other than money and "what have you done for me lately?" does not apply.)

Slower PPP growth. Firms made surgical cuts in their ranks last year. But there's only so much muscle that can be excised. If clients still demand discounts, and firms aren't able to capture the premium work or raise rates fast enough, partner profits may take a hit.
(If the strategy to survive is thowing babies out the back of the sled to slow down the pursuing wolfpack.....your strategy begins to fail when you run out of babies.)

But after more than two years of stress and volatility, for many partners, that may be a

concession they're happy to make.
(Until you are selected as the next baby, perhaps so.)