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ARTICLES

BACK TO THE FUTURE: THE BUYER'S MARKET AND THE NEED FOR LAW FIRM LEADERSHIP, CREATIVITY AND INNOVATION

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This article is the by-product of a larger body of work concerning the elements of lawyer competence. At present that work is reflected in several educational courses and programs and three unpublished manuscripts forthcoming in 1994, The Elements of Lawyer Competence: Their Nature, Acquisition and Utilization, A Preliminary Inquiry into Gender Differences Among Lawyers and Law Students, and Lawyer Professionalism and the Seven Deadly Trends. The author wishes to thank Campbell University, Columbia University, the North Carolina Bar Foundation and the Center for Creative Leadership for their support of his work. For their insights concerning the substance of this article he is grateful to Wes Jones, Jeanne Hill, John Hutchinson, Deborah Rinehart, Joe Quinn, David Campbell, Bill Cobb and Noel Dunivant; his colleagues on the North Carolina Bar Association Task Force on the Quality and Value of Legal Services, its chair, H. Parks Helms, and Professor Rhoda Bryan Billings, who appointed the Task Force during her term as President of the North Carolina Bar Association; and particularly to Richard C. Reed of Seattle, chair of the American Bar Association Law Practice Management Section Alternative Billing Task Force.
buyer's market n (1926): a market in which goods are plentiful, buyers have a wide range of choice, and prices tend to be low—compare seller's market.

seller's market n (1932): a market in which goods are scarce, buyers have a limited range of choice, and prices are high—compare buyer's market.


LEADERSHIP: action that focuses resources to create new opportunities.

DAVID CAMPBELL, IF I'M IN CHARGE HERE WHY IS EVERYBODY LAUGHING? 44 (1980).

I. INTRODUCTION

A current complaint is that the practice of law "isn't as much fun as it used to be." Perhaps the primary reason the practice of law was so much fun in the 1960s and most of the 1970s was that most lawyers had available to them more work than they could do.¹ The country had too few lawyers to facilitate the legal and business events that clients needed to occur in an expanding economy. The existing lawyer base was therefore able to sell its services in a "seller's market".

Today lawyers practice in a "buyer's market". That means lawyers and most of the services they offer are plentiful, buyers have a wide range of choice, and prices should be low. As the market for legal services corrects itself, law firms that are creative, innovative,² and possess good leadership will prosper in comparison with other firms. With stellar leadership³ some law firms

¹. "Competitive markets are not much fun for sellers; the effect of competition is to transform producer surplus into consumer surplus." Richard A. Posner, The Deprofessionalization of Legal Teaching and Scholarship, 91 Mich. L. Rev. 1921, 1922 (1993) (continuing, Posner notes that when lawyers speak of a decline in ethics, they are speaking only of one aspect of legal ethics; the aspect they perceive is primarily the decline in a sense of obligation to courts and non-clients by lawyers, caused in part at least by the enhanced sense of obligation to clients that a competitive market encourages).

². In the firm context, Harry Nyström defines innovation as "radical, discontinuous change" and creativity as "the ability to devise and successfully implement such change". HARRY NYSTRÖM, CREATIVITY AND INNOVATION 1 (1979).

may reinvent themselves\textsuperscript{4} and, when their successful innovations are adopted by others, ultimately reinvent law practice.

Good leaders have three special kinds of knowledge. First, they know themselves and their own strengths and weaknesses. This knowledge allows them to take advantage of their strengths while protecting themselves from their weaknesses. Second, they know other people, both about human nature in general and about the particular people with whom they interact. Knowledge of others' strengths and weaknesses enables leaders to build strong teams and to develop sound strategies to protect their teams against the strengths of adversaries while exploiting their adversaries' weaknesses. Third, leaders must know about the environments in which they are expected to lead. Though I view self-awareness and knowledge of others to be distinguishing characteristics of good lawyers,\textsuperscript{5} the first two kinds of knowledge are not the focus of this article. Its purpose is to provide information about the current environment for law firm leadership, to examine how that environment came about, and to suggest responsive leadership initiatives and contexts for the reinvention of law practice.

I will examine how the legal market and legal profession have changed as they have transitioned from a buyer's to a seller's market and back over the last forty years. The dominant cultural change in the seller's market was the advent of the billable hour, followed by the "tyranny of the time sheet" during the transition back to a buyer's market. If we trace the history of the rise and fall of the seller's market and understand the causes of the current buyer's market, we gain insights into how lawyers have responded, and might best respond, to past, current and projected environments.

\section{Lawyers' Lives and Legal Fees Before 1960: The Nature of the Buyer's Market}

Those who began practice during the Depression and throughout the decade following World War II tell the rest of us that law practice was much different then. Most people tended to

\textsuperscript{4} Reinvention is a current management and organizational development concept. See the discussion and examples in Tracy Goss et al., \textit{The Reinvention Roller Coaster: Risking the Present for a Powerful Future}, HARV. BUS. REV. Nov.-Dec. 1993, at 97.

go to law school not because they expected to make a lot of money but because other aspects of lawyers' lifestyles were pleasing to them: interesting and important work, opportunities for leadership roles, and the ability to make a difference in the lives and institutions of other people.

However, at that time, perhaps a third of graduating law students did not practice law. There being few if any MBA programs available to them, some had pursued legal educations as preparation for business. In their initial years in industry they found at their sides law school classmates who had wanted to practice law. Many of the leaders of the Bar today were unable to find positions in law practice following graduation from law school. They worked in government or business, as insurance adjusters and elsewhere, until they were able to find law firm work or save enough money to open their own practices. Other classmates never entered practice.

When they began practice in the 1930s, '40s, and '50s, lawyers normally charged clients one of four types of fees: a **fixed fee** bargained for in advance, a **contingency fee**, a **percentage fee** based upon a percentage of dollars involved in a transaction (e.g., one percent of the amount involved in a real estate closing) or a **retrospective fee** (one set at the conclusion of a matter based upon the amount of work done and what the lawyer had accomplished). Each of these methods of billing was value-based. Since an ample number of lawyers was available to meet client needs, before selecting their lawyers clients were able to determine the value of services in advance through bargaining, except in the case of the retrospective fee. Even when lawyers set retrospective fees, because they were in a buyer's market, they found their fiduciary duties to clients reinforced by their desire to maintain good relationships with those clients. Clients were scarce, and lawyers wanted to retain their loyalty.

Client relationships were also preserved, and lawyers protected, by minimum fee schedules, the first of which had appeared

6. The estimate of one third is one that recurs in conversations with senior lawyers. They think almost all of their classmates entered law school wanting to practice law.

7. Of course, many clients lacked equal bargaining power with their lawyers. It was inefficient for them to incur information and transaction costs in determining available market prices; interestingly, they were aided somewhat in this effort by the existence of minimum fee schedules, which were subsequently abolished on antitrust grounds. See infra p. 161.
in Massachusetts in 1790. Indeed, at all levels of the profession, from institutional representation of major corporations by larger firms to the varied representations of citizens by the community lawyer, the economic welfare of lawyers was grounded in their establishment of constant relationships with clients. But things began to change in the 1960s.

III. The Seller's Market and Its Impact on Lawyer Population and the Value of Legal Services

Clients began to need more and more services, and more and more people went to law school to help meet those clients' legal needs. We can best visualize the evolving market for legal services by looking at two statistics: gross national product divided by lawyer population and FIRE (finance, insurance, and real estate) employment compared to lawyer population. Figure 1 helps us visualize the first statistic and Figure 2 the second. As Figure 1 shows, in the buyer's market preceding the 1960s, the number of

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lawyers compared to gross national product remained relatively constant, at around $7,000,000 of GNP per lawyer in constant 1987 dollars. As the economy began to expand in the 1960s, much more legal work became available. More people began going to law school to help meet the demand for those services, but the profession kept losing ground to the demand curve until around 1970. As still more people began to aspire to help meet the demand for legal services, law schools uniformly increased enrollments and new law schools opened to meet the demand (see Table I for data representative of what was happening nationally in legal education). As we entered the 1980s lawyer population and GNP appeared to have begun reestablishing a relationship similar to but somewhat below that of the 1950s buyer's market, at around $6,500,000 of GNP per lawyer.

### Table I. North Carolina Law and National Law School Enrollments

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<td>Campbell</td>
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<td></td>
<td>270</td>
<td>298</td>
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<tr>
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<td>562</td>
<td>1,082</td>
<td>2,145</td>
<td>2,271</td>
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All schools in the United States 41,399 59,498 116,150 120,694


### A. "FIRE" Employment and the Need for Lawyers

Perhaps the best indicator of the need for lawyers is the number of people employed in the finance, insurance and real estate industries (FIRE employment). When the economy is robust, banks and insurance companies lend money, businesses and individuals insure against more risks, and real estate transactions are a part of economic growth. As Figure 2 demonstrates, the growth in the number of lawyers parallels the growth in FIRE employment, the number of lawyers appearing to be a variable dependent upon FIRE employment. Over the last 40 years, an average of 9.43 FIRE employees has been supplying work to each
lawyer in the United States. It appears that when each lawyer has more than 9.5 of these employees (or the purchasers of legal services they represent) competing to purchase the lawyer’s services in the national economy, lawyers are in a seller’s market. However, when the competition among clients decreases to around nine FIRE employees per lawyer, a buyer’s market emerges. Figure 1 and Figure 2 are consistent in their depiction of a transition into and back out of a seller’s market from the 1960s to the 1980s. The correlation becomes even more dramatic in Figure 3, where the curve in Figure 1 is compared to a curve representing the ratio of Fire employment per lawyer.

B. Law School Enrollments and Lawyer population

Figure 4 shows the increase of total LL.B. and J.D. law school enrollments since 1946, and Figure 5 shows the actual and projected impact of those enrollments on the national lawyer-population ratio through 2030. In 1950 there were 741 persons per lawyer in the United States; in 1992 there were only 318. Yet because employment was also growing in other areas of the econ-
FIG. 3: MILLIONS OF DOLLARS OF GNP PER LAWYER COMPARED WITH FIRE EMPLOYMENT PER LAWYER: 1946-1991

Source: Campbell University IS-POL-SED.

The perceived "lawyer glut" remained in fact a lawyer shortage throughout most of the 1970s. It appears that lawyer-population ratios are not particularly good indicators of the need for lawyers in the United States. What is important is the extent to which persons need legal assistance in the making and implementing of their plans. The number and complexity of those plans are products primarily of economic activities that are measured in large part by GNP and FIRE employment.

C. The Value Curve

As more legal work became available, more people decided to go to law school. As more lawyers became available, the value of their services declined. This phenomenon is demonstrated by Bill Cobb's "value curve", (see Figure 6) the characteristics of which

10. A basic premise of this article is that the work of lawyers can best be analyzed in the context of law practice as the making and implementing of plans.

are intensified in a buyer’s market. Cobb says that as more work of a particular kind is available for lawyers to do, many lawyers learn to do that kind of work. Because of the large number of competitors in the market, these services become more price-sensitive. Clients feel that any good lawyer can perform the service, and they tend to shop for the best price. Cobb calls these services “Commodity” services and estimates that they constitute 60% of all available legal work. An example of this type of work, and of the dynamics surrounding its decreasing value over time, can be seen in residential real estate closings, the fees for which are very price sensitive.

Cobb refers to work that is more important to the client, but still somewhat routine, as “Brand Name” services. Cobb estimates they constitute 20% of the market. In this instance the client’s shopping culminates in a lawyer or firm being hired because of an institutional reputation for doing a particular kind of work. Because of the work’s importance it has more value to the client, but it is still price sensitive. Real estate development and related compliance work, as compared to the residential real estate closing, is an example of “Brand Name” work.
Cobb refers to clients' high impact and high risk work as "Experiential" services. Because of their importance the client is no longer looking for a brand name firm to handle the work, but for the best possible lawyer, based on that lawyer's experience in handling the particular type of case. An example might be the rezoning application that if unsuccessful will preclude the important real estate development. This work, constituting about 16% of available services in Cobb's model, is much less price sensitive.

Finally, at the top of the value curve is "Unique" or "Bet Your Company" work. An example might be a business workout or reorganization that, if unsuccessful, will put the client out of business. For this work, which Cobb believes constitutes about 4% of the legal work available, price is not a concern.

Obviously, lawyers who charge a flat hourly rate for all work that corresponds to a point on the value curve at the intersection of commodity and brand name work will overprice some and underprice other of their services. Assuming they possess typical competence, their flat hourly rates will exceed the value of commodity work and be less than the value of brand name work. Lawyers who do not develop strategies for delegating work to
lower cost providers or for using substantive systems will lose commodity work to other lawyers or nonlawyers who charge less for the service. Lawyers who do not charge more for time expended doing experiential and unique work, though they may gain market share because of lower prices, may suffer financially if they fail to recover the research and other information costs that are essential in preparing one to deliver rare, differentiated services. Despite these facts we find ourselves in a lawyering culture in which lawyers tend to value each of their hours and services identically, even though their clients obviously do not value their needs for services that way. It is important to define this culture and understand how it arose during the 1970s and '80s.

IV. FLUCTUATIONS IN THE PROFESSION DURING THE SELLER'S MARKET: COST-BASED BILLING SYSTEMS

A. Cost Accounting and the Advent of the Billable Hour

We have said that prior to 1960 lawyers normally charged clients one of four types of value-based fees: fixed, contingent, percentage or retrospective. As the 1960s dawned and lawyers became very busy, they began to adopt tools of business. One of
these methods was cost accounting. By keeping time and comparing time spent with fees charged, firms were able to determine [1] the differing costs of serving clients in different practice areas and [2] the relative profitability of the different areas. The theory was that when firms discovered unprofitable practice areas they could adopt several strategies: [1] increase fees to make the practice area more profitable, [2] develop methods of producing work products more efficiently, thereby making the practice area more profitable without increasing fees for particular products, or [3] abandon the practice area to lower cost providers.

While firms continued to charge value-based contingent and percentage fees in practice areas in which the market had established the value of those services, the timekeeping associated with cost accounting led not to value-based adjustment to fixed fees and fees set retrospectively, but to their replacement by hourly rate fees. Several studies had revealed that the net income of lawyers who kept time substantially exceeded that of lawyers who did not. The time-keeping lawyers were more profitable because they were aware of time expended when setting retrospective fees and used their knowledge of time spent on task to increase their efficiency in earning fixed fees. Nevertheless, a new strategy soon became dominant: to sell time to clients.

Hindsight reveals why it was so easy, and so reasonable, for lawyers to transition to cost-based hourly billing in the '60s and '70s. First, as to ease, lawyers were transitioning into a seller's market in which they had a monopoly, and their clients had little bargaining power. Second, as to reasonableness, business people had to agree that lawyers' arguments in favor of hourly billing made good business sense. Lawyers should insure that they paid their overhead, and they were entitled to a reasonable livelihood. So it made sense that a lawyer should determine overhead, add the amount of money the lawyer wanted to make in the coming year, and divide that sum by the number of hours the lawyer planned to work. The result equaled the lawyer's hourly rate for the coming year. This procedure seemed consistent with the tra-


13. Id.
dition that a lawyer would make a comfortable living while practicing, but would not become wealthy from practice.

In addition, because most lawyers had more work than they could do, clients did not have to worry about monitoring their lawyers. Since lawyers were so busy, they could not afford to "churn" cases to build hours; doing so would prevent them from serving other needy clients and would be a detriment to the firm. Law firms did in fact become more efficient in the 1960s and '70s, not because of cost accounting, but because they had to do so in order to meet the pent-up demand for legal services.

B. Billable Hours, NIPP and the Growth of Law Firms

One way lawyers could become more efficient was to employ persons, such as associates and paralegals, to whom they could delegate work of limited complexity. Fortuitously, partners could not only better meet client needs by growing their firms and delegating work, they could also make a profit from the work of their employees. They could be both capitalists and professionals. Law practice could become a means not only of making a comfortable living, but of acquiring wealth. This could be done through leverage, by purchasing the time of nonpartners at wholesale and providing it to clients at retail prices. As professionals, partners could serve clients personally and make a good living; as capitalists they could sell the labor of others and accumulate wealth.14 Ultimately, the economics of this practice became best explained by an equation for determining net income per partner, the NIPP formula:15

\[
\text{NIPP (net income) = (1+L) \times U \times BR \times R \times M per partner)}
\]

where

- \( L \) = Leverage, the ratio of nonpartner timekeepers to partners
- \( U \) = Utilization, or average hours billed per timekeeper
- \( BR \) = Billing Rate, the average blended hourly rate charged by the firm
- \( R \) = realization rate, the percent of billed hours collected
- \( M \) = Margin, or profit margin, the ratio of net income to gross fees

14. MARC GALANTER & THOMAS PALAY, TOURNAMENT OF LAWYERS: THE TRANSFORMATION OF THE BIG LAW FIRM 20-36 (1991) (dealing with the "Golden Age" of large law firms, the authors demonstrate that the selling of associate's time was not dependent upon the billable hour).

Initially, the seller's market of the 1960s and early '70s seemed to create a win-win situation for lawyers and their clients. By growing their firms, partners could both better serve their clients and make more money by leveraging the time of associates. In the late 1960s growth and leverage were particularly advantageous to partners because associate salaries were so modest. Then, in 1968 the firm of Cravath, Swaine and Moore drastically upped the going Wall Street salary for new associates by one-fourth or better, to $15,000 per year. If firms were in the business of selling the time and talent of associates, Cravath could differentiate itself by acquiring the best associates, and could acquire the best associates by paying differentiated salaries. The talent of those associates would justify higher hourly rates, creating greater net income per partner. Cravath's competitors quickly followed suit, and the subsequent escalation in associate salaries became a nationwide trend that remained unabated until the most recent recession.

The growth of large law firms within a growing profession was a dominant feature of the seller's market, and the growth continued through the 1980s. In 1975 the nation's largest law firm consisted of 326 lawyers, and the largest 100 firms contained only 7144 lawyers, for an average of seventy-one per firm. By 1990 the largest firm had 1519 lawyers, and the largest 100 contained a total of 40,336 lawyers. The largest eight contained more lawyers (7380) than the largest 100 had in 1975 (7144). The 250th largest firm had 131 lawyers. Similar growth patterns were taking place throughout the nation, at all levels of the profession. For instance, in North Carolina the largest firm had only forty-one lawyers in 1975, and the state had only fifteen firms of twelve or more lawyers. These twelve firms had a total of only 300 law-

17. Cravath accelerated the trend again in 1986, increasing first year salaries to $65,000. For two reactions to that increase, see John F. Walker and J. Joseph Bainton, Do Salary Wars Harm the Legal Profession?, 72 A.B.A. J., Oct. 1, 1986, at 50.
19. Id.
20. Id.
21. Id.
yrs, or about five percent of the state’s lawyer population.\textsuperscript{23} By 1992, 2204 of North Carolina’s 9667 private practice lawyers, or twenty-three percent, practiced in offices with twelve or more lawyers.\textsuperscript{24}

\textbf{C. The Late ’70s and Signs of Things to Come: Court Decisions and State Ethics Codes}

Two important U. S. Supreme Court decisions, \textit{Goldfarb v. Virginia State Bar},\textsuperscript{25} and \textit{Bates v. State Bar of Arizona},\textsuperscript{26} had surprisingly different impacts on the hourly billing practices of lawyers. The 1975 \textit{Goldfarb} decision abolished minimum fee schedules (at least those not the product of state action) on antitrust grounds. This decision probably accelerated the then growing practice of hourly billing. Minimum fee schedules in many cases provided ceilings as well as floors on the cost of legal services (in the \textit{Goldfarb} case, thirty-seven lawyers cited the same fee for a loan closing, none lower and none higher).\textsuperscript{27} In the absence of the market information minimum fee schedules had supplied to lawyers and clients, it was easy to justify substituting cost-based hourly billing for the value-based fixed fees contained in minimum fee schedules.

Two years later, however, on the ground of freedom of commercial speech \textit{Bates} invalidated state action that prohibited the fixed fee advertising of routine legal services.\textsuperscript{28} This decision encouraged lawyers to pursue methods of delivering quality work products in less time for fixed fees. \textit{Bates} encouraged systematization, specialization, the use of technology and growth of firms through employment of less expensive non-lawyer personnel to whom routine work could be delegated.

The commercial free speech protection of \textit{Bates} has subsequently been extended to substantially all truthful print advertis-

\textsuperscript{23} Id.
\textsuperscript{25} 421 U.S. 773 (1975).
\textsuperscript{26} 433 U.S. 350 (1977).
\textsuperscript{27} Goldfarb v. Virginia State Bar, 421 U.S. 773, 775 (1975).
\textsuperscript{28} Bates v. State Bar of Ariz., 433 U.S. 350 (1977) (Regulating lawyer advertising by the state as sovereign was held to be immune from antitrust sanction).
ing and to lawyers' solicitation of those expected to need specific legal services through targeted mailing. Political free speech guarantees have been extended to non-coercive in-person solicitation of clients when the lawyer's motivation is political rather than pecuniary. State ethics codes allow in-person solicitation of family members and those with whom lawyers have had "prior professional relationships". As the legal market matured, firms of all sizes began devoting more of their budgets to marketing. Law firm promotional expenditures, exclusive of salaries of in-house personnel and the value of partner time spent in marketing activities, have grown to more than one percent of gross firm revenues. Total costs should ultimately approach or exceed the five percent-plus figure mature professional services industries spend on marketing.

While court decisions have affected the way lawyers charge for their services, the practices of courts in setting and approving lawyers' fees have had an even more profound impact. In the 1970s the "lodestar" method of setting fees was sanctioned by courts. A lodestar was created by multiplying typical hourly rates by the number of hours lawyers worked on cases, and the lodestar was adjusted upward or downward depending upon other factors. This method obviously required contemporaneous time-keeping by attorneys. While adjustments upwards were often allowed in limited practice areas, in others strict hourly billing became commonly utilized. Hourly rates and time records provided courts with administrative tools that appeared objective and were easy to use.

D. The Growth of In-house Counsel

The advent of hourly billing undoubtedly contributed to the growth of in-house counsel. Private firms' utilization of hourly rates was based on an assumption that all of an individual lawyer's time was of equal value, whether spent handling routine cor-

32. ABA MODEL RULES OF PROFESSIONAL CONDUCT Rule 7.3 (as amended 1993); N.C. RULES OF PROFESSIONAL CONDUCT Rule 2.4 (as amended 1989).
respondence or analyzing a novel problem to which the lawyer could apply great expertise. In fact, much legal work for which hourly rates were charged was not complex, was repetitious, and could be handled even more expeditiously if systematized and delegated in part to non-lawyers. Such work was very useful for training new associates, and the cost of training could be passed on to clients. Corporations quickly realized they could reduce their transaction costs by acquiring these services in-house rather than purchasing them from law firms on the open market.35

The growth of in-house counsel stimulated other changes in the legal marketplace. The new corporate counsel possessed both the ability and the motivation to monitor the work of outside counsel, and to bargain over price. Many came to their new corporate positions from management committees of private law firms, and they were wise consumers of legal services. They also came at a time when the profession was beginning its transition back to a buyer's market.

V. THE BEGINNING OF THE BUYER’S MARKET

A. Porter’s Model

For many larger firms the transition back to a buyer’s market was intensified by general counsel taking much of their commodity “cash cow” work in-house. Large firms that had been using routine legal work to train their new associates found themselves with excess capacity when they lost that work to in-house counsel. In order to utilize that capacity firms moved into new practice areas and expanded their practices geographically. Mergers, the opening of branch offices, and marketing of legal services, including explicit efforts to encourage clients to switch counsel, all continued to expand. Competitive Shifts in the Emerging Buyer’s Market

In his widely-used model of competition in the marketplace,36 Michael Porter listed four factors that determine the extent of jockeying for position by existing competitors in a market: the threat of new entrants into the marketplace, the threat of substi-

35. See, R. H. Coase, The Nature of the Firm, ECONOMICA, Nov. 1937, at 386 (explaining the basics of why the growth of in-house counsel was inevitable).
FIG. 7: FORCES DRIVING INDUSTRY COMPETITION

POTENTIAL ENTRANTS

Threat of new entrants

Bargaining power of suppliers

SUPPLIERS

INDUSTRY COMPETITORS

Bargaining power of buyers

BUYERS

Rivalry Among Existing Firms

Threat of substitute products or services

SUBSTITUTES

Forces Driving Industry Competition


... constitute services, the bargaining power of customers, and the bargaining power of suppliers.

i. Threat of new entrants. For the legal profession threats of new entrants included out-of-town and out-of-state firms interested in establishing branch offices, strategic mergers between existing firms, the continuing large number of new law graduates, and the expanded staffs of in-house corporate counsel.

ii. Bargaining power of clients. In-house counsel were new entrants competing for commodity and brand-name work. They were also clients with increased bargaining power. Perhaps the best indicator of the shift of bargaining power from attorney to client was the near universal decision of in-house counsel in the 1980s to seek transactional rather than general assistance with matters requiring outside assistance. This trend was described as a decision to hire the best lawyer for a particular matter rather...
than the best firm for general representation. The best lawyer was not necessarily the most expensive. Assistance was required for matters falling within all segments of the value curve: commodity, brand name, experiential, and unique. In many instances the “best lawyer” was the lawyer who could deliver the work product least expensively; in others it was the lawyer who could deliver the product fastest or best communicate with in-house counsel. But in each of these situations in-house counsel considered it economically efficient to incur transaction and information costs in establishing new relationships with outside counsel rather than continuing to rely on a single firm or a few firms for outside assistance.\(^{37}\)

Likewise, small businesses, larger businesses without in-house counsel, and individuals were finding it advantageous to shop for lawyers. They had been taken for granted in the seller’s market and were sometimes surprised\(^{38}\) to receive from their “regular firm” time-based bills following brief telephone calls for information. Lawyers who advertised, solicited, and utilized other marketing devices found many of these unhappy clients receptive to the idea of switching lawyers.

iii. **Threat of substitute services.** The threat of substitute services had been strengthened by the decisions of lawyers to abandon less profitable practice areas, such as tax return preparation, residential real estate, and estate planning. Much of this work was abandoned not to other lawyers but to accountants, title insurance companies, banks and insurance companies. Paralegals, whose time had been sold by law firms, began to see opportunities to sell their time at closer to retail prices by offering services to firms that needed paralegal services on a non-routine basis, or directly to clients.\(^{39}\)

iv. **Bargaining power of suppliers.** Finally, there emerged what appeared to be a counterintuitive result with respect to the bargaining power of suppliers, to the extent that suppliers of the

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37. The bargaining power of in-house counsel, combined with down-sizing of in-house offices so that general counsel now has less time to seek out the best lawyer for each matter, have led to a return to the in-house strategy of relying upon a limited number of firms for outside representation. Larry Smith, *Midsize Strategies, Of Counsel*, Jan. 17, 1994, at 2.

38. Because they had neither been asked nor forewarned.

time and talent being sold by law firms were law schools and their new graduates. There appearing to be a lawyer glut, or oversupply of lawyers, one would have assumed that demand would have adjusted to supply and that beginning associate salaries would decrease. They did not. Figure 8 shows the reason why. At the 1988 Graylyn Conference sponsored by The North Carolina State Bar, representatives of 17 of the state’s largest firms predicted for their firms an average annual growth rate of 10.5% for the next five years.\footnote{F. Leary Davis, Demographic, Economic and Structural Factors, The Graylyn Conference 26 (1988) (on file with The North Carolina State Bar).} That rate matched the general rate of growth of law firms for the preceding decade.\footnote{See figure 9 infra p. 168.} When the rates of growth were matched against the supply of new lawyers passing July bar examinations, it was discovered that the relative supply of new law graduates was actually declining rather than increasing. While in 1975 the 15 North Carolina firms of over 12 lawyers had to hire only 30 of 440 lawyers passing the 1976 bar examination to experience 10% growth, in 1986 the 45 firms of that size had to employ 130 of 410 graduates to experience the same growth. If firm growth and bar passage rates continued, those 45 firms would be expected to hire half of the successful July bar examinees by 1993. In fact, the growth of those 45 firms slowed (though the growth of other firms was such that by 1992 the total number of lawyers in firms of 12 or more equaled the 1986 projections for 1993), and over 500 persons passed the July 1993 bar exam. Large law firm growth halted abruptly in the early 1990s, as Figure 9 illustrates. Despite the decline in the rate of law firm growth, the salaries of new associates has remained high,\footnote{Kenneth Rutman, Salaries Holding Steady, Nat’l L. J., Sept. 27, 1993 at S3.} so high that associates are perceived to be only marginally profitable to the firms employing them.

As law firms have continued to grow, the bargaining power of their suppliers has remained strong. Many of their suppliers, such as landlords and vendors of technology, also sell to other markets, and their bargaining power is affected as much or more by national and regional economies as by the legal marketplace.

B. Rising Overhead and the Profit Squeeze

Because the bargaining power of their suppliers was great, law firms saw their overhead continue to rise. Because the bar-
VI. FLUCTUATIONS IN THE PROFESSION DURING RE-ENTRY TO THE BUYER’S MARKET: THE THREE WAVES

Lawyers' adjustments to the buyer's market can be observed to unfold incrementally in three stages, or waves. Today, most firms may be found at different stages in the adjustment process. The three stages are:

1. Attempts to capitalize on aspects of hourly rate cultures by paying close attention to elements of the NIPP formula as the buyer's market evolves
2. Attempts to change billing systems to capture premiums for added value while retaining cost-based protection, and
3. Changing the culture of law practice to be compatible with a buyer's market and with the traditions of the legal profession.
In hindsight, it can be seen that the stages have unfolded naturally, like a series of experiments. Each was built upon the lessons of experience learned in the stages that preceded it. Law firms kept what worked, discarded or modified what was not working, and tried new strategies and tactics.

A. The First Wave: Incremental Tactical Adjustments to the NIPP Formula

The profession’s initial adjustments to the evolving buyer’s market did not address fundamental problems inherent in hourly billing. The change to a buyer’s market was so gradual that it was difficult to perceive. Periodic recessions made it difficult to distinguish a basic transformation of the market from temporary disturbances of the economy. Consequently, it did not appear that the system of hourly billing was broken. Even today, in the absence of longitudinal FIRE and GNP/attorney population data, it might appear that problems of lawyers who bill by the hour will end with
the beginning of a robust recovery from the last recession. Since it did not appear that the system was broken, there was no need to fix the system itself. However, lawyers did find it necessary to modify behavior to minimize the profit squeeze.

The primary tool with which firms addressed the profit squeeze was strategic planning, the formulation of goals that flowed from the matching of firms' internal strengths and weaknesses against opportunities and threats in the external environment. However, to the extent that the firms doing the planning continued to sell time, their plans were more tactical than strategic. These firms continued to view the strengths, weaknesses, opportunities and threats they confronted within the context of the NIPP formula. The First Wave tactics they adopted can best be categorized within the same context.

i. Increased Marketing

The two crucial elements in the NIPP formula are leverage and utilization (hours worked). As professionals selling their own time, it was important that lawyers have clients for whom they could work, and that they spend considerable hours doing that work. As capitalists selling the time of others, it was important that partners have available other timekeepers whose fixed expenses were less than the income generated from the sale of their time. It was natural, then, that firms' strategic plans began to focus on marketing and upon the efficient utilization of their personnel.

ii. Lateral Hires Instead of Mergers

With respect to utilization, firms asked themselves what they could do to get their billable hours up. One solution was to change strategies with respect to the acquisition of new partners. Mergers flourished in the seller's market when firms had more work than they could do. These busy firms needed the excess capacity of less busy firms. In the buyer's market, many firms had too little rather than too much work. They began looking for the individual lawyer who could bring to the firm a portfolio of clients to whose work they could allocate their excess capacity. So the strategy of "cherry picking," acquiring the most attractive indi-

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individual lawyers from another firm, replaced the strategy of merging with the entire firm.

iii. Modified Compensation Systems

Since firms wanted to motivate lawyers to bill lots of hours and to bring in work for which other lawyers could bill lots of hours, they replaced their lock-step and fixed percentage partner compensation plans with plans that rewarded lawyers for origination and production of work. These "Os and Ps" compensation plans were based on formulas that rewarded lawyers for originating new work and for producing billable hours by working on cases. Firms are driven by their compensation plans, and firm cultures began to change to reflect their new compensation systems. Firms that rewarded origination more than production found their lawyers more interested in getting work than doing it, and vice versa.

iv. Short-term Focus on Billable Hours

Other individual and firm tactics to enhance utilization were consistent with the new firm culture. Minimum billable hour requirements for associates drove their utilization. They and their partners desired that they specialize earlier in their careers. By training associates quickly in a narrow specialty and immediately putting them to work in that specialty, partners maximized their short- and intermediate-term utilization. Less training for associates was a tactic that fitted well with a second tactic: Requirements of more billable hours from partners. If the partners were going to be busier originating clients and producing work themselves, they would not have time to train associates. The fact that both partners and associates were focusing on their billable hours meant decreased pro bono work from firms that billed by the hour. Associates and partners alike were beginning to pay a great price for their financial compensation in terms of decreased quality of life. 44

v. Modifications to Enhance Leverage

During the seller's market, law firm growth was fueled by high beginning salaries for associates. In the buyer's market,

firms had to ask themselves if they could continue to pay those high salaries and the other overhead that accompanied them. The concept of leverage in the NIPP formula began to be questioned but not abandoned. Firms asked themselves what tactics they could adopt to maintain a satisfactory ratio of associates or other fixed overhead timekeepers from whom they got sufficient utilization to justify the entrepreneurial risks of the firm’s equity partners. In the seller’s market the tactic was merely to employ more new associates as older associates became partners. In the buyer’s market, when fewer new associates were being hired, one tactic to maintain leverage was to increase the number of years in the partnership track before promotion to partner. Another was to initiate multiple-tier partnerships. Salaried partners could be leveraged as easily as could associates. Finally, satisfactory ratios could be created as easily by decreasing the number of partners as by increasing the number of associates. Many firms expelled partners or encouraged them to retire earlier than they formerly planned. Cherry picking of partners with portfolios of business that could be performed by associates, of course, could enhance a firm’s leverage as well as its utilization.

vi. Billing Techniques

Billing rates are naturally the most difficult element of the NIPP formula to adjust upward in a buyer’s market. The utilization of blended rates, with the client’s permission, allowed firms to raise the rates of paralegals and junior lawyers in exchange for a reduction of the normal hourly rates of senior partners to the uniform blended rate. Billing conventions, such as the convention of not recording increments of less than .1 or .25 of an hour, or that of recording the greater of the actual time spent or .2 of an hour on each telephone call, do not have the effect of raising the actual billing rate. In application, however, they raise the effective hourly rate. If agreed to by the client, billing conventions are an acceptable tactic. Without client consent, they are equivalent to the padding of time. The most reasonable tactic was the adoption of differentiated rates, in which a lawyer would charge a low hourly rate for time spent on commodity work and a high hourly rate for experiential work.

vii. Management Initiatives

Tactics adopted to improve realization address the issue of how firms can collect for as much of the work they do as possible.
These tactics, including **improved timekeeping and billing procedures, improved letters of engagement and disengagement, and appropriate utilization of technology**, benefitted both firms and their clients.

**viii. Reducing Overhead**

Finally, some tactics designed to improve the **margin** were counterproductive, making the firm less competitive in the buyer's market. Others made sense, such as holding the line or decreasing starting salaries of associates. Most firms also had **clients pay more of the overhead of their cases**. They did this by passing on such expenses as telephone calls or photocopying to the client, or even by establishing profit centers within the firm for activities such as photocopying.

**B. The Second Wave: Attempts to Change the Method of Billing Without Changing the Product**

First wave tactics were helpful in eliminating inefficiencies in practice, in motivating firms to articulate their goals, and in getting firms to focus more on their clients. However, because they focused on the elements of the NIPP formula: leverage, utilization, billing rates, realization, and margin, they could be of only limited effectiveness in overcoming the profit squeeze in a buyer's market. **Leverage** had become unattractive because of the marginal profitability of associates resulting from their high salaries and the scarcity of work for them to do. Even when work is available, there exists a practical upper limit on **utilization** somewhere in the neighborhood of 2,000 billable hours per year, and the pressure on that figure is downward because of increased management and marketing responsibilities of all lawyers in a buyer's market. It is inherent that **billing rate** increases meet price resistance in a buyer's market, at least for commodity and brand name services. One-time enhancements of **realization** can be realized by better timekeeping and more prompt billing, but there exist few ethical ways to realize more than 100% of one's time.45 Finally, attempts to increase profit **margin** by decreasing overhead are likely to be counterproductive, decreasing the firm's ability to deliver quality legal services in a timely manner.

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45. Billing conventions agreed to in advance by clients, see supra text at p. 171, constitute one such way.
The second wave was brief, stimulated by the realization that the sale of time was no longer working for lawyers or their clients. It involved the natural, incremental attempt to change the way lawyers got paid without changing the way they practiced law. Symbolic of the second wave was the concept of PREMIUM BILLING (not VALUE billing, though that is what its proponents called it). Essentially, large firm lawyers wanted to bargain in advance for bonuses in the event they were able to obtain superior results, which seems like value billing. However, the in-house counsel who refused to contract with outside lawyers on that basis pointed out that the outside lawyers were unwilling to reduce their fees if they got inferior results. That refusal seems inconsistent with value billing.

Hourly billing, blended rates, premium billing, and billing conventions that produced unit fees for such events as telephone calls were all cost-based billing methods. These methods assured lawyers that they could pay their overhead and make a comfortable living if they had enough work to do. The second wave led to a lot of thinking and talking about alternative billing methods, most of it ably led by Richard Reed of Seattle. This discussion centered around the tendency of cost-based billing systems to reward ineptitude and punish efficiency and innovation. It helped accelerate the swing of the pendulum back toward traditional value-based fees (fixed, contingent, and percentage, if not retrospective).

As the pendulum swung lawyers found that clients who had rejected pure premium billing were willing to accept hybrid billing systems, which lay somewhere between cost-based and pure value-based billing systems. Hybrid systems rewarded lawyers for assuming the risk of absorbing uncompensated advance information costs or of obtaining an undesirable result. Examples of hybrid systems include the true non-refundable retainer paid for taking a case in which information costs have previously been assumed, plus an hourly rate for work done subsequent to the retainer. Another hybrid system includes the hourly rate plus a fixed documentation, research and development or systems fee. The systems or documentation fee compensates the attorney for

information and development costs previously incurred in designing a substantive system utilized to produce a standard document in minimal time.

Finally, risk-sharing relationships were developed for hourly rates plus contingencies that overcame the objections to pure premium billing. In exchange for a premium for very good results, lawyers agreed to charge less than their normal hourly rates in uncertain cases. In all of these instances, the lawyer in some manner shares risks with the client. In the two-step methods (documentation or systems fees followed by hourly rates), the lawyer shares the risk in advance by incurring information costs that might never be recovered, but which might allow the lawyer to meet future clients' needs in minimum time. In the hourly rate plus contingency situation, the lawyer shares the risk of a bad result by charging less than the normal hourly rate given the work's position on the value curve. The market therefore limits premium billing (a contingent fee added to a lawyer's normal hourly rate) to situations in which the client's demand is for price-insensitive unique or experiential services. Incremental Second Wave thought and hybrid billing tactics prepared a foundation for more dramatic Third Wave change.

C. The Third Wave: Back to the Future by Reestablishing Relationships with Clients and Forward by Creating New Frameworks for Practice

The First Wave provided focus and introduced realism to law practice. It compelled lawyers to begin to think strategically, though for the most part their strategic thinking remained confined within the framework of a billable hour structure. The attempts of firms to modify their behavior in ways that maximized elements of the NIPP formula were a series of incremental experiments in a complex environment. As such they allowed the profession to "muddle through" as it began to ascertain that it was indeed entering a buyer's market.

The Second Wave caused lawyers to think about what they did for clients, and how they charged them for those services. It provided a prelude to a Third Wave which is still in its formative stage. If the Second Wave was symbolized by an attempt at pre-

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mium billing, the genesis of the Third Wave was symbolized by the Total Quality Management movement, particularly its client-centeredness and its call for changes in law firm culture. While the Third Wave is informed by the pre-1960s buyer's market and lawyering environment, its movement is relentlessly forward into the next century.

Out of necessity that movement is likely to be accelerated by innovation, "radical, discontinuous change". The lawyer glut, the expansion of technology and information, internationalization of law practice, rising overhead, the tyranny of the timesheet, the fragmentation of the bar, and the declining quality of professional life provide powerful stimuli to creativity and change. The profession knows what it wants to move away from. As it defines what it wants to move toward, the ultimate product of the Third Wave may be a radically reengineered, if not reinvented, legal profession.

The thinking of lawyers has evolved from a focus on their needs in the First Wave, through a rethinking of what they do and how they charge for it in the Second Wave, to a focus on the needs of clients in the Third Wave. Clients insist on this focus. When clients bargain for fixed, contingent, or percentage fees in a buyer's market, they are quite explicit about what they are and are not paying for. They are not paying for time, at least not in the sense of billable hours, of minutes or multiples of minutes. They desire certain events to occur, and they consider themselves to be paying for those events. The events may be closings of transactions or trials of cases, or they may be decisions — decisions that lead clients to pursue or refrain from certain courses of action. Clients use lawyers to make these events happen because they lack the requisite information and skills to make the events happen by themselves, or if they possess the requisite knowledge and skill, because it remains economically efficient to utilize lawyers.

49. HARRY NYSTRÖM, CREATIVITY AND INNOVATION 1 (1979).
51. Time may also be defined as some time management experts define it: as a series of ordered events, so that in managing time we are really managing the occurrence of a series of events. The concept of time as events is congruent with Einstein's theory of relativity. See generally CHARLES R. HORBS, TIME POWER (Day-timers Concepts 1983) (recording with accompanying publication).
Lawyers, then, help clients make and implement plans they cannot make, or find it economically inefficient to make and implement, by themselves. By thinking of lawyers' work in the contexts of planning and leadership, one can develop frameworks for reinvention of the profession. Leaders focus resources to create desirable opportunities. Leaders, lawyers and other planners use seven categories of resources in making and implementing plans. They are time, talent, commitment, capital, facilities, information and positioning. As clients make and implement

52. Some aspects of the seven categories of resources are self-evident but nevertheless worth summarizing.

1. TIME. Time as a resource can be neither created nor destroyed. It merely provides a context or frame within which one can cause a series of events to occur. If it is not utilized for that purpose, the particular frame is gone forever. Time cannot be transferred from one person to another, but by working on projects together individuals can create large numbers of events as teams.

2. TALENT. Talent is the ability to do. It consists of knowledge and skill, plus the personal attributes that allow one to translate one's knowledge and skill into competent representation. Talent can be created. The more it is used, the more it grows. If talent is not used it will atrophy.

3. COMMITMENT. Commitment is what causes people to use their talent. Like talent, commitment must be utilized or it will disappear. But unlike talent, even when commitment is utilized it will deteriorate if its utilization is not reinforced at least intermittently by some positive response.

4. CASH AND OTHER CONSUMABLE OBJECTS. Cash can be traded for other resources, or wasted. Either way, once it is used, it is gone, just as are stationery, envelopes and other consumable supplies for which cash might be exchanged.

5. FACILITIES AND OTHER NON-CONSUMABLE OBJECTS. To implement plans, one needs housing and hardware. If a firm aggregates individuals to build resources of time and talent, the firm must house them and have equipment with which they can work.

6. INFORMATION. Information used to be considered a subset of talent. Today information can be separated easily from personality, whether on computer disk, substantive system, or otherwise. Information can be leveraged. If it is marshalled into a substantive or procedural system, it can cause a series of events to occur in much less time than a talented individual without ordered information can make them occur. Information other lawyers do not have is very valuable, particularly in the form of a system. Information tends to become less valuable as others acquire and systematize it.

7. POSITIONING. Positioning is other peoples' perception of what one can do, not necessarily what one can in fact do. Creating this perception has a lot to do with trustworthiness and with integrity, the idea that one will do what one says one will do, and that if for any reason one is unable to do what one says, one will inform others so that they may protect themselves. Positioning relates to the ability of lawyers in firms to approach, to be listened to, and to be believed by other lawyers, judges, potential witnesses, and the parties to proceedings and
their plans, they are most concerned about the timeliness and the quality of the events that lawyers help them facilitate. So value is a function of time and quality in the delivery of legal services. In any representation of clients' plans we can expect time to be inversely proportional and quality to be directly proportional to the quantity of the six planning resources other than time and to the harmony of their interplay.

The concept can be illustrated by depicting the resource of time as a frame in which the other resources are displayed:

<table>
<thead>
<tr>
<th>TIME</th>
<th>CAPITAL</th>
<th>TALENT</th>
<th>INFORMATION</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>FACILITIES</td>
<td>COMMITMENT</td>
<td>POSITIONING</td>
</tr>
</tbody>
</table>

The more of the other resources a firm possesses and the better coordinated their utilization, the smaller the time frame required for the firm's lawyers to cause events to occur for clients.

Readily apparent characteristics of the seven resources are narrated in footnote 52, supra. It is useful to think about other aspects of their interplay. For instance, while specialized information is the resource around which the profession is built, information in the sense of raw data is not valuable in itself. It is the processing of information that makes it valuable. Both the speed and the quality of information processing within a firm are dependent upon the firm's facilities and the talent of its personnel. They are what translate information into decision-events. The conversion of information into work products will allow lawyers to remain both professionals and capitalists even if their ability to leverage associate's time disappears. As capitalists and as professionals, lawyers should remain aware that information loses value as it becomes readily available in the marketplace, that information-based experiential services can quickly become commodity services, and that the continuous creation of new information is necessary to retain positioning on the value curve.

The importance of positioning cannot be overemphasized. It is what motivates clients to come to lawyers for the differentiated and more expensive legal services that fall into the experiential and unique categories on the value curve. As the perception of others, positioning represents what people think a lawyer will do transactions. Leary Davis, The Elements of Lawyer Competence: Their Nature, Acquisition, and Utilization, (forthcoming 1994) (manuscript on file with author).
based upon pre-conceived ideas before the lawyer is retained. But thereafter the perception of the client is informed by experience. There exists a feedback loop between talent and positioning, and the perception of clients will be strengthened or weakened depending upon the lawyer's application of talent both in the rendering of legal services and in communicating with the client about the representation. In turn, the utilization of talent for those ends will depend upon the lawyer's commitment and the information and information-processing facilities available to the lawyer.

Commitment is the resource that is most imperiled in a billable hour culture that encourages lawyers to work physically taxing hours to meet unreasonable billable hour goals. At one level the billable hour culture is adverse to commitment to the goals of the client; it penalizes efficiency. The less time a lawyer takes to cause events for the client within the culture, the less money the lawyer makes. At a second level the billable hour culture encourages and even rewards overcommitment. Firms need many clients and cases to be assured their lawyers can work and charge for long hours. Yet the overcommitted lawyer becomes committed to no one. No single client is able to access the talent of the overcommitted lawyer, except at the expense of other clients. Information that would ordinarily be accessible to the lawyer becomes inaccessible because of cognitive distress and competing demands and distractions. The brief period of relaxation that falls between the incubation and illumination phases of the creative process is unavailable to the lawyer when the truly creative solution is needed by the client. Finally, if lawyers are overcommitted they cannot do for clients what they have said they will do; as a result they lose their trustworthiness and their positioning.

Because of the interrelationships of planning resources, focusing them to create desirable opportunities is often complex. These interrelationships may be most readily apparent in small and mid-sized firms. Such firms certainly find it easier than do megafirms quickly to focus resources to solve problems and take advantage of opportunities. It is in these firms that we should expect to observe the first of the Third Wave innovations.

**D. Examples of Leadership in Law Firms**

R. Steve Bowden of the Greensboro firm of Bowden and Associates has reinvented the practice of law for himself, his staff and his clients. He describes a reengineering of his plaintiffs personal
injury practice that allows his firm to deliver higher quality services faster through the leveraging of information and the organization and development of firm talent through training and teambuilding. Improved performance and communication with clients and other decision-makers has enhanced his positioning. Key to the firm’s success have been two strategies that run counter to the current industry and law firm tactics of specialization and downsizing. With respect to specialization, Carlyn Bowden, the firm’s administrator, has restructured the work of the firm’s non-lawyer personnel. Previously, each employee performed discrete, specialized tasks as cases proceeded through stages of representation. Files moved from station to station throughout the office. After restructuring, a single employee is responsible for all aspects of a client’s case, from opening of a file to its closing. With respect to downsizing, she has also determined the number of cases each employee, and therefore the total firm, should be able to handle comfortably. Whenever that number is attained, the firm hires and trains a new employee. This tactic ensures the firm’s support staff will always have excess capacity. As a member of a team which includes the client and the responsible attorney, each employee has client contact and assumes many routine client communication tasks previously performed by lawyers.

The key to the success of the Bowden firm is leadership, as David Campbell defines it: “Actions that focus resources to create desirable opportunities.” (emphasis added) Since clients want lawyers to make high quality, high value events occur for them quickly, the key to success for law firms will be the resources they possess. The key to the sound acquisition and deployment of those resources is leadership. As the Bowden case demonstrates, the


54. From firm and client perspectives, performance of these tasks by lawyers was usually suboptimal within the time frame of the resource matrix.

55. Bowden, as a personal injury plaintiffs lawyer, charges contingent fees and is rewarded for increases in efficiency. The fact that most solutions to clients problems are being generated by such lawyers is reminiscent of the six phases of a project, hourly billing being a project: (1) enthusiasm, (2) disillusionment, (3) panic, (4) the search for the guilty, (5) the punishment of the innocent, and (6) praise and honor for the nonparticipants.

resource matrix can be a valuable tool in explaining and predicting the degree of a firm's relative success. When lawyers set fees retroactively, the matrix can serve as a guide in determining what a fair retrospective fee will be. Just as cost-accounting provided a valuable tool in justifying hourly rates to clients in a seller's market, in a buyer's market the matrix is a valuable tool in justifying to clients in advance the value of fixed, contingent, percentage and hybrid fees. In conjunction with other models relating to the structure of work it can also be used as a device to test the reasonableness of hourly rates in a particular case.

The matrix also provides a valuable supplementary planning tool for lawyers. They need merely ask which resources of time, talent, commitment, information, positioning, capital and facilities they possess; which of them they need; and how they can best acquire and utilize those resources in the service of clients. The matrix leads to the asking of broad, general strategic questions. It will not eliminate the need for something like the NIPP or other algebraic formulas that report what happens quantitatively in law firms. The resource matrix helps the firm develop a vision of the resources the firm needs and of the goals for which it should strive. The NIPP formula measures some ways resources are utilized in service of the firm's goals; it is a management tool.

But vision and management are only two tasks of leadership. David Campbell lists seven, modified for law firms as follows:

- Vision, to clarify the general overall goals of the firm, determining where it is going.
- Management, to focus resources on these goals.

57. Bowden ordered information differently within the firm, acquired facilities and trained new talent to process that information, ensured commitment, and enhanced positioning by communicating with clients as team members, then performing well in less time.


59. The matrix was initially designed to illustrate that fees charged by counsel for the debtor in possession in a bankruptcy reorganization were reasonable. F. Leary Davis, Justifying the Hourly Rate, or What Lawyers Sell Instead of Time, 1990 Eastern Bankruptcy Institute L-1.


LAw FIRM LEADERSHIP

Empowerment, to select and develop team members able and committed to achieving these goals.

Politics, to forge coalitions with peers, superiors, subordinates and important outside decision makers.

Feedback, to listen carefully to clients and other relevant persons and publics.

Entrepreneurship, to find future opportunities for the firm.

Personal Style, by personal example, to set an overall tone of integrity, competence and optimism for the firm.

The 30-lawyer Raleigh firm of Smith, Debnam, Hibbert & Pahl brought into play each of the seven tasks in a situation described by managing partner Thurston Debnam. The firm has a substantial commercial collection practice. During the seller's market it had focused resources of information, facilities, talent and commitment to resolve clients' collection efforts quickly and successfully, utilizing substantive systems and charging percentage fees. In the process it developed software now utilized by the Commercial Law League and law firms across the United States. During the recent recession many of its clients began downsizing. After downsizing, some clients had too few employees to analyze adequately accounts and forward them to law firms for collection. The firm subsequently lost a stream of income. So did the clients. Because they failed to collect the accounts they were previously able to forward, they had to downsize further, and a vicious cycle began. The firm broke the cycle by suggesting that it send its personnel to the clients' offices to analyze accounts for them. The firm's fee for performing the formerly in-house tasks of their clients was an additional percentage of accounts collected. This win-win situation resulted in larger fees for the firm and added value to the client.

E. Creativity in Law Practice

Herbert A. Simon has stated that problem solving can be considered creative under any of the following conditions:

1. The product of the thinking has novelty and value (either for the thinker or for his culture).

2. The thinking is unconventional, in the sense that it requires modification or rejection of previously accepted ideas.

3. The thinking requires high motivation and persistence, taking place either over a considerable span of time (continuously or intermittently) or at high intensity.

4. The problem as initially posed was vague and ill-defined, so that part of the task was to formulate the problem itself.64

The Bowden initiatives were creative, particularly under the first and second conditions, and the Smith, Debnam initiative under the first and fourth.

Leaders find opportunities in the unusual, and much of their creativity will be found in their ability to redefine problems, to "think outside the box",65 or solve seemingly intractable problems by approaching them in a different manner, free of the limitations we tend unconsciously to impose upon ourselves in defining problems.

As the Smith, Debnam case suggests, downsizing in other industries may create client needs that can be met by the creation and delivery of services not previously rendered by law firms, if law firms are willing to rethink what they do and how they do it. Downsized companies can be expected to look to the open market for services previously organized in-house. Data from the 40 years prior to 1990 would lead market observers to believe that the 40-year average ratio of 9.48 FIRE employees per attorney is a reasonable measure of the need for lawyers and may be utilized to measure lawyer surpluses and shortages over time, as illustrated by Figure 10.

But data for the last four years challenge that assumption, or at least show something unusual when plotted in Figure 11. FIRE employment in the United States actually decreased from 1989 to 1993. Figure 11 indicates that the finance, insurance and real


65. The term "thinking outside the box" is derived from the problem of how to connect a three-by-three array of nine dots which form a square box with only four straight lines. Most people find the problem difficult to solve because they restrict the drawing of their lines within the perimeter of the box formed by the array of dots. The problem is easy to solve once they "think outside the box" and extend their lines beyond its perimeter. For discussions of the problem see WAYNE A. WICKELGREN, HOW TO SOLVE PROBLEMS: ELEMENTS OF A THEORY OF PROBLEMS AND PROBLEM SOLVING, 63-64 (1974); JAMES L. ADAMS, CONCEPTUAL BLOCKBUSTING, 16-17 (1974), appearing in LOUIS M. BROWN & EDWARD A. DAUER, PLANNING BY LAWYERS: MATERIALS ON A NONADVERSARIAL LEGAL PROCESS, 291-295 (1978); F. Leary Davis, The Elements of Lawyer Competence: Their Nature, Acquisition and Utilization (forthcoming 1994) (manuscript on file with author).
estate industries might have down-sized so drastically that they have created markets for substitute services from law firms. Lawyers must ask what the resulting departures from the normal supply curve in the 1990s mean. They could indicate a gross oversupply of lawyers. They could signal a dramatic and permanent transformation of FIRE industries, or a less dramatic adjustment that creates a need for downsized companies to purchase previously in-house services in the open market, perhaps from lawyers. If the latter, law firms must ask further whether they desire to provide the new services. Their provision might be innovative, a break with the past, the creation of new professional services and markets. If the data signify a more basic transformation, creativity and innovation will be in even greater demand.

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66. Many of these services may be outside conceptions of the traditional practice of law and in the realm of "ancillary business", such as management consulting services. At its 1994 mid-year meeting the American Bar Association amended its Model Rules of Professional Conduct to allow law firms to offer such services. See Model Rules of Professional Conduct Rule 5.7 (1994).
Even in the absence of the need for innovation that is the equivalent of "radical, discontinuous change" in the buyer's market, leadership will still be needed to focus resources to create desirable opportunities for lawyers and their clients. The lessons of experience of the pre-1960s buyer's market, the seller's market of the '60s and '70s, and today's buyer's market suggest prudent initiatives for all lawyers.

VII. RECOMMENDATIONS FOR LAW FIRM LEADERS AS THE THIRD WAVE CRESTS

The emphasis of law firms in today's buyer's market is on delivering legal services faster, better, and less expensively. Utilization, realization and profit margin remain important concepts in the buyer's market. But the idea of LEVERAGING is being replaced by the concept of TEAMWORK, and hourly BILLING RATES are being replaced by FIXED FEES for services of determinable value. The key to financial success will not be to cause the maximum number of hours to be worked, but rather to cause the maxi-

67. Nyström, supra note 2, at 1.
mum number of valuable events to happen for clients in the minimum amount of time. In that regard, I offer the following suggestions.

A. Recognize We'll Be in a Buyer’s Market Indefinitely

Assuming lawyers remain in a buyer's market, they can anticipate doing most of their work in the future for fixed and other traditional value-based fees. When the need for new kinds of services for corporate clients arises and a value has not been established for those services, anticipate that in-house counsel will want the work done for an hourly fee. However, after the results and fees of various firms performing the service have been monitored and analyzed, in-house counsel will be able to determine an appropriate fixed fee for the work and will thereafter bargain for that fixed fee, particularly for commodity or brand name services. Lawyers should position their firms to render high quality fixed fee services in a timely manner.

B. Plan Personal Finances Conservatively

Lawyers' personal financial planning should also be consistent with a buyer's market for our profession, i.e., conservative and responsible. People who decide to enter the profession should not do so because they expect to make a lot of money. Like those who entered the profession during the last buyer’s market, they should go to law school because other aspects of lawyers’ lifestyles are pleasing to them: interesting and important work, opportunities for leadership roles, and the ability to make a difference in the lives and institutions of other people. Should they then experience years in practice that exceed their financial expectations, they should not adjust their standards of living based on the assumption that all subsequent years will be equally profitable.

C. Handle Business Aspects of the Profession in a Business-like Manner

Lawyers should retain the realism about practice gained in the First Wave of the buyer’s market. Even though lawyers may be doing primarily fixed fee work, they should continue to record fee-producing time for cost accounting purposes. Likewise, they should account for non-billable time to determine how it can best be utilized to create potential value for clients.
D. Change Firm Culture

Firm cultures should be consistent with a buyer's market: client-centered. Lawyers should attempt to make quality things happen for clients as quickly as possible, preserving or adding value to clients' enterprises. Lawyers should visualize themselves charging a price for creating events valuable to clients, rather than a fee, which clients may perceive not as something that adds value, but as an added cost of doing business. When appropriate, lawyers should share risks with clients.

Changing firm culture should be deliberate, a planned action. Plans for the firm should establish client-centered goals. Total planning for the firm should include development of annual and shorter term individual development plans for firm personnel that are consistent with overall firm goals. As a part of their new cultures, firms should adopt compensation plans consistent with firm goals, including plans for realistic (i.e., often lower) first-year associate compensation.

E. Improve Delivery of Legal Services

Law firms' plans should call for improved delivery of legal services. The firm should invest in research and development, systematize its practice, utilize technology appropriately, and enhance training and team approaches.

F. Improve Communications With Clients

Lawyers should strive to continue to enhance their communication skills, particularly interviewing, counseling and presentation skills. They should achieve clarity of initial understandings with clients as to the scope of representation and fees for services. Lawyers should prepare representation plans jointly with their clients.

Lawyers should improve the billing processes of their firms, being prompt and regular in their billing. They should not surprise a client with a bill, but should ensure that their billing practices are consistent with client expectations.

Lawyers should conduct client audits to get feedback on their performance, and above all, return their telephone calls.

G. Build Practices on Good Relationships With Clients

As lawyers establish or reestablish appropriate relationships with their existing clients, they should move incrementally from cost- to value-based billing methods. Nevertheless, they must realize some clients (courts, general counsel, etc.) will desire hourly billing in situations where they need to monitor lawyers' activities. Lawyers should facilitate that monitoring, while continuing to bill promptly, often, and without surprises.

H. INNOVATE! and Use Resource Matrix and Value Curve Lines of Reasoning to Justify What You Do and How You Charge for It

Though lawyers will remain in an overall buyer's market for some time, they may differentiate themselves by offering needed, unique services. Until other lawyers begin to offer the same new services, such lawyers will occupy a seller's market with respect to at least part of their practices. In the Third Wave buyer's market, innovation will require high motivation and persistence, the formulation or redefinition of vague and ill-defined problems, and unconventional thinking, "outside the box", which has novelty and value.69

VIII. Conclusion

If lawyers are going back to the future, they should be happy that they are returning to a time when mythology states the practice of law was more professionally, if not as financially, rewarding. And they are going back to the future with tools unavailable 40 years age. They can reinvent the profession, and the futures of their clients and communities. The challenges, and rewards, of law firm leadership are greater today than they have ever been. With the appropriate utilization of the seven planning resources lawyers have the potential to make more high quality events occur for their clients in less time, and in the process of creating value for clients, to nurture the justice values that brought them to the profession in the first place.

69. See supra, notes 64 and 65 and accompanying text.
## APPENDIX A

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APPENDIX B: RECOMMENDATIONS

RECOGNIZE WE'LL BE IN A BUYER'S MARKET INDEFINITELY

- Anticipate and respond to needs of clients
- Transition from cost- to value-based billing methods
- Maintain reasonable expectations; be conservative and responsible in handling personal finances

HANDLE BUSINESS ASPECTS OF PROFESSION IN A BUSINESS-LIKE MANNER

- Continue keeping time for cost accounting purposes
- Keep non-billable time to determine how it can best be utilized to create potential value for clients

CHANGE FIRM CULTURE

- Plan for the firm and establish client-centered goals
  - Make quality things happen as quickly as possible
  - Charge a price (a value) rather than a fee (a charge)
  - Share risks when appropriate
- Develop annual, shorter and longer range individual development plans for firm personnel consistent with firm goals
- Adopt compensation plans consistent with firm goals, including realistic associate compensation

IMPROVE DELIVERY OF LEGAL SERVICES

- Invest in research and development
  - Systematize practice
  - Utilize technology appropriately
  - Enhance training and team approaches

IMPROVE COMMUNICATION WITH CLIENTS

- Return phone calls
- Achieve clarity of initial understanding as to scope of representation and fees
- Prepare representation plan jointly with client
- Improve billing processes
  - prompt
  - regular
  - no surprises
- Conduct client audits to get feedback
BUILD PRACTICE ON GOOD RELATIONSHIPS WITH CLIENTS

• Realize some clients (courts, general counsel) will desire hourly billing: facilitate their monitoring; bill promptly, often, and without surprises
• Move incrementally from cost- to value-based billing as establish appropriate relationships with clients

INNOVATE!

• Be creative
• Exercise leadership
• Help clients grow the economy, creating needs for more lawyers