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Study: Law Firms Shouldn't Chase Growth Just to Grow

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Most companies hope that in getting bigger they will become more efficient by, say, spending less time on routine tasks or cutting the cost of producing goods. Not law firms, which—according to Georgetown University Law Center researchers—approach expansion simply as a matter of adding more lawyers billing more hours at the same, or even higher, rates.

The economic dissonance between the legal sector and other industries when it comes to growth is at the heart of a new report from Georgetown Law's Center for the Study of the Legal Profession and Thomson Reuters Peer Monitor, which argues that firms are bulking up for all the wrong reasons—and doing so at their peril. "Growth for growth's sake is not a viable strategy in today's legal market," the report states flatly. Instead, its authors insist, law firms should focus their efforts on "issues that clients care about," such as being more responsive, efficient and cost effective.

The report comes on the heels of what was a record-setting year for law firm mergers in the U.S., according to data compiled by Altman Weil. All told, the legal consultancy tallied 88 announced mergers in 2013, with all but a handful involving larger firms acquiring smaller shops with less than 50 lawyers. Three proposed mergers between pairs of Am Law 200 firms that would have been among the larger deals of the year also sputtered in rapid succession in recent weeks: Orrick, Herrington & Sutcliffe's talks with Pillsbury Winthrop Shaw Pittman; McKenna Long & Aldridge's proposed tie-up with Dentons; and Locke Lord's negotiations with Patton Boggs.

To support its thesis, the Georgetown report cites research showing a low correlation between profits per partner and size within The Am Law 200, a negative relationship between a firm's size and its profits as a percentage of revenue, and the diminishing benefits of scale that accrue once a firm has more than 100 lawyers.

"In our view, much of the growth that has characterized the legal market in recent years … frankly masks a bigger problem—the continuing failure of most firms to focus on strategic issues that are more important for their long-term success than the number of lawyers or offices they may have," the report states.

Milton Regan, a Georgetown Law professor and codirector of the Center for the Study of the Legal Profession, said in an interview that a shift in how in-house legal departments view the firms they hire should be the primary factor firms consider in assessing how big they want to get.

"For a long time, the mantra was, we're growing because clients want to do one-stop shopping," Regan says. "From what you hear, it's now heading in the opposite direction, and there's an unbundling of those services."

Altman Weil principal Ward Bower takes issue with the Georgetown report's premise. Bower says the vast majority of law firms execute mergers for such strategic reasons as expanding the size of a specific practice area or entering a potentially lucrative new market, and not just to get bigger. "When a 300-lawyer firm acquires a 10-lawyer firm, it's not to become a 310-lawyer firm," he says.

"Law firm leaders will criticize other firms, saying they're growing for growth's sake," Bower says. "But if you talk to leaders of firms that have grown rapidly, generally they have a strategic purpose. Many of them believe they've achieved that purpose, like K&L Gates, Reed Smith and DLA Piper."

Law firms have sophisticated ways of tracking the success or failure of their expansion efforts, Bower notes, including analyzing the number of intraoffice referrals generated in the wake of a tie-up. K&L Gates, for instance, reported last year that 27.5 percent of its work in 2012 could be categorized as having originated in one office and performed in another—a proportion the firm said has been rising for the past decade.

Mark Hinderks, managing partner of Stinson Leonard Street—the product of a merger that took effect Jan. 1 between Kansas City, Mo.–based Stinson Morrison Heckler and Minneapolis-based Leonard Street—cautioned against trying to make generalizations about law firm mergers.

"If you look at them just as a matter of increasing scale or size, sometimes the friction associated with putting a merger together can outweigh the benefit," Hinderks says. "In our case, when we looked at [the Leonard Street merger] in specifics, it was a very low-friction merger … with a lot of client opportunities that really give us a much larger upside than just becoming a bigger law firm."

Gary Sasso, the CEO and president of Carlton Fields Jorden Burt, says he agrees with the Georgetown report and that he's deliberately worked to keep his firm small to avoid the additional costs and challenges that come with unbridled expansion. Florida's Carlton Fields finalized a merger Jan. 1 with 70-lawyer, Washington, D.C.–based Jorden Burt, creating a firm with 365 lawyers.

At that size, Sasso's firm falls in the range of what a recent analysis by LexisNexis called firms that are "large enough"—those with between 200 and 500 lawyers. Such firms, according to LexisNexis, have been capturing an increasingly large market share over the years, with the nation's 50 largest firms losing ground in the process.

Sasso says he is content to stay "large enough" for the foreseeable future.

"Over the last six years, we've had more opportunities to grow than you can imagine," he says. "We get approached all the time. We could be many thousands larger if we had taken advantage of the so-called opportunities. I can see how it could be tempting to get into that."

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