

Hiring Teams from Rivals:
Theory and Evidence on the Evolving
Relationships in the Corporate Legal Market

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Law Firm Evolution: Brave New World

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*“He who studies books alone
will know how things ought to
be, and he who studies men
will know how they are”*

Charles Caleb Colton

Prior literature

- Legal scholarship: law of lawyers
- Economics: firms, expert services
- Management: non-legal PSFs
- History, sociology: legal profession, companies, law firms

- Our focus: relationship between law firms and large companies

Prior literature

- Asymmetric Information exchange between clients and lawyers
- Long Term Relationships (LTRs) assure quality
 - Firms monitor/screen
- Individual Lawyers = specialized experts
 - “Hire the L, not the firm”
- More sophisticated and experienced CLOs
 - Less Information asymmetry
 - Less need for LTRs

Null Hypothesis

- Long Term Relationships have diminished in the corporate legal market



Theory

Prior Literature

- LTRs assure quality
 - Firms monitor/screen
 - Golden age of exclusive LTRs
- Ls = specialized experts
 - “Hire the L, not the firm”
 - AI -> quality nonverifiable
- Better CLOs
 - Less AI
 - Less need for LTRs

∴ Spot contracting

Our Extensions

1. LTRs also provide
 - Client Specific Knowledge (esp. within teams)
 - Capacity insurance
2. CLOs and Corps are agents
3. Exclusivity has costs but LTRs can vary
 - Dependency (Co. + CLO)
 - Blunt incentives
4. As firms grow, quality assurance falls

∴ Non-exclusive LTRs

∴ With mix of firms + teams

Law “firms” are networks of co-branded teams



- Non-exclusive LTRs
- Among a mix of firms and teams
- Increased importance on teams and departments within firms



Methods

- Focus group / informal surveys
- Structured interviews (n=43)
- Survey of entire S&P 500 (n=139)
 - 28% response rate
- Representative samples of
 - Large high-legal demand companies
 - Large public companies generally



CLOs in our sample . . .

- 90% of CLO survey participants & 60% of interviewees report directly to CEO
- More than half of survey respondents are promoted from within
- Median salary of survey resp is \$2.2MM (min. \$464MM)
- Median legal budget of survey resp \$37MM (min. \$3.5MM)
- Interview and Survey Resp spend btwn 53-60% of legal budget outside

Table 3. Summary Statistics Legal Departments for Survey Respondents



	Mean	Minimum	25 th p-tile	Median	75 th p-tile	Maximum	N
Data from Survey Respondents							
2006 legal budget (excluding compliance) (\$MM)	65.42	3.50	15.00	37.00	76.00	606.00	131
% of 2006 legal budget spent on law firms	60%	2%	20%	60%	70%	97%	130
Number of law firms used in 2006	127.05	5	30	65	150	1000	133
Number of law firms used in 2003	141.82	4	27	75	170	1000	117
Number of law firms accounting for 80% of 2006 outside legal expenditures	15.09	1	5	10	20	110	135
Number of law firms accounting for 80% of 2003 outside legal expenditures	17.31	1	5	10	25	100	115
Change in number of law firms accounting for 80% of outside legal expenditures from 20003 to 2006	-2.2	-80	-2	0	1	44	114
Number of lawyers overseen by CLO	68.85	0	17	35	75	1250	134
% of CLOs reporting to CEO	89.2%						139
% of CLOs male	80.0%						80
Data on Survey Respondents from Other Sources							
Tenure of CLOs as CLOs [1]	4.6	1	2	3	7	19	80
Tenure of CLOs at company [1]	9.6	1	3	6.5	14	35	86
CLO promoted from within company [1]	56.4%						78
CLO salary in 2006 (\$000) [2]	468.6	201.92	356.00	420.42	517.50	1513.20	46
CLO total compensation in 2006 (\$000) [2]	2459.9	463.53	1287.16	2208.32	3099.67	7278.61	39
% CLOs male [2]	87.0%						46
Data from Interview Participants							
2006 legal budget (excluding compliance) (\$MM)	210.79	10.00	40.00	91.50	332.64	750.00	18
% of outside budget spent on law firms	53%	20%	40%	50%	64%	90%	27
Number of law firms used in 2006	239.86	6	40	150	300	1000	29
Number of law firms accounting for 80% of 2006 outside legal expenditures	20.00	1	5	10	20	100	31
Use of preferred provider lists	60%						40
% of preferred provider lists that are mandatory	17.5%						40
Number of lawyers overseen by CLO	161.07	2	40	100	150	1480	41
Number of non-lawyers in legal department	112.17	3	112	75	112	500	23
% of CLOs reporting to CEO	59.5%						41
% of CLOs male	76.7%						41
% of CLOs overseeing compliance	81.0%						40

Data sources : [1] *American Lawyer* 2007 Survey of Fortune 500 Legal Departments; [2] Execucomp

Survey: Hiring for Very Significant Matters



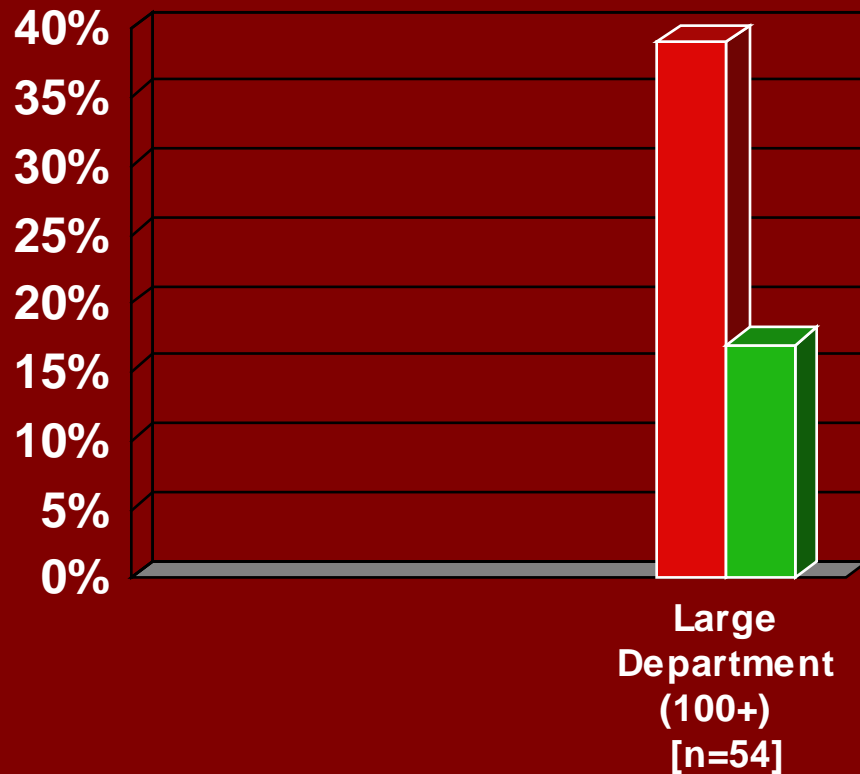
Type of Matters	N	%
Intellectual Property	13	9%
Litigation (class action, consumer, etc.)	69	50%
Regulation (Anti-trust, investigation, etc.)	17	12%
Strategic (Corporate, Tax, M&A, etc.)	35	25%
Other	5	4%
Total	139	100%

	(1) Overall Average	Internal Sources		External Sources	
		(2) Average if based on Personal Knowledge	(3) Average if based on Intra- Firm Second- Hand Knowledge	(4) Average if based on External Second-Hand Knowledge	(5) Average if Based on Public Data
Overall average		97% = yes	75% = yes	50% = yes	17% = yes
Prior experience	4.4	4.5	4.5	4.4	3.8
Reputation	4.5	4.5	4.5	4.5	4.2
Rankings in periodicals	1.9	1.9	1.9	2.1	2.2
Results in similar cases	4.5	4.5	4.6	4.6	4.5
Size	2.9	2.9	3.0	2.9	3.2
Geographic scope	2.6	2.5	2.7	2.7	3.0
Market share	2.2	2.2	2.3	2.2	2.4
Recent growth history	1.7	1.6	1.7	1.7	1.8
Leverage	1.8	1.8	1.9	2.0	2.0
Turnover rates	2.0	2.1	2.1	2.2	2.2
Partnership structure	1.4	1.4	1.4	1.5	1.7
Ancillary businesses	1.4	1.4	1.4	1.5	1.6
Pro bono	1.8	1.8	1.8	2.0	2.0
Commitment to diversity	2.7	2.7	2.8	2.9	3.0
Profits per partner	1.5	1.5	1.6	1.7	1.9
Partner compensation system	1.6	1.6	1.7	1.8	2.0
Associate compensation systems	2.0	2.0	2.2	2.2	2.3
Quality control systems	2.6	2.7	2.7	2.9	2.6
Ethical infrastructure	2.6	2.6	2.7	2.9	2.5

1=not important
 2=not very important
 3=somewhat important
 4=important
 5=very important



Terminations by Largest Legal Departments



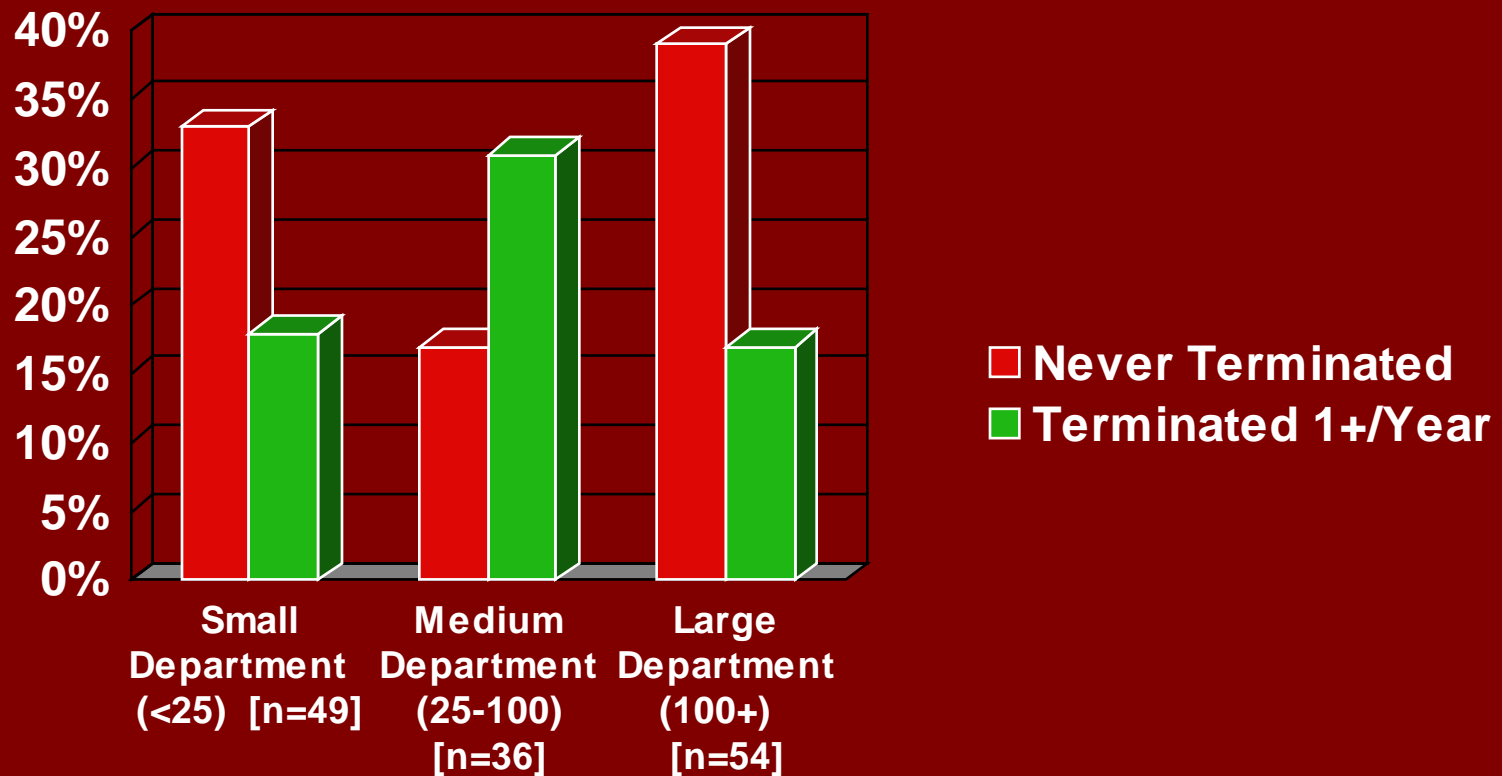
Terminating a law firm is “obviously a big step. You know, you don’t do that to people.”

■ **Never Terminated**
■ **Terminated 1+/Year**

“I inherited 2 primary relationships. [I]n both cases, they get work that frankly we're not happy with because they're there...”

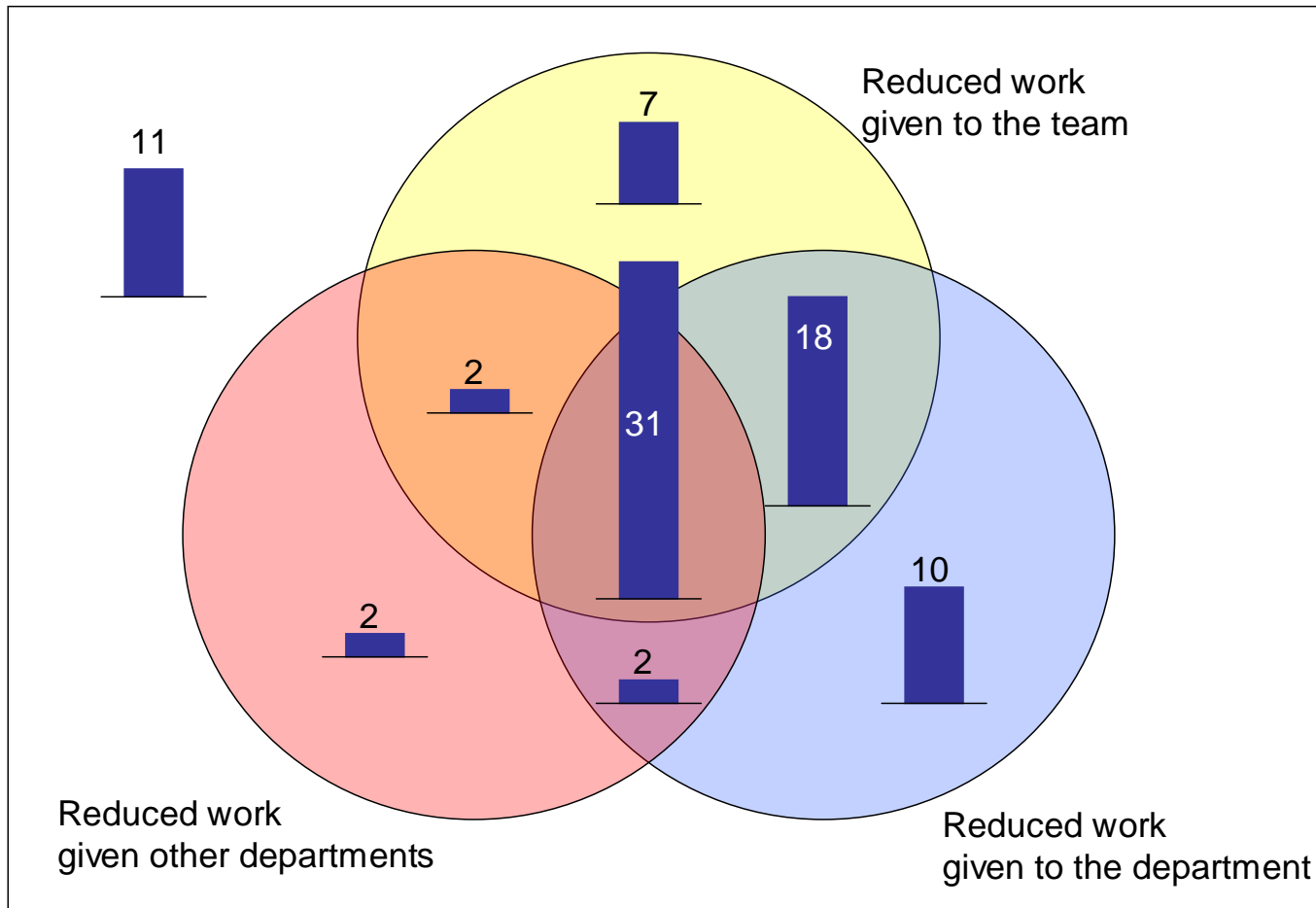


Terminations by Legal Department Size

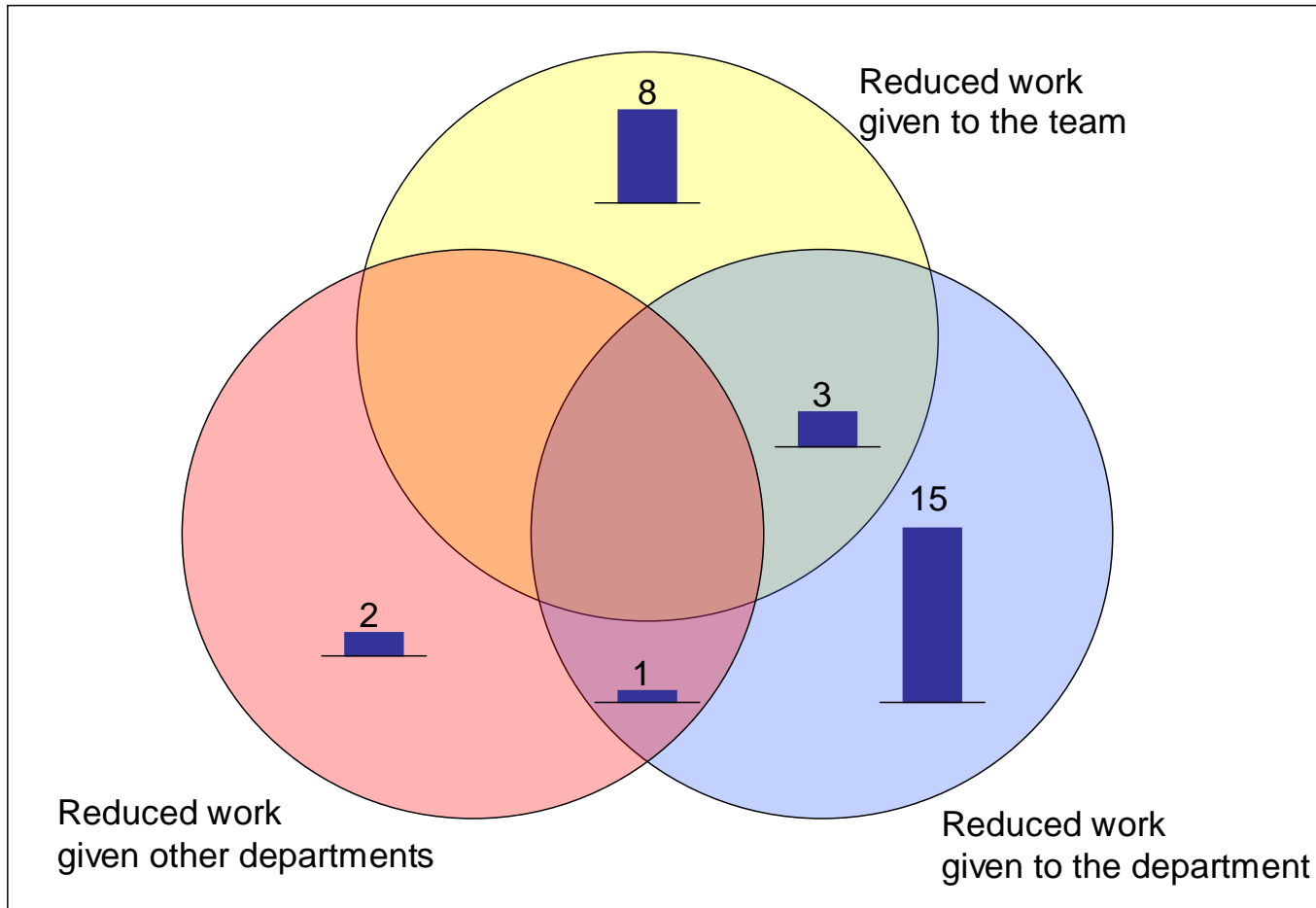




The "Penalty Box"

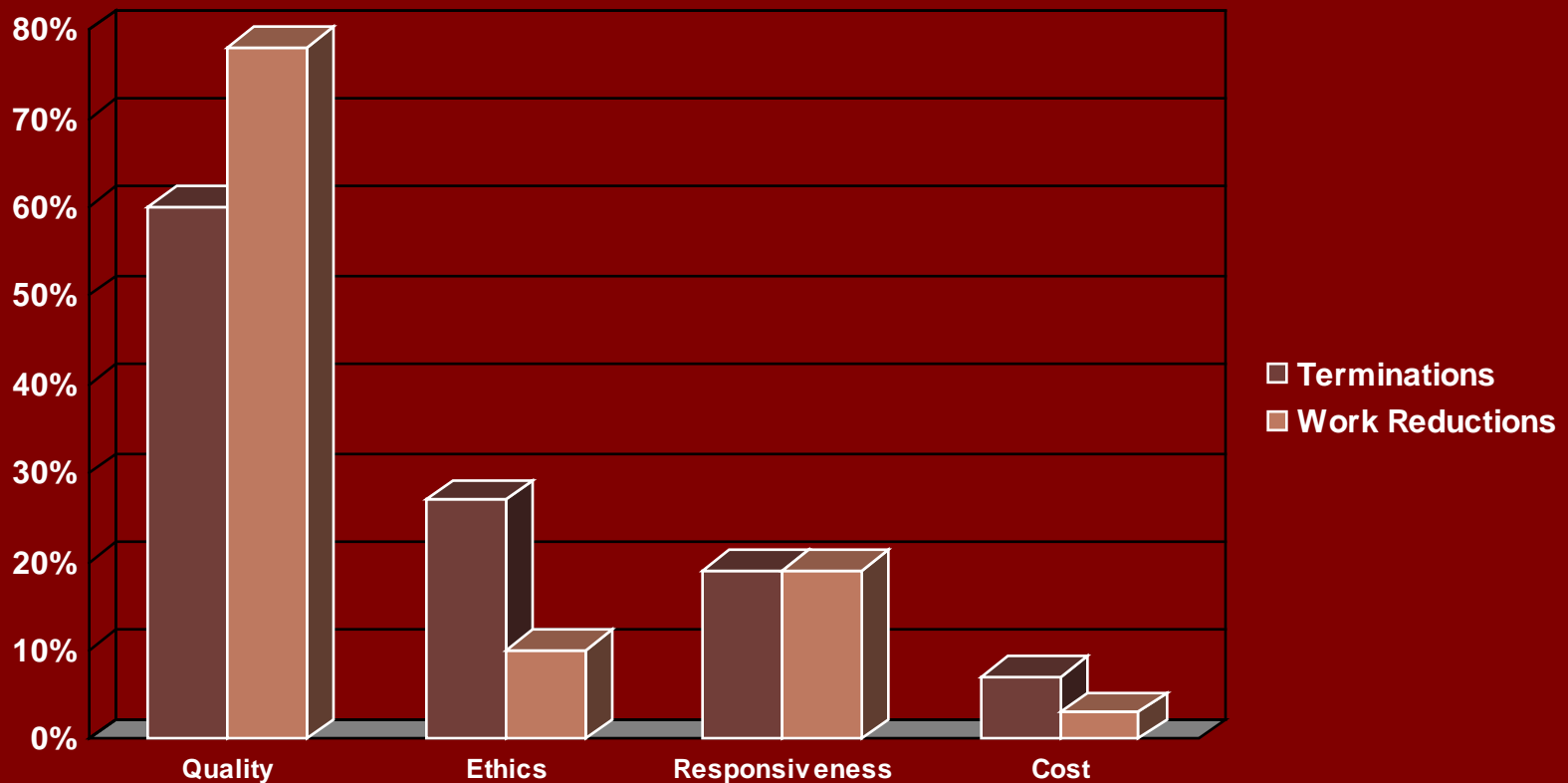


Work Reductions Not Affecting Individual Underperformer





Causes of Terminations and Work Reductions



Stars



- 54% of CLO survey respondents reported observing star lawyers moving laterally.
- 67% of CLOs claim that the star lawyers consulted with the CLO before moving every time or sometimes.
- Most CLOs followed the stars but were more likely to follow if the star lawyers moved as part of a team
- CLOs are generally satisfied with the quality of work with the star lawyer/team at the new firm



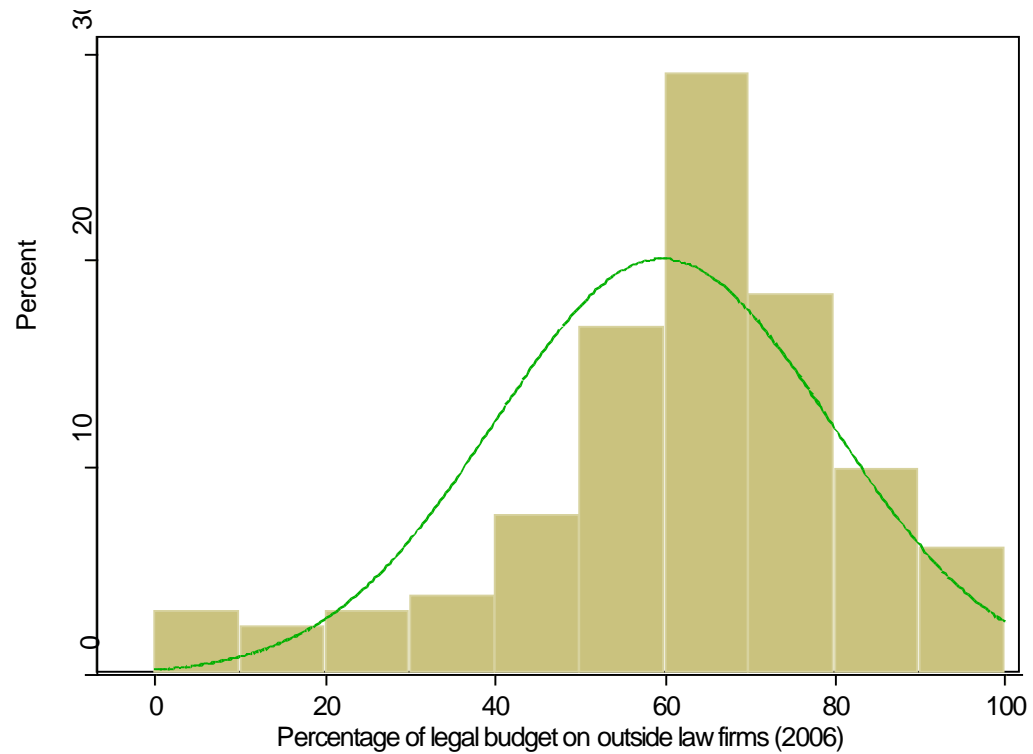
Implications

- CLOs
 - Cost / value management still a big challenge
 - Opportunities: objective data, law firm management (keiretsu)
- Law firms
 - Relationships more durable than typically depicted
 - But CLOs focus may turn to internal working of law firm and law firms will have to justify systems and practices
 - Management, control systems (quality, ethics), capital, retention
 - Tensions between powerful subunits and efforts to centralize mgt and function as one entity
- Law schools
 - Align legal education to corporate legal market by including basic management skills
 - Strategy, leadership, team building, mentorship, marketing, delegation
- Academics (Theory)
 - Interdisciplinary scholarship that brings serious empirical methods to study the organization and development of the legal profession

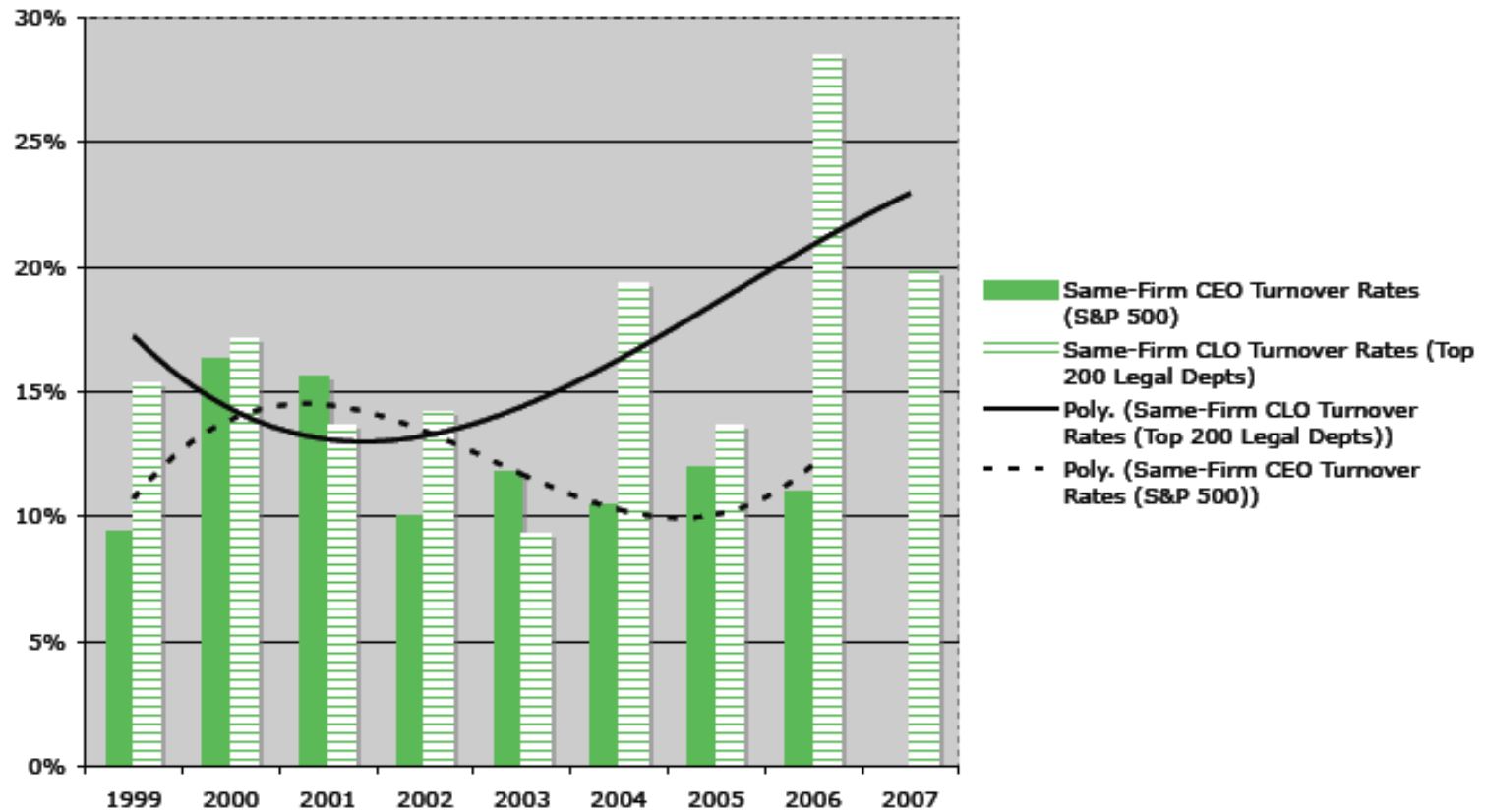
Qualitative findings

- Convergence prior to 2003, now stalled
- Hiring: relationships and first-hand knowledge
- Terminations (of firms) not common
- Reductions (to teams, departments) common
- Most CLOs are more willing to move work to follow a “star” lawyer if that lawyer moves as part of team
- Variation and possible signs of change

Outside Spends



CEO and CLO Turnover in Large Firms Exclusive of Turnover due to Sale or Merger of Firms





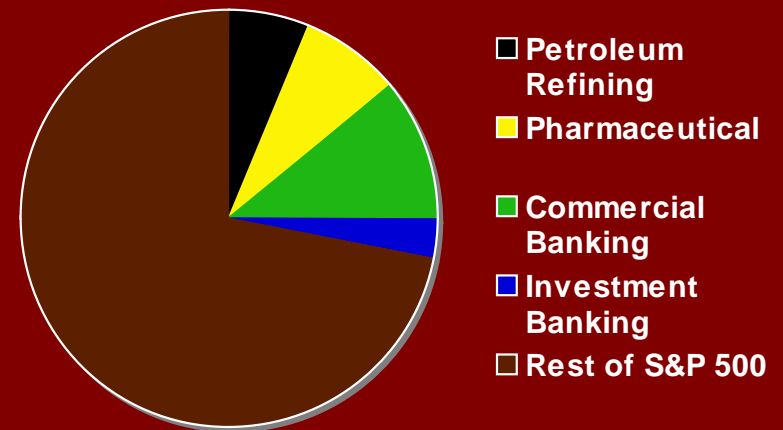
Additions to Theory

- LTRs vary in exclusivity
 - Bilateral or one-way monopolies vs. neither
 - Exclusivity has costs
- Multiple non-exclusive LTRs
 - Can achieve benefits with fewer costs
- Law firms are networks of co-branded teams
- Financial institutions especially value LTRs

Interviews

- Oversampled industries
 - Financial services
 - Investment banks
 - Commercial banks
 - Pharmaceuticals
 - Petroleum Refining
- ~1/3 of S&P 500 market cap
 - \$8.9 BN annual legal budget
 - \$4.9 BN annual outside spend
- = 8.5% of AmLaw 100 Revs. (\$57 Bn)

**Share of S&P 500
2006 Market Cap**



Survey Respondents

SIC codes	Industry	Report to CEO	N	Mean Legal Budget (\$MM)
1-9	Agriculture, Forestry, and Fishing	100%	1	90.0
10-14	Mining	100%	4	10.3
15-17	Construction	100%	2	67.5
20-39	Manufacturing	94%	50	79.9
40-49	Transportation, Communications, Electric, Gas, And Sanitary Services	96%	24	43.3
50-51	Wholesale Trade	100%	3	10.5
52-59	Retail Trade	91%	11	40.1
60-67	Finance, Insurance, and Real Estate	71%	28	75.3
70-89	Services	86%	14	38.8
91-99	Conglomerates	100%	2	412.0
	Total	89%	139	65.4