

Lateral Partner Moves in London

Do they deliver value?

Summary Research Findings

Motive Legal Consulting Ltd, October 2011

Introduction and Executive Summary

How much value do lateral hires deliver to law firms?

Earlier in 2011, Motive Legal Consulting conducted research into 1,944 partner moves in London during a five year period (July 2005-July 2010), and found there was a serious degree of attrition with many partners exiting quickly, presumably before they had begun to deliver much, if any, profitable revenue to the firms they had joined.

While attrition in the first two years is, as might be expected, modest, further down the line the proportion of those quitting becomes much higher: the research found a third of partners left the firm they joined after three years, while after five years the percentage jumps to 44%.

What the research did not attempt to look at is to what extent law firms' lateral hiring programmes deliver value.

To investigate this point, the same data set of 1,944 lateral partner hires across five years was used. Six pairs of London

law firms were chosen from among the data. The pairs were chosen on a number of criteria:

- Similar size
- Similar strategy/focus
- Similar geographic location/spread
- Similar Revenues Per Partner (all partners)
- No major mergers during that time
- Differing (in most cases) lateral hiring strategies

The pairs were compared at the 'starting line' – 2006 (financial year 2005-2006) and the 'finish line' – 2010 (financial year 2009-2010).

The purpose of the research was to determine what effect firms' lateral hire programmes might have had on their financial performance during the five-year period.

The research found that firms with a conservative lateral hiring strategy have been more successful than either their more active or minimally-active direct competitors.

Indicative, not definitive – *a caveat to this research*

Law firm development is affected by a multiplicity of factors in which lateral partner hiring is only one. Partners leaving and taking clients with them, clients quitting the firm or being taken over, international offices being added or lost, downward pressure on fees and profitability due to competition and economic factors, all of these can have a significant impact on firms.

However, lateral partner hiring remains the main perceived engine of law firm growth, with practically every large firm in the market having a dedicated programme – if not strategy – to hire partners.

It stands to reason, therefore, that these programmes must be presumed to be having some effect to law firm financials over time, otherwise why do it?

What it is not possible to say is whether firms with fairly static figures over the period have been adversely affected by other factors, that is to say that they have been effectively ‘running to stand still’. Equally, it is not possible to say that firms with a major lateral hire programme which have experienced significant growth in profits and turnover have done so as a result of this lateral hire programme, although this case is perhaps a stronger one.

Thus, these results cannot provide any definitive guide – there are just too many variables. However, what they do show is that similar firms active on similar work and producing similar amounts of revenue per partner but with different lateral hiring and integration strategies have performed differently.

Selecting the comparators

This research only looks at UK firms, and not the other main grouping of firms in London, US firms.

This is primarily because the data for US firms has not been available in the same way as for UK firms, but also because US firms in London are, ultimately, only branch offices of a foreign entity. While many US firms are relatively autonomous in London, the strategic imperative cannot,

in all cases, be said to originate in London, and therefore the lateral hire strategy and development may have other factors which make comparisons invidious.

Nonetheless, finding six pairs of UK law firms with comparable competitive positions was a delicate task, given the sheer number of variables. To choose simply on Profits per Equity Partner (PEP) for instance would have been misleading, as PEP can be manipulated by restricting access to senior equity, among other things; similarly, to look simply at similar turnover would not have reflected aspects of profitability, and so on.

While a basket of factors was compared and contrasted, the key determinant was Revenue Per Partner (RPP), a measure which takes in all partners, whatever their status, and which provides a very levelling baseline. Key to the selection of this criterion was the fact that although the role of partners may vary wildly from firm to firm (and indeed within firms!), and even within the same status band (eg equity), the word ‘partner’ has certain connotations, and implies certain behaviours and responsibilities, even if these may be curtailed in a particular firm compared to another. Partners, whatever their status, are there to win, keep and supervise work.

When a partner seeks to move, and when a law firm seeks to hire a partner, these behaviours, responsibilities and connotations are implicit in the recruitment brief and ever-present in the minds of those assembled, thus removing many of the potential distinctions between partners in one firm and another.

On the recruitment market, firms are competing with other firms of similar ‘punching weight’, and partners will gravitate towards firms of a similar ‘weight’ to their own experience and practice in RPP terms. More often than not, where a partner has a choice, it will be between firms in very similar financial positions.

Therefore the success, or otherwise, of a lateral hire programme will often depend in part on the firm’s ability to persuade a partner in direct competition with a comparable rival.

The research pairings

The research exercise examined six comparative pairs:

Pair 1: Large, City-based international law firms with extensive international networks. Both firms provide a general service to major UK and international clients. The pair had virtually identical turnover, Revenue Per Partner (RPP), Profits Per Equity Partner (PEP) and gross profit margin in 2006.

Pair 2: National firms. This was a more complicated grouping to find direct comparators, surprisingly, given the seeming similarity in strategies. These two are both quality UK national firms relying primarily on UK sources for their fee income. The two had very similar RPP in 2006, although one was somewhat smaller in turnover and size of partnership, and they have radically different lateral hire strategies.

Pair 3: City-based, sector-focused. Both these firms are specialist in a particular broad sector, although both have general service capability and international interests. Both started out in 2006 with very similar financials in some regards – revenue per lawyer, PEP and RPP – but differences in turnover, number of partners and profit margin, with the smaller of the two being superficially the superior financial performer.

Pair 4: City-based, private wealth. These two firms are what one might term City-based ‘independents’, reliant for a large part of their income on private wealth, including private client, trusts, real estate and matrimonial work. Both have international interests to some degree. They started out in 2006 in an almost identical position with regard to size of partnership and PEP, with very similar profit margins, turnover and RPP.

Pair 5: Scottish firms. These two firms are both based in Scotland, with significant London operations. The firms were almost identical in size, turnover and RPP terms in 2006, although PEP was slightly higher in one than the other, and profit margin considerably greater.

Pair 6: Midtown. These last two are quite different firms based in Midtown, between the City and the West End. The firms started off in 2006 looking very similar in many ways, virtually identical in size and with comparable RPP and RPL figures, but radically different in character and approach.

The comparisons

Pair 1: City-based international firms, comparison between 2006 and 2010 figures

(source: *The Lawyer*, UK200)

Firm	Number of partners hired	Attrition rate	Total partners	Annual Turnover	Profit margin	Profits per equity partner	Revenue per partner	Revenue per lawyer
A	26 (12%)	19%	+0%	+10%	-23%	-2%	+11%	-14%
B	20 (10%)	5%	+28%	+32%	+0%	-9%	+4%	+12%

Commentary

These two firms started out in 2006 at a virtually identical revenue per partner (RPP), very similar turnover, partnership size and PEP. Whereas Firm B's revenue per lawyer (RPL) was quite a bit lower than Firm A's in 2006, by 2010 Firm B had closed the gap, showing a large increase in turnover and keeping profit margin steady, although equity partners seem to have taken a bit of a hit in difficult trading conditions.

While the firms' hiring strategies seem to have been similar, Firm B was either picking better or integrating better, for its attrition rate is a quarter of that of Firm A. What appears to be a more conservative strategy all-round, with a continuing emphasis on partners delegating work at Firm B (RPP +4%, RPL +12%) rather than keeping it to themselves at Firm A (RPP +11%, RPL -14%), seems to have paid dividends, albeit at the expense of headline PEP.

Although there is in some respects little to choose between the two, Firm B's more careful hiring strategy seems to have paid off across the five-year period, with the firm now some 20% larger than its rival and having closed the gap on the important measures of RPP and RPL.

Pair 2: UK national firms, comparison between 2006 and 2010 figures

(source: *The Lawyer*, UK200)

Firm	Number of partners hired	Attrition rate	Total partners	Annual Turnover	Profit margin	Profits per equity partner	Revenue per partner	Revenue per lawyer
A	29 (17%)	24%	-4%	+4%	-22%	-10%	+8%	+1%
B	6 (5.5%)	33%	+11%	-5%	-20%	-30%	-15%	-13%

Commentary

These two firms also started out in 2006 with a virtually identical 'punching weight' (RPP), although one was larger than the other in turnover and partner numbers and its PEP was higher, albeit with a lower gross profit margin, indicative of a tighter equity structure.

The two had very different growth strategies across the five-year period. Firm A followed a reasonably substantial lateral hire programme, hiring 29 partners in the five years, while cutting partner numbers overall (what some might call 'upgrading'); Firm B, meanwhile, hired very cautiously – just six in five years – preferring instead to bring partners in at the bottom and not cut existing partner numbers, resulting in an 11% increase in partners by the end of the period.

Both firms, primarily reliant on UK revenue, suffered in difficult trading conditions, with profit margin and PEP down, but Firm A's hiring strategy – despite a 24% fallout rate – seems to have cushioned it somewhat, with marginal improvements in RPP and RPL allowing it to slow its decline in PEP. Its rival, however, suffered badly, with its home-grown talent seemingly unable to generate more work from existing clients or bring in new ones, with resultant double-digit drops in RPP and RPL and a brutal 30% reduction in headline PEP.

Pair 3: City-based, sector-focused, comparison between 2006 and 2010 figures

 (source: *The Lawyer*, UK200)

Firm	Number of partners hired	Attrition rate	Total partners	Annual Turnover	Profit margin	Profits per equity partner	Revenue per partner	Revenue per lawyer
A	39 (44%)	21%	+31%	+35%	-44%	-2%	+5%	-3%
B	14 (11%)	2%	+42%*	+54%*	-17%	+13%	+19%	+7%

*includes mini-merger

Commentary:

From very similar starting positions, these two specialist super-boutiques adopted quite different growth strategies.

Firm A chose a radical strategy of lateral hiring, equivalent to almost half its partnership in new arrivals, with an overall boost to partner numbers of over a third in the five-year period. Firm B seems to have chosen much more carefully, its attrition rate among its fewer lateral hires just a tenth of its rival. Instead, it underwent a mini-merger (not included in the lateral hire figures here), taking in what amounted to several teams, boosting not only turnover and partner numbers, but also – in concert with its lateral hire programme – boosting all its other numbers as well.

Both firms suffered tough trading conditions, but Firm B seems to have weathered them better thanks to what seems like a more conservative, less fluid – and therefore less risky – strategy.

Pair 4: City-based private wealth firms, comparison between 2006 and 2010 figures

 (source: *The Lawyer*, UK200)

Firm	Number of partners hired	Attrition rate	Total partners	Annual Turnover	Profit margin	Profits per equity partner	Revenue per partner	Revenue per lawyer
A	3 (4%)	33%	+5%	+8%	-33%	-22%	+3%	+2%
B	6 (7%)	17%	+18%	+28%	-4%	-15%	+12%	+18%

Commentary:

These two firms also started out in 2006 with very similar figures across the board – turnover, size, profits and PEP, although Firm B's RPP and RPL were higher, indicating perhaps a tighter equity at Firm A and better fundamentals at its rival.

The five-year period has put clear blue water between the two, with Firm B besting its rival on every measure, although both have seen headline PEP reduced.

Both firms have pursued conservative hiring strategies, though the increase in partner numbers at Firm B indicates that either more partners have been made up in the period or fewer lost, or most likely both. From this distance, Firm A's distinctly sluggish performance across the period does not seem to have benefited from the injection of new lateral hire blood, as has benefited other firms. One could conjecture that Firm A has been too conservative or perhaps simply ineffective at persuading the 'right' lateral hires to join.

Pair 5: Scottish firms, comparison between 2006 and 2010 figures

(source: *The Lawyer*, UK200)

Firm	Number of partners hired	Attrition rate	Total partners	Annual Turnover	Profit margin	Profits per equity partner	Revenue per partner	Revenue per lawyer
A	9 (13%)	22%	+30%*	+25%*	-16%	-4%	-6%	+3%
B	15 (21%)	0%	+14%	+13%	+3%	+3%	-1%	-1%

*includes mini-merger

Commentary:

The two Scottish firms in the sample started out in 2006 head-to-head in many respects, with very similar turnover and partnership numbers, broadly comparable in other measures.

Both pursued significant lateral hiring programmes, with Firm A using some of its lateral hiring ‘energy’ to secure a mini-merger, something its rival eschewed, preferring single partners.

Firm B seems to be the clear winner across the period, most notably losing not a single one of the 15 partners hired during the period. However, its performance across five years remains pretty static, with increases in partner numbers and turnover not producing any corresponding increase in the fundamental numbers – RPP, RPL – and PEP only inching up.

However, this conservative strategy is enough to have put a little distance between it and its now larger rival, Firm A, whose fundamentals have gone the other way, with revenue, profit and headline PEP all falling. One might ask, though, whether Firm B is being tough enough on its laterals. It is all very well to lose none, but if they are not bringing any marked financial difference to the firm, should another strategy be pursued?

Pair 6: Midtown firms, comparison between 2006 and 2010 figures

(source: *The Lawyer*, UK200)

Firm	Number of partners hired	Attrition rate	Total partners	Annual Turnover	Profit margin	Profits per equity partner	Revenue per partner	Revenue per lawyer
A	20 (47%)	25%	+27%	+39%	-16%	+9%	+18%	+10%
B	13 (23%)	0%	+15%	+30%	+9%	+26%	+19%	+6%

Commentary:

In some ways this is the most interesting pairing because the two firms are, culturally, chalk and cheese. However, in 2006 they had many very similar financial fundamentals. The only real differences were in the amounts of revenue – and hence profits – being driven through partners. In 2006, the partners at Firm A were getting much more bang for their buck than those at Firm B.

In the intervening period, Firm A adopted a radical lateral hire strategy, taking in 20 partners, equivalent to almost half the original number. Firm B was a lot more conservative. That conservatism extended to selection and integration, with Firm B losing not a single hire in the period, compared to a 25% attrition rate at its comparator firm.

By the end of the period, Firm B has closed the profit gap on Firm A, despite A’s ‘sound and fury’ lateral hire programme, and both headline profits and margin are up, although both firms could be said to have weathered the storm relatively well compared to market norms.

Conclusions

Lateral hiring remains the primary growth strategy of law firms. It is taken as read that hiring partners or teams with the elusive 'client following' is a good thing, but is this right in all cases? It stands to reason that hiring excellent partners with masses of profitable revenue who integrate well and don't force people out of the door is going to be a good thing, but how often is this really happening?

As stated at the beginning of this document, the conclusions to be drawn from the comparison of the data in this exercise are not definitive, but are perhaps illustrative of some patterns to law firm growth strategy.

Some may look at the research and say, "ah well, this is distorted by the recession", but the data is deliberately self-referential, and the pairs of firms started off from very similar if not identical starting positions. Firms are only being judged on their own benchmarks and against their nearest comparator, and what could be a more apt comparison, regardless of economic conditions?

Nonetheless, this is perhaps as much a judgement on firms' reactions to recessionary pressure and overall business strategy as lateral hiring per se. That some firms can put on a PEP increase of 26% in five years, while others see their PEP decline by 30% would suggest some very different responses to tough economic conditions in the latter part of the research period.

This research would seem to indicate that excessive or sloppy lateral hiring (ie having a high attrition rate) can put law firms at a serious disadvantage vis-à-vis their competitors. In all cases, firms with lower attrition rates and generally lower hiring rates have performed better than their nearest rivals.

Equally, being too conservative about hiring leads to sluggish performance. Too much new blood risks washing away what is there already, or diluting the culture; too little, and the firm stagnates, with new, organically-generated partners unable to drive revenue growth.

Partner behaviours are also manifest in the figures. Firms whose Revenue Per Partner (RPP) has increased while

their Revenue Per Lawyer (RPL) has decreased suffer badly in profitability terms, unsurprising as partners would seem to be hoarding work, perhaps redolent of a culture where partners are under severe pressure on personal performance rather than business-building, or perhaps where compensation is too tightly tied-in to partner personal billings.

This will, in turn, impact on lateral hiring. Self-sufficiency is all very well, but in extremis it inveighs against successful integration and can create a firm composed of sole-traders which will inevitably be more volatile – and hence more expensive – to run.

In conclusion, then, it seems the best hiring strategy is the Goldilocks solution: not too hot, not too cool, but just right.

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