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## **In search of excellence in the practice of law?**

*Law firms optimally combining size and leverage appear to be the most profitable.*

*Are they also the most interesting places to work, with the most attractive career potential for entering associates who have high value added skills and degree combinations that can engender innovation, profit and growth? This exploratory analysis provides suggestive indications that law firms are pursuing strategies depending more on the dimensions of staff skills, organization and culture than on the brute force of size or the limitations of narrow specialization.*

Among law firms, the firms that consistently top the list of the most profitable firms on a per partner basis are neither the largest firms nor the smallest firms. They are somewhere in the middle. This suggests that the benefits of size are not ever increasing, but that some size is needed to sustain profit-maximizing levels of staff leverage. Is this true or are the profits among the medium size firms merely a reflection of transient conditions such as the specific industries a firm serves at a certain time?

Law firms provide an interesting place for organization and strategy specialists to examine theories of organizational economics. The legal profession is a large and relatively homogeneous industry. Across the United States there are hundreds of law firms and sufficient information about these organizations and their business activities exists to allow a level economic inquiry that is not so readily possible in most other industries.

Law firms vary widely both in size and in the ratio of associates to partners working for the firm. The former relates to the scale and scope of operations. The latter called the leverage ratio relates to the use of junior staff at higher profit margins per hour than a partner. At first impression it appears some scale is required to achieve higher levels of utilization. But, it also appears that beyond a certain point, size and leverage cannot both be sustained.

In everyday business the tradeoff between profit margins and asset utilization is a central undertaking. It often defines corporate and business strategy. A Chevrolet, for example is a high volume, low margin automobile produced in mass quantity on assembly lines that turnover and stop for no one. The margin on each car is small and total profits depend most on the asset leverage or utilization. This leads to repetition and standardization. On the other hand, a Ferrari is a high margin automobile that is customized for each buyer. The margin made on a Ferrari is high and the craftsmanship that goes into each car will not tolerate rapid utilization of assets and personnel.

In mature industries such as the legal profession, where innovation would be thought to be a constant, or at least slow changing, we expect the participants to align themselves in groups along the tradeoff between margins and asset turnover. This tradeoff is roughly equated to size in most industries. Larger companies most often have lower margins and higher turnover. Smaller companies have higher margins and slower turnover.

Typically the level of average profitability across an industry is a constant and all that truly varies across the firms in the industry is the method by which the profits are earned. Those who study corporate and business strategy are of the general opinion that the most defensible competitive positions in an industry are at the extremes of the margin/turnover tradeoff. Firms in the middle are expected, if anything, to perform less well than the firms that achieve cost leadership at large scale with low margins and rapid turnover or firms with the greatest focus at a small scale and high margins.

The legal profession exhibits an anomaly to the so-called “stuck in the middle” hypothesis that has been espoused by industrial organization economists and strategy experts for a relatively long time. Medium sized firms appear to achieve a balance of size and leverage that allows them to out-perform their larger and their smaller competitors. What is the nature of this phenomenon and what explains profit-maximizing patterns among the medium sized firms?

### ***VARIATION IN LAW FIRM SIZE, SCOPE AND STRATEGIC EMPHASIS***

Details are lacking about law firm margins and asset turnovers. Margins or profits as a percentage of sales are plain enough, but it is difficult to impossible to quantify and value the asset base of a law firm the same way that it is possible for an industrial firm. That leaves us only the blunt instrument of size measured by total lawyers in a firm as the best approximation of the underlying strategic tradeoffs in the legal profession.

Just to get a first insight into the size and strategy variation of a cross-section of law firms, I focused on the 38 largest firms nominally headquartered in New York City. Here is that list taken from the most recent [Internet Legal Research Group Study](#) of the [IRLG Largest 250](#). Among these data I was able to confirm the systematic link between firm size and the expected strategic emphasis of the firms. Though far from fully developed, the picture is consistent with the usual expectations about the presence of the often-cited “generic” strategies characterized in the earlier discussion.

The first diagnostics that organizational specialists consider relative to size are what we call “economies of scale” and “economies of scope.” Economies of scale are simply the gains we observe from sharing fixed costs allocated across all units of production until the per unit quantity of such costs approaches zero or is driven as low as possible.

Economies of scope are similar, but a little different in that they recognize inherent limitations of time and space and lead to a physical distribution of production across multiple market areas. This is why, for example, there are regional Budweiser factories

around the United States and the world. In the ideal world Budweiser, will put the just right sized plant in the just right geographical areas to create the most profitable combination of joint economies of scale and scope.

### *Law firm size*

The top 38 law firms headquarter in New York City vary in size from White and Case with 1,983 lawyers and Curtis, Mallet-Prevost, Colt & Mosie with as few as 180 lawyers. It is best to define size in a real measure such as the number of lawyers. Basing a measure of size on accounting statistics like revenue can rapidly lead to tautological assessments. While it is likely that larger firms defined as the number lawyers have more dollars in profit, it is not so obvious that firms with more lawyers have more profit per partner.

<b>New York Law Firms</b>	<b>Lawyers</b>	<b>Partners</b>	<b>Associates</b>	<b>Leverage</b>
<a href="#"><u>White &amp; Case</u></a>	1,983	385	1,139	2.96
<a href="#"><u>Latham &amp; Watkins</u></a>	1,840	527	1,234	2.34
<a href="#"><u>Skadden, Arps, Slate, Meagher &amp; Flom</u></a>	1,790	393	1,306	3.32
Holland & Knight	1,224	704	398	0.57
Weil, Gotshal & Manges	1,142	293	777	2.65
Shearman & Sterling	1,013	212	784	3.70
Paul, Hastings, Janofsky & Walker	964	253	586	2.32
Cleary Gottlieb Steen & Hamilton	889	170	669	3.94
Wilson, Elser Moskowitz, Edelman & Dicker	828	256	519	2.03
Orrick, Herrington & Sutcliffe	744	283	406	1.43
Proskauer Rose	715	182	458	2.52
Simpson Thacher & Bartlett	687	157	503	3.20
Paul, Weiss, Rifkind, Wharton & Garrison	644	105	373	3.55
LeBoeuf, Lamb, Greene & MacRae	641	190	371	1.95
Davis Polk & Wardwell	639	149	461	3.09
Sullivan & Cromwell	627	158	419	2.65
Willkie Farr & Gallagher	594	134	421	3.14
Dewey Ballantine	572	144	396	2.75
Cadwalader Wickersham & Taft	565	108	386	3.57
Milbank, Tweed, Hadley & McCloy	548	134	392	2.93
Fried, Frank, Harris, Shriver & Jacobson	525	138	358	2.59
Kaye Scholer	512	140	292	2.09
Cravath, Swaine & Moore	479	87	294	3.38
Thelen Reid & Priest	454	202	195	0.97
Chadbourne & Parke	440	130	248	1.91
Schulte Roth & Zabel	398	77	285	3.70
Stroock & Stroock & Lavan	367	98	220	2.24
Epstein Becker & Green	352	157	195	1.24
Hughes Hubbard & Reed	332	82	208	2.54
Kramer Levin Naftalis & Frankel	325	98	195	1.99
Kelley Drye & Warren	321	100	196	1.96
Thacher Proffitt & Wood	274	64	197	3.08

Cahill Gordon & Reindel	261	64	175	2.73
Brown Raysman Millstein Felder & Steiner	253	85	133	1.56
<a href="#">Wachtell, Lipton, Rosen &amp; Katz</a>	202	76	97	1.28
<a href="#">Kenyon &amp; Kenyon</a>	197	57	125	2.19
<a href="#">Patterson Belknap Webb &amp; Tyler</a>	189	57	103	1.81
<a href="#">Curtis, Mallet-Prevost, Colt &amp; Mosle</a>	180	55	90	1.64

This way of looking at the picture gives us a little insight into the character and business of the firms. We can understand why the public better knows White and Case than Curtis, Mallet-Prevost, Colt & Mosie. But does that mean that White and Case is a “better” law firm. Does it practice law better than others, does it make more money than others, and is it a better place to work than others? Maybe it does for some and maybe not for others.

### *Law Firm Scope*

The following is a small table taken from the top and bottom of the size distribution of the New York Law firms. It shows the three largest firms and the four smallest firms along with the number of offices they report and the number of practice areas they also report to operate in.

New York Law Firms	Lawyers	Offices	Practice Areas
<b>Largest</b>			
<a href="#">White &amp; Case</a>	1,983	40	40
<a href="#">Latham &amp; Watkins</a>	1,840	24	56
<a href="#">Skadden, Arps, Slate, Meagher &amp; Flom</a>	1,790	22	80
<b>Averages</b>	<b>1,871</b>	<b>29</b>	<b>59</b>
<b>Smallest</b>			
<a href="#">Wachtell, Lipton, Rosen &amp; Katz</a>	202	1	6
<a href="#">Kenyon &amp; Kenyon</a>	197	3	22
<a href="#">Patterson Belknap Webb &amp; Tyler</a>	189	1	25
<a href="#">Curtis, Mallet-Prevost, Colt &amp; Mosle</a>	180	11	31
Averages	<b>192</b>	<b>4</b>	<b>21</b>

Between the extreme ends of the size spectrum there is a visible tendency towards both economies of scale and scope, on the one hand, and specialization and focus on the other. Among the large firms they emphasize a global practice in a wide array of areas across a large number of worldwide offices. A corporate strategist would tend to see this as a

strategy aimed at overall cost leadership coming from the conduct of repetitive and interchangeable tasks that can be produced in multiple units and for multiple markets.

Among the smaller firms there are many fewer offices and many fewer professed practice areas. A corporate or business strategist would see the latter as an effort to extract customer value from product differentiation. There are business relationships with a few select customers on the basis of personal attention, craftsmanship and the tailored adjustments.

### *Limits of scale and scope*

In every basic economics text, cost curves are portrayed as U-shaped. Unit costs decrease for a while until a minimum is reached and then increase again at an increasing rate. This model is rationalized by the concept of diseconomies of scale. Diseconomies of scale are merely costs that rise as the scale or scope of production rises. They are not hard to imagine in the legal profession.

Skadden Arps, Latham Wadkins and White and Case, for example, must incur very significant costs to clear client conflicts. The point of maximum efficient scale in the dimension conflicts is something worth knowing. It has a clear impact on organizational design and substantive marketing and production strategies. It is possible the largest firms have reached the maximum efficient scale and further expansion is not the major thing on their minds as managers.

When economic consulting firms, by way of analogy, hit about \$400 million in revenues, the flow of conflicts become hard for high value-added experts inside the firm to tolerate. The experts have to spend what they believe to be inordinate amounts of time looking for ways to game the conflict system and push their own business interests ahead of each other. It is the closest thing, drawn straight from first-hand experience, to the classic introductory text example which portrays the gruesome fictional image of field workers cutting each other's legs off with their scythes in over-crowded fields.

### *Strategic Emphasis*

Law firms like any other business, require a rational basis for organizing and channeling their energies. Many commercial and industrial companies spend much management time and other corporate resources in order to clarify the mission of the company and in order to communicate to interested parties what their business purposes are.

One way to evaluate how law firms see themselves differently is to examine their self-descriptions made to the widest possible audiences on their respective websites. The websites provide a view inside the firms and they are intended to be helpful for client contacts, staff recruiting and a variety of other applications.

*What the bigger firms say about themselves?*

**White and Case:**

“Through a collaborative global network of local offices, we work as a team across geographic boundaries to help our clients succeed with multiple challenges”.

**Latham and Wadkins:**

“Founded in 1934, Latham & Watkins has grown into a full-service international powerhouse with more than 2,100 attorneys in 24 offices around the world. The founders of Latham & Watkins instilled an ethic of hard work, commitment and quality that flourishes today and has nurtured the firm's dramatic growth into one of the world's premier business law firms. With that growth, we have built internationally recognized practices in a wide spectrum of transactional, litigation, corporate and regulatory areas”.

**Skadden Arps:**

“Skadden Tops Thomson Financial's 2007 Legal Advisors Review

Thomson's 2007 US Capital Markets Legal Advisor Review (February 2008) ranked Skadden:

First in global IPOs by U.S. issuers when representing both issuers (by deal size and number of issues) and managers (deal size)

First when representing U.S. issuers of global equity (deal size and number of issues)

First when representing managers of U.S. IPO's (deal size)

Thomson's 2007 Mergers & Acquisitions Review (January 2008) ranked Skadden:

First for worldwide and U.S. announced transactions based on value

Second for Asia Pacific (ex-Japan) and third for Australia and New Zealand based on value of announced transactions

Top ranked U.S. firm based on value for European announced transactions”.

Clearly, there is a pattern among the larger firms. Scale and scope are the main things on their mind. Nothing is said about focus in terms of geography, client type or practice areas. The major by-line is that we are large prestigious, global and we can reproduce repetitive tasks across a wide range of legal practices and geography. The websites of

these firms are distinct for the absence a unifying theme that synthesizes what the firm does apart from signals about its size and scope. It is certainly OK to be a big, global firm with a sparkling worldwide reputation.

The only suspicion is that it is difficult to maximize profits per partner in such a wide array of activities and on such a large scale.

*What do the smaller Firms Say About Themselves?*

**Wachtell, Lipton:**

“Wachtell, Lipton, Rosen & Katz provides expert service to its clients and enjoys a global reputation as one of the most prominent business law firms. We specialize in matters that require special attention, extensive experience, a high level of sophistication and the reputation of our partners. We are privileged to be involved in a high percentage of the largest and most sophisticated merger and acquisition transactions, and are routinely called on to assist clients in their most sensitive and critical matters, including “bet the company” litigation and government investigations and proceedings. We offer our clients an intense and highly individualized focus on their matters.

We operate with a ratio of partners to associates far above that of our major competitors, and matters undertaken by our firm are afforded the direct personal attention of partners having expertise and sophistication with respect to the issues. Our associates consistently are among the best and brightest law school graduates from around the country’.

**Kenyon & Kenyon:**

“Kenyon & Kenyon LLP is one of the largest and most diversified law firms in the country concentrating on the practice of intellectual property. Founded over 125 years ago and with offices in New York, Washington DC, and Silicon Valley, the firm provides litigation, prosecution, licensing and counseling services relating to patents, trademarks, copyrights, trade secrets and related matters, such as unfair business and unfair trade practices. The firm is equipped with the most preeminent intellectual property litigation group in the country. We have some of the nation’s best litigators who possess very deep and first-chair trial experience. This is largely unmatched by other law firms practicing in our field of expertise”.

**Patterson Belknap:**

“Founded in 1919, Patterson Belknap is a law firm of nearly 200 lawyers committed to maintaining its independence, its diversity, and its focus of providing superior legal advice and service to clients. We make our clients’ business issues our own. At the same time, we care about our attorneys and our staff and the community we are privileged to serve. As a result of our performance and our values, the firm has earned a top 10 ranking on The American Lawyer’s 2007 “A-List” of

elite firms and we are one of just five firms to be in the top 10 each year since the list's inception.”

**Curtis, Mallet-Prevost:**

“Curtis, Mallet-Prevost, Colt & Mosle LLP is an international law firm headquartered in New York, with branch offices in the United States, Mexico, Europe and the Middle East. Founded in 1830, Curtis has a diversified practice and range of experience, which permits our lawyers to offer global representation in the most challenging assignments.”

“Curtis’ core practices of International Corporate Law, Finance and Litigation are complemented by numerous specialty areas, including Admiralty, Advertising & Media, Banking & Regulatory, Bankruptcy & Creditors’ Rights, Environmental, Intellectual Property, Real Estate, Tax and Trusts & Estates. “

Looking over what the small firms say about themselves, there is again a clear but different pattern. There is a predictably distinct effort at differentiation and customer focus. All of the firms emphasize high-value added services and higher degree of specialization than the largest firms. There are few surprises. Small firms with low leverage extol the virtues of direct contact with partners. This is a very similar appeal to that used by small colleges who promise students closer contact with professors.

In the legal profession as in almost all other industries it turns out that size is a revealing dimension of corporate strategy. The quest for economies of scale and scope drive size expansion in almost every industry. Those who do not follow that path tend focus on selected customer groups in order to deliver higher value added services to them. When we look at the extreme ends of the size spectrum among the New York law firms, we do find the expected indicators of lower margin and high turnover at the large-size end of the scale and the opposite and the small-size end of the scale.

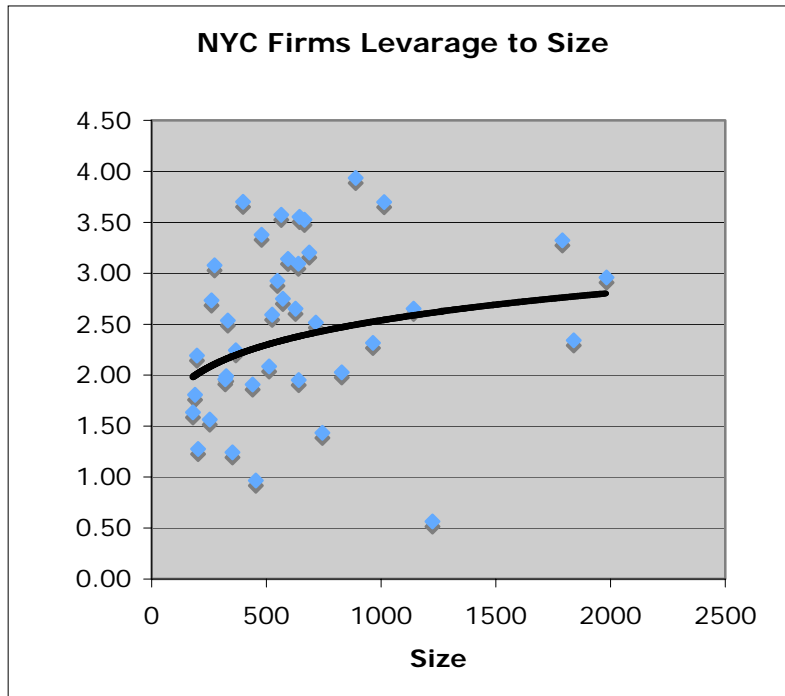
***WHAT ABOUT AN OPTIMAL STRATEGY?***

Statistical studies of industry profits and firm size often exhibit a positive relationship. This can sometimes be the result of tautological designs. But, it is more often than not because sizes can proxy for many other variables.

One of the things that size is likely to proxy for in law firms is leverage. It is just a simple matter of arithmetic that more leverage leads to more lawyers. But only slightly less subtle is the notion that size and leverage follow reputation and ability. The fact remains that it is not the largest firms consistently populating the ranks of the most profitable firms on a per partner basis. The more profitable firms are frequently the smaller and mid-size firms.

### *Introducing leverage*

In order to get at the relationship of firm size and leverage rates in more detail, I again centered my sights on the New York firms. The graph below shows all the 38 firms plotted against each other in terms of their leverage and size:



The most interesting thing about the graph is that the relationship between firm size and leverage is one of marginal decline. That is to say very large law firms do seem to have difficulty maintaining leverage. Though modest evidence based on limited data, the picture indicates the presence of diseconomies of scale among firms in the legal profession. There appear to be reasons larger firms are unable to sustain same rates of leverage as medium sized firms.

There is also a pattern that suggests that the very smallest firms operate with less leverage than the mid-sized firms overall. The pattern is less pronounced, but is quite visible for firms with less than 500 lawyers.

Spotlighting firms around the average size tends to cut off the tails of what we know from self-descriptions are the specialized boutiques on the small-size end of the scale and the global commodity producers at the large-size end.

By inspecting the graph, it appears higher leverage ratios exist on average among the firms with 400 to 1000 lawyers. Eight firms, for example, have 400 to 1000 lawyers and leverage ratios above 3.00. Half the number, or four, are in the same size range and have leverage ratios below 2.0.

As an aside, medium-size, high-leverage firms as suggested by these data, together with what we observe about the typical leaders in profit per partner, appear to internalize certain economic benefits that similar sized firms with low leverage are content to pass up. One plausible conjecture is that the two (potential) strategic groups vary in the degree they outsource lower valued inputs such as document management.

Since I have mentioned more than once the link between mid-sized firms and per partner profits this seems a good place to add a little data about profitability to the evolving analysis.

***Who makes the most money?***

Do medium size firms with higher leverage ratio make more profits per partner? The clear answer requires much more data and analysis than this humble little empirical sketch reveals, but the quick take seems to point in the direction of YES.

In the following table, I identify the eight firms of around medium size with high leverage ratios from the IRLG data:

Firm	Follow On Profit Analysis		
	Size	Leverage	Adam Smith
<a href="#">Cleary Gottlieb Steen &amp; Hamilton</a>	889	3.94	
<a href="#">Simpson Thacher &amp; Bartlett</a>	687	3.20	yes
<a href="#">Debevoise &amp; Plimpton</a>	666	3.53	
<a href="#">Davis Polk &amp; Wardwell</a>	639	3.09	yes
<a href="#">Willkie Farr &amp; Gallagher</a>	594	3.14	
<a href="#">Cadwalader Wickersham &amp; Taft</a>	565	3.57	yes
<a href="#">Cravath, Swaine &amp; Moore</a>	479	3.38	yes
<a href="#">Schulte Roth &amp; Zabel</a>	398	3.70	yes

Then, based on a February 24, 2006 post on [Adam Smith, ESQ](#). I was able to make the simple observation that five of the eight firms above were included among the top ten most profitable (in profit per partner) New York Law firms for the years 2004 as reported by [The American Lawyer](#). Of additional interest is that the remaining five most profitable firms on the list are all medium sized firms with between 400 and 600 lawyers in the same most recent IRLG listing.

With a little further investigation, I also observed that composition of the top ten firms in profit per partner according to The American Lawyer remained much the same in 2006 as

it was in 2004. The two lists contained seven in ten overlapping firms. That gives some sense that the organizational strategies of the firms are not so fleeting as to disappear in three years.

Admittedly, this is not an exhaustively rigorous analysis. Still my proposition is that there is something to these regularities. There are broad economic and strategic management frameworks that shine light on the data. The logic and evidence are consistent – at least in a very general way.

There is no use for the moment in arriving, or even attempting to arrive, at some normative conclusion that to make more money per partner a firm needs to be medium sized and highly leveraged. There are many other matters of choice that enter the equation for the organizers of a law firm. All of them have some form of economic value, even if they are hard to measure in monetary terms. Just a few include:

- What kinds of law do we want to practice?
- What kind of work culture do we want?
- What level of collegiality are we after?
- How do we want to treat the associates who work for us?
- What kind of future do we want for our employees and ourselves?

### *Is it just a matter of size or is it substance?*

As we see the most profitable firms on a per partner basis are neither the largest firms nor the smallest firms. They are the medium sized firms which are clearly not “stuck in the middle” and doing just fine on the bottom line. There are at least two possible explanations for this. One is that there are (and there probably are) certain diseconomies of scale in selected areas of practice that keep the largest firms from hitting the “sweet spot” of leverage all the time. They need to have practitioners in those select areas to fill out the full-service offerings -- but it does not make sense for them to build up to the maximum levels for such reasons as excessive conflicts.

Another less obvious explanation is the prospect of innovation from the cost sharing of both tools and techniques across related but diversified business activities and practice areas. These interactions are usually referred to as synergies. We might easily speculate that the more profitable medium-sized firms are specialists in a collection of areas where resources can be shared and that they organize their resources to facilitate the sharing.

For over 40 years strategists have recognized the prospect of related-diversification. In my own Ph.D. dissertation, I observed that there were firms who were able to exploit investments in technology across multiple but related business activities.

These ideas about the prospect of some optimal organizational form are not without skeptics. I confess also that the relationship I found in my dissertation seemed far more tenuous and far less economically significant than most strategy proponents urge their

audiences to accept. Economists are the most skeptical and are less inclined than business strategists to accept the idea of some static organizational structure that generates innovation and profits. They are more likely to conclude that higher observed performance is based on industry effects.

Individual industry effects are obvious. How many firms, for instance, maintained telecommunication practices 50 years ago. How many focused on the law of life science or healthcare? The question here, however, is a shade different than “what is the next boom industry?” There is no convenient way to assess if the more profitable firms are merely riding the crest of certain industries they happen serve. All we can say is that does not appear to be the case based on the self-descriptions of the firms.

In any case, the regularities that suggest some kind of substantive and organizational optimization or synergy exist. And we can at least say across most industries that there appears to be a general association, even if not causation, between related-diversified business portfolios and higher levels of profitability. So, it is not too strange to wonder if is it possible for law firms to “internalize” in a planned way the economic gains that come from technical progress?

More precisely, what we want to know is whether we can cluster related activities around some technology to extract more profits than either complete specialization or overall market diversification will yield.

### ***Are certain assets more critical to profits than others?***

Value can come from many sources. It can come from the kind of individual custom attention that seems to be the earmark of the smaller low-leverage firms and it can come from the likely repetitive assembly of mass work product such as is suggested for some of the very large firms. All forms of legal practice appear needed and we can suppose all forms are efficient and wanted to make society function well.

The contrasts between the medium size high-leverage firms the rest of the firms suggest a different emphasis. What that is, of course, stands far from obvious? But, whatever it is; industry effects, timing, etc. there are interesting profit implications suggested in the prior comparisons.

In casting about for a theory. My particular favorite (maybe it is also the most self serving) is the one that says the medium sized firms are engaged in a kind of foresighted optimal strategy for themselves. It is their plan, I conjecture, to recruit high value associates and give them the opportunity to grow across related areas now, giving them enrichment as a sense of professional growth, followed by a decent chance at the lottery of significant income later in their professional career.

I am long way from having any broad or reliable estimator of associate quality, but I find it attractive to borrow the thesis advanced in an article posted on Adam Smith, Esquire and cross-posted in my own blog at [www.kengartrell.com/blog/](http://www.kengartrell.com/blog/).

The article from the [\*Journal of Economic Education\*](#) is entitled “Do Economists Make Better Lawyers? Undergraduate Degree Field and Lawyer Earnings.” By R. Kim Craft and Joe G.

Where in the abstract it says:

Using nationally representative data, the authors examine the effects of preprofessional education on the earnings of lawyers. They specify and estimate a statistical earnings function on the basis of well-established theory and principles. Along with standard control variables, categorical variables are included to represent graduate degrees in addition to the law degree and an assortment of undergraduate major fields. Holding a Ph.D. or M.B.A. degree, with the law degree, is associated with significantly higher earnings in some sectors. Lawyers with undergraduate training in economics earn more than other lawyers, ceteris paribus, and economics is the only undergraduate field associated with earnings that differ significantly. The available evidence supports the hypothesis that economics training increases a lawyer’s human capital compared with other undergraduate majors.

Could it be then that the more profitable medium-sized firms with higher leverage ratios assemble a higher relative proportion of economics and business students on their team and employ them in diverse, but related fields, where knowledge of such things is transferable?

As an expert in economics, finance and accounting, for example, I have a lot of first hand experience with lawyers and the courts in connection with the knowledge we have about these fields. I have very strong views that a great deal of the value of the technical work has been lost when lawyers did not have the technical skills, drive, budget or some combination of them to make the best use of our work.

My work is not always in a litigation context, so I can also say this same point holds true in connection with advisory services, contract preparation and a variety of other areas in the practice of law. The logical extension is to assume that business clients look at the situation much the same as I do. It is of persistent importance to all consumers of professional services that they want to feel comfortable that the professionals who serve them “understand the business.” This in turn begins when the professionals have more than a laymen’s understanding of business and economics in general.

On the basis of the theory above I looked into this possibility that it was a business emphasis at the core of the strategies of the most profitable law firms. I found some useful evidence that lawyers with economics and business in their non-legal training are more imbedded in the high-leverage firms than in others. The results are far from conclusive, but they are at least consistent with the thinking to a measurable extent.

According to the data in the table below, the 8 New York firms of around medium size and high-leverage, I could get information about the degrees the lawyers held besides from law schools. In 5 of the 8 cases, I found a list of those who studied either economics, had an MBA or had a BBA. For the usable observations, I pooled the data and calculated that the size weighted average of those with such degrees represented just less than 10% per capita of the members of their firms.

#### Other Degrees in

Firm	ECONOMICS	MBA	BUSINESS	Total
<a href="#"><u>Cleary Gottlieb Steen &amp; Hamilton</u></a>	6.786%	2.111%	1.659%	10.557%
<a href="#"><u>Simpson Thacher &amp; Bartlett</u></a>	4.444%	4.444%	0.212%	9.099%
<a href="#"><u>Debevoise &amp; Plimpton</u></a>	6.917%	4.192%	0.838%	11.947%
<a href="#"><u>Davis Polk &amp; Wardwell</u></a>	NA	NA	NA	NA
<a href="#"><u>Willkie Farr &amp; Gallagher</u></a>	2.470%	2.223%	0.741%	5.433%
<a href="#"><u>Cadwalader Wickersham &amp; Taft</u></a>	5.898%	5.161%	0.737%	11.796%
<a href="#"><u>Cravath, Swaine &amp; Moore</u></a>	NA	NA	NA	NA
<a href="#"><u>Schulte Roth &amp; Zabel</u></a>	NA	0.344%	NA	0.344%
Weighted Average				9.846%

As a quick baseline for control, I looked at the top three law firms in size and did a similar search of the staff. I found that about 8% percent of the lawyers in the big firms had other degrees in economics and business. I then examined the smaller firms and found that in general the lawyers with backgrounds in economics and business were less than 5% per capita in their respective firms. In other words, at nearly 10% per capita the relative population of lawyers with business and economics in their background was an estimated 20% higher in the medium sized firms than in the largest firms and almost double that of the smaller firms.

Obviously, these results are subject to measurement error. What really is needed is a more exhaustive study of the staff makeup of the major firms. There is no obvious reason a smart lawyer cannot learn the economics and the institutional details needed to function effectively as a business lawyer or a litigator. There is, nevertheless, a reasonable prospect that the technical knowledge base of business has now gotten to the point where it is not readily accessible without specialized training. This would seem especially true in the more developed and complex areas of financial economics.

## ***SUMMARY***

There are crude ways of understanding the difference in law firms according to their relative size. There is clearly more than one way to practice law – not only in terms of substantive law but also in terms of organizational design and emphasis. As this exploratory examination shows, there are also ways to penetrate another layer and make some further sense out of how law firms organize. The distribution of firm size takes a different shape and meaning when the dimension of staff leverage is introduced. The largest firms and the smallest firms do not utilize the most leverage or make the most profits per partner. On the other hand, medium size firms with high leverage ratios do manifest higher per partner profits at certain points in time.

It would be unwarranted to make claims there is an optimal path to profits in law firms. The weaknesses of the foregoing analysis are obvious. The only way to be more confident is to study the entire population of law firms and lawyers with as much rigor and data as possible.

Right now, I am operating in the realm of hunches. They tell me that it is worth the time and effort to begin the process of scaling up a deeper study and getting a better handle on a cross section of data. If that effort leads to something, then I would likely do more to understand the dynamics underlying the profit.

For now, however, I am content to lay this modest study on the table for consideration of what it suggests. There is a lot of interest in applying business concepts to the management of law firms and the ideas examined here are an outgrowth of the longer-term study of business and industry in general. There is no clear reason they would not have some application to the legal profession.