Sea Change in the Legal Market

by William D. Henderson
William D. Henderson is a Professor at Indiana University Maurer School of Law, where he directs the Center on the Global Legal Profession. He is also a principal with Lawyer Metrics, which specializes in data analytics within the legal industry.

An analysis of data from the 2002 and 2012 NALP Directory of Legal Employers reveals how much the legal market has changed over the last ten years.

Bill Gates one remarked, "We always overestimate the change that will occur in the next two years and underestimate the change that will occur in the next ten."

Many of us working in the legal industry have ample recent experience with Gates's former point that we overestimate the pace of change over the short term. The collapse of Lehmann Brothers in the fall of 2008 was supposed to be the beginning of the Great Reset where associate salaries would come back down to earth and law firms would adopt more sensible and sustainable hiring models. Although a couple of large law firms adopted apprenticeship models, which traded in high starting pay for better training and client secondments, these innovations failed to spread. The $160,000 payscale, which came into being during the frothy salary wars of 2005 to 2007, also remains largely intact.

Yet, what about Gates's latter point that we tend to underestimate the magnitude of change that will occur over a ten-year period? With the benefit of data from the 2002 and 2012 NALP Directories of Legal Employers, I decided to put this theory to the test.

To set the stage, it is important that we take ourselves back to the mindset we likely had in the early 2000s. In the spring of 2000, the dot-com bubble began to burst, slowing down the white-hot Silicon Valley economy. The next year, the 9/11 terrorist attacks plunged the nation into recession. By the fall of 2002, many of us were expecting the worst to be over. President George W. Bush had just signed Sarbanes-Oxley into law. As a historical matter, new and complex federal regulation has generally been good for the lawyering business. By all counts, it was time to get the legal industry humming again.

The primary advantage of the ten-year retrospective is that it takes our frame of reference beyond the 2008 recession, which enables us to see broader patterns beyond the normal cycles of commerce. Based on my analysis of the data, three distinct patterns emerge.

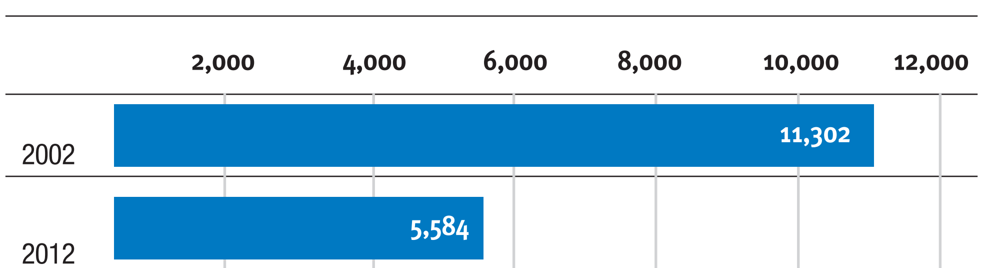
Fewer Law Firms, Less Associate Hiring

In many key respects, the NALP Directory of Legal Employers is a bellwether for the legal economy. Specifically, when a law firm submits its NALP form, it is signaling to the market that it is interested in hiring entry-level legal talent.

Over the last ten years, the number of market participants has shrunk significantly. In 2002, 583 law firms submitted NALP forms on behalf of 1,379 local offices. Based on prior research, we know these figures went to even higher levels (613 law firms and 1,443 branch offices) in 2005. (See Henderson, "Diversity by the Numbers," *NALP Bulletin*, July 2012.) By 2012, however, the number of participating law firms had fallen to 491 law firms representing 1,077 local offices. For the decade, this amounts to a 16% decline in the number of law firms and a 22% drop in branch office participation.

Among those law firms still in the market for entry-level lawyers, the volume of hiring has declined considerably. As shown in **Figure 1**, the number of summer associates at NALP Directory law firms plummeted from 11,302 in 2002 to 5,584 in 2012 — over a 50% decline over the course of the last decade.

Figure 1: Summer Associates at NALP Directory Law Firms 2002 and 2012



On balance, the diminution in associate hiring has had an uneven geographic effect that favors larger law firms operating in larger markets. In 2002, offices in Top 10 Markets (in order, New York, Washington DC, Chicago, San Francisco Bay Area, Los Angeles, Boston, Philadelphia, Houston, Atlanta, and Dallas) comprised 73% of all summer associates in NALP Directory law firms. By 2012, this figure had increased to 81%. Similarly, the proportion of offices belonging to Am Law 200 law firms (a ranking of the top 200 law firms based on gross revenues) increased from 69% to 89%.

A Different Type of Leverage

The decline in the volume of associate hiring appears to be part of a broader restructuring of law firm leverage. One of the primary advantages of NALP Directory data is the reliance on a standard set of titles for classifying lawyers. In addition to associates and partners, NALP tracks counsel/senior attorneys and staff attorneys. Counsel/senior attorney positions are typically taken by experienced, technically sophisticated law firm associates who are transitioning off the partnership track. Staff attorneys, in contrast, are typically hired into a firm on a non-partnership track.

Over the last decade, the relative proportions of these lawyer designations have been in a state of flux. As shown in **Figure 2**, the proportion of partners, counsel/senior attorneys, and staff attorneys has grown significantly, all at the expense of associates. Further, this pattern is evident in both large and small markets.

Although the ranks of partners appear to be growing among NALP Directory law firms, the Directory does not break down partners by equity versus non-equity status. Yet, based on the data from the *National Law Journal*, it is likely that virtually all of the growth in the partnership ranks has occurred within the non-equity tier. Between 2002 and 2012, the number of non-equity partners in NLJ 250 firms increased from 9,700 to 20,700 (+112%). In contrast, during this same period, the number of equity partners increased from 32,900 to 33,400 (+2%). Non-equity partners now comprise 38% of partners at NLJ 250 firms compared to 17% a decade earlier.

The growth of law firm partnerships, primarily through non-equity partners, reflects a new type of leverage that is closely tied to perceptions of value from the firms' corporate clients. In comparison to junior and mid-level associates, partners and counsel/senior attorneys generally have greater technical expertise and thus are perceived as offering greater value, even after adjusting for a higher billing rate. Conversely, staff attorneys may be perceived as a better value for clients because their billing rates are lower than associates'

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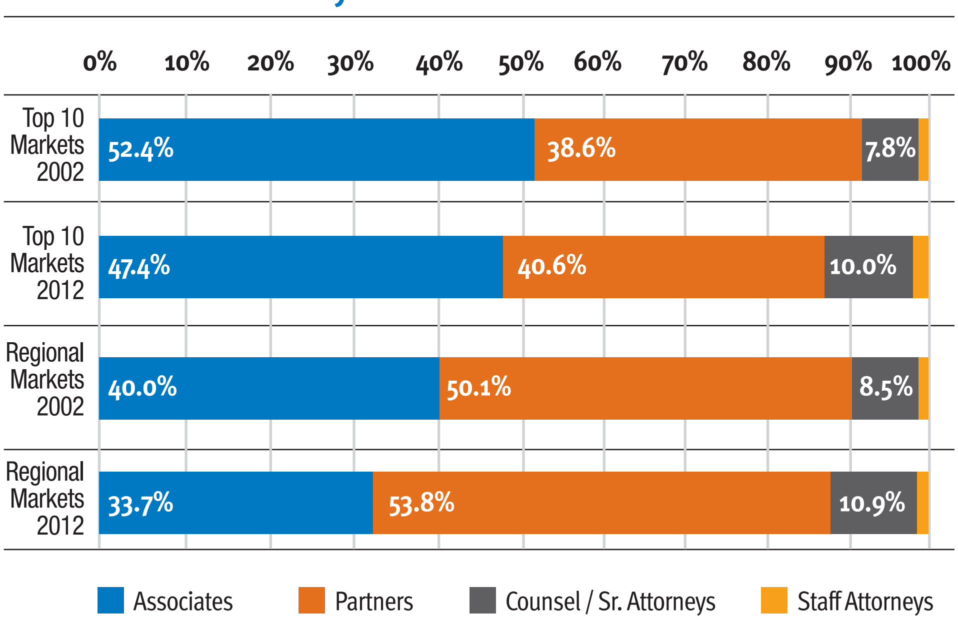
Figure 2: Composition of NALP Directory Law Firms by Title 2002 and 2012



"Our experience over the last decade strongly suggests that the era of growth is over."

and the nature of the work tends to be more routine and lower stakes.

Perhaps a more important trend reflected in Figure 2 is that the lawyers in most large law firms are, on average, getting older. In an effort to maximize short-term profits, this change may make economic sense. Yet the failure to build and augment expertise among the next generation of lawyers is akin to a farmer deciding to eat his seed corn. The long-term implications of this short-term strategy will likely become even more visible over the next ten years.

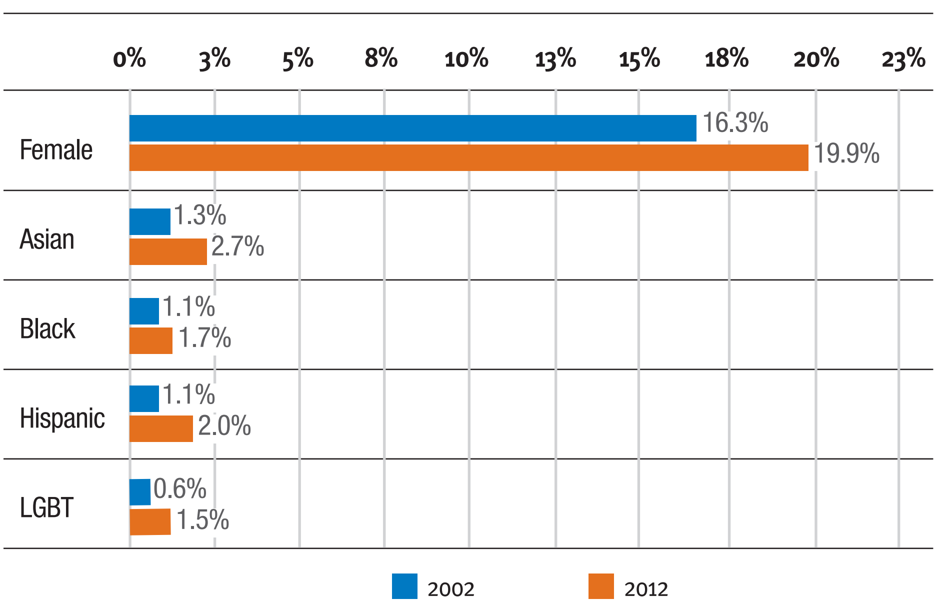
Progress on Diversity but Looming Pipeline Problems

One piece of good news that emerges from this ten-year retrospective is that large law partnerships have become more diverse, albeit the pace of progress remaining stubbornly slow. As show in **Figure 3**, between 2002 and 2012, the percentages of female, Asian, Black, Hispanic, and LGBT partners have all increased.

In terms of percentages, similar gains can be observed at the associate level. Between 2002 and 2012, the percentage of female associates increased from 42.2% to 45.0%; Asians increased from 6.8% to 10.9%; Hispanics increased from 2.9% to 4.0%; and the percentage of LGBT associates went from 1.2% to 2.5%. The percentage of Black associates fell backwards from 4.5% to 4.3%, albeit some of this loss possibly being due to a broadening of NALP's demographics to include a Multiracial category. In 2012, 780 associates were categorized under this designation (2.0% of all associates).

This relatively positive news regarding diversity, however, is tempered by the broader trend of fewer incoming associates. Although virtually all diverse groups made percentage gains over the last decade, the absolute number of diverse associates has declined significantly. The only exception to this trend is a surge among LGBT associates (from 709 to 973), which may be partially explained by changes in cultural norms making it more acceptable to be out in the workplace.

Figure 3: Partner Demographics



Conclusion

For several decades, the large law firm sector enjoyed fairly steady growth, thus creating an aura of permanence and regularity to the law firm hiring cycle. Our experience over the last decade, however, strongly suggests that the era of growth is over. In the years to come, the biggest source of growth is likely to be the ability of one law firm to take market share away from another — and this reflects nothing short of a sea change in the market for corporate legal services. Law firms that successfully rise to this challenge are likely going to be relying upon methods of organization, recruitment, and training that reflect a significant break from past practice.

If the past decade is any guide, we will once again overestimate what will be accomplished in the next two to five years but underestimate what will happen in ten. ■