

The Changing Nature of “Leverage”

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By Neil Oakes



Ten years ago, profitability was relatively straightforward: leverage, price and productivity, right? The more the better. Ten years ago, one of the strongest correlates to ‘high-profit performance’ was ‘employed lawyers with less than five years experience per equity partner’.

How things have changed. It is becoming increasingly difficult to delegate work and clients to junior lawyers; an increasing number of clients are refusing to pay for lawyers they perceive as learning on the job. Regardless of pricing methodology, clients want to pay less and they want their work done by capable, senior people.

While these challenges manifest, salary margins (cost relative to fees billed) are tightening, and productivity levels are declining. The market for legal services in Australasia is declining for a number of reasons, all well documented and discussed. In other jurisdictions ‘new law’ challenges – observed in some detail by my colleague, Jordan Furlong – are contracting demand and increasing supply. I suspect that we will see some significant changes in the way we employ, pay and manage employed lawyers. If you want a prediction, here is one: in ten years time, the notion of secure, full-time employment in a successful law firm for a certain annual salary will be a fond memory, not current reality.

Despite an acknowledged lawyer supply / demand imbalance, we currently pay many multiples of the average wage, with relatively soft expectations. (Lawyers don’t believe this, but go tell a farmer or retailer or hotelier – or just about any small-business person, for that matter – that you work harder than most!) We then invest in various ‘engagement’ strategies in the hope that employed lawyers will be ideally productive. I don’t see this arrangement lasting for long.

I am encountering more firms that have evolved to a contracting model, paying hourly rates for hourly rates or cents for dollars billed, depending on pricing strategy. In these firms, flexibility and indeed ‘engagement’ are entirely in the control of the employee. I think this model will become mainstream. No doubt better firms will account for work origination relative to delegated work done, and determine an appropriate measure for non-financial contribution, though it is more likely that the latter will be an expectation included in minimum acceptable behaviour / contribution.

Firms have tried to manage the inherent risk in employing expensive senior lawyers through base salaries and bonuses (at risk pay) but this seems to meet with mixed success. [You may remember my discussion in a recent Edge Communiqué around the budgeting process?](#)

Try this on for size: “Here’s your budget. It is 3.5 times your salary. If you exceed it we’ll pay you one third of the excess billings.” Sound familiar? I see this quite a lot. Partners tell me it works well, but employed lawyers usually have a different view. They see it as unattainable, far from motivational.

Bonuses are increasingly being used as a risk-management strategy, not a tool for motivation. Rather than commit to a higher salary, firms are minimising the risk of lesser performance by paying a lesser salary with the prospect of a 'top up', subject to performance. This is a credible strategy but it is a risk-management strategy, not a motivational tool. Most lawyers see their worth as being their base plus the bonus. It's difficult to motivate someone to work above and beyond by paying them their perceived worth; it's a basic entitlement that can only serve to remove dissatisfaction.

In other industries where bonuses drive performance and behaviour (think real estate or investment banking), a common set of phenomena seem to exist. Firstly, bonuses are more immediate and more frequent, secondly bonuses are a much bigger proportion of total pay, and thirdly bonuses seem – to me – ludicrously large. We don't have the margins to play this game, unless partners are prepared to significantly reduce their income expectations.

Most importantly though, the salary / bonus construct leaves the responsibility (and risk) of motivation and engagement with the firm. It also leaves much of the cost of flexible arrangements with the firm. It is this fundamental construct that I see changing. Given the relatively predictable nature of the demand for legal services in the next five to ten years, and the continuing oversupply of lawyers, I see it as inevitable. Employed lawyers will be responsible for large salary risk, flexibility and engagement. Firms will no longer invest in layers of HR professionals to produce these outcomes (with mixed success).