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With Less Margin For Error, Profitability Becomes a Growing Focus In Compensation At Midsize Firms

Leaner firms are studying profitability, but they may be using different tools or considering additional factors.

By Andrew Maloney | February 19, 2021



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Just as large firms are increasingly studying profitability to determine attorney pay, midsize and smaller firms are moving in the same direction.

Indeed, some midsize firms may have more of an edge because they have less of a margin for error. For others, they've learned to keep their margins even higher than some Am Law 100 peers.

"Some of these boutique firms, smaller firms, their margins might be 60% or more, which is pretty much unheard of for the Am Law 200-type firms, which look at 40% to 50%," said Jeffrey Lowe, global practice leader for Major, Lindsey & Africa (<https://www.mlaglobal.com/en/>)'s law firm practice, adding smaller firms tend to be "focused more on lower overhead and understanding profitability and how their money is spent."

As The American Lawyer reported last month, firms are looking at profitability when setting and evaluating partner compensation, putting a focus on realization rates, frequency of discounts and the degree of leverage. They are also hiring more staffers (<https://www.law.com/americanlawyer/2021/01/19/push-for-profitability-brings-new-roles-software-to-big-law/>) with business expertise to help them make the calculations

Much as sports have evolved over the last 20 years toward efficiency—with teams utilizing richer and richer data to pinpoint winning plays and accumulating the talent and strategy to maximize them—law firms are moving to maximize profit. Two books of business might bring in \$10 million of revenue, for example. But if one takes more time and people to service, the other might be more profitable, and worth incentivizing.

Smaller, leaner firms are studying profitability too, but they may be using different tools or considering additional factors.

Ron Safer, founding partner of Riley Safer Holmes & Cancila (<https://www.rshc-law.com/>), a firm of about 80 lawyers with offices in Chicago, New York, Michigan and California, said profitability was somewhat of a foreign concept for firms a little less than a decade ago. Unlike other businesses, he said, firms are used to distributing profits at the end of the year and weren't conditioned to think about efficiencies on an ongoing basis.

"But I think law firms have become more sophisticated, compensation systems have become more sophisticated," said Safer, a former managing partner for Schiff Hardin. "And when people are measuring contributions to the law firm, and also analyzing the pricing of matters, analyzing the pricing of clients, you need to consider profitability or you're going to find yourself devoting an enormous amount of resources to

a project or a client where those revenues might not justify that expenditure of costs or that devotion of costs.”

He added that not every decision can be based on profitability alone. Perhaps a firm offered a different rate structure for a new client in order to win their business going forward. Maybe the firm is trying to get new lawyers exposure to a specific area or is tackling a matter that’s in the public’s interest.

“There are many reasons why a matter might not be particularly profitable and still be a tremendous success,” Safer said. But, he added, it’s a long-overdue change that focuses on a firm’s most important metric of financial success.

“You can’t follow it blindly, because there are perverse incentives, But it’s a critically-important metric that, historically, firms didn’t measure,” he said.

Client pressure is one reason firms of all sizes have emphasized profitability over the last decade. Demand has been consistently lackluster since the Great Recession, Michael McKenney, managing director of Citi Private Bank’s Law Firm Group, told The American Lawyer last month. So firms have responded by trying to get smarter and more disciplined.

John Banks, chief operating officer for 250-lawyer Benesch Friedlander Coplan & Aronoff (<https://www.beneschlaw.com/>), said his firm is “definitely” interested in advanced methods to track profitability because their clients “live and breathe off of margin.”

“There are a lot of ways we can control our profitability other than just charging more in terms of rates—how you staff it, who you staff it with. So, we have a whole system in place, and I think that’s certainly been part of us continuing our own profitability increases,” Banks said. “And we use that margin as well when we’re out front pricing.”

Of course, measuring profitability will look different for plaintiff firms that aren’t based on billable hours.

Steven Levin, founder and senior partner at the Chicago personal-injury firm Levin & Perconti (<https://www.levinperconti.com/>), said it’s difficult to track profitability based on contingent fees and without tracking hours.

“Our business will 100% align with the clients, and if the clients get a substantial recovery, we get a substantial fee,” he said. “So we can’t use pure numerical markers.”

For his team, Levin said they keep track of activities—how many complaints each lawyer has filed, how much discovery issued or answered, as well as depositions, for example, and analyze it as a marker of whether lawyers are working efficiently.

He said they also keep track of case-types, such as medical-malpractice or catastrophic injury, what kinds of results they got in those cases, and compare them over different periods of time to see how each attorney stacks up relative to their peers. The firm has built out a database of that kind of information over time, Levin said.

Levin added the firm is seeking new tools to help track productivity measures, adding the firm is working “with others to develop a software that sort of gives us a dashboard approach, looking at all the lawyers and see how they’re doing on these metrics.”

He said at the end of the day, the data metrics are still going to be imperfect.

“Some lawyers may have an incredible ability to settle cases without doing a lot of work. Someone who works really hard may never settle. So, you’ll always have a little more art than science,” Levin said. “But that’s always been the challenge.”