

IN FOCUS

MIDSIZE FIRMS

Middle-market firms thriving in the land of giants

‘Small giants’ can offer what megafirms sometimes can’t, including personal attention.

By David T. Brown

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FOR SOME TIME NOW, law firms and legal industry observers have been obsessed with the creation of large law firms, primarily via mergers and acquisitions. There were more than 50 law firm mergers in the United States in 2006, a greater number than in each of the preceding three years.

At the same time, questions are being asked about the viability of middle-market firms that choose not to participate in the merger mania. What so many observers seem to be missing is that this “megafirm” trend actually is helping to ensure the continued success of middle-market firms and the attorneys who work for them. While the leaders of the nation’s largest firms are hard at work trying to identify and woo attorneys in the middle market, other forces are at work in the wider business and legal environments.

In the general business world, the insights of Bo Burlingham, author of *Small Giants: Companies That Choose to Be Great Instead of Big* (2005), are receiving significant attention. Burlingham, who is editor-at-large of *Inc.* magazine, has firmly asserted that “growth for growth’s sake is out,” and that truly great companies are focused on excellence rather than size. “Small Is the New Big,” *Inc.*, Feb. 2006, at 80.

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Burlingham’s work shines new light on advertising executive Jay Chiat’s famous quote, “How big can we get before we get bad?” Simon London, “Why size isn’t everything for the modern multinational,” *Financial Times*, Nov. 2, 2005, at Business Life 14. Applying this question to the current business environment, he explained that many of the world’s 150 largest companies are struggling to achieve consistent growth. Others are profitable, but not very complex. Microsoft Corp., for example, earns a substantial portion of its profit from the sales of one product—the Windows computer operating system. In addition, the company employs only 60,000 people, compared to Wal-Mart’s 1.3 million.

Also suggesting a bright future for middle-market firms is the continual growth in the small-to-midsize business sector, which represents the primary client base for these firms. According to the U.S. Small Business Administration, companies with 500 or fewer employees created 60% to 80% of net new jobs annually during the decade ending in 2006. These businesses, which represent 99.7% of all U.S. employers, create more than 50% of nonfarm private gross domestic product. “Frequently Asked Questions,” *The Small Bus. Advoc.*, July-Aug. 2006, at 5.

While these companies may not be among the country’s largest, their legal needs can be quite complex. In fact, these clients sometimes need global representation that middle-market firms can satisfy through highly effective networks of select, like-minded firms around the world.

One need only look to the accounting industry for a powerful analogy of middle-

market potential. Following consolidation and other changes during recent years, accounting firms that have focused on the middle market have thrived. On a national level, CCH Inc.’s *Public Accounting Report 2006* illustrates the trend that non-Big Four firms are growing at a faster clip than the Big Four. In fact, the data show that non-Big Four firms experienced 21.9% growth in 2005—an increase from the previous year’s 16.4% mark. Big Four firms grew by only 14.7%, an increase from their 6.9% mark in 2004. CCH Inc. *Public Accounting Report 2006* and CCH Inc. *Public Accounting Report 2005*.

Clearly, accounting firms such as RSM McGladrey Inc., Moss Adams LLP and Plante & Moran LLP are all reaping the rewards of their focus on the middle market. Logic dictates that as there become fewer middle-market law firms, similar benefits will accrue to firms that remain in the sector.

These factors—growth in the small-to-midsize business sector, combined with the trend toward law firm consolidation—should ensure substantial, increasing demand for the legal services provided by the middle-market law firms that remain focused on delivering high levels of service and value.

The voice of the market

It is important, of course, to examine what the legal marketplace is trying to tell us about the megafirm trend. In a recent opinion piece, Thomas Sager, chief in-house litigation counsel for E.I. du Pont de Nemours & Co., wrote that merger mania is not a good thing for clients. Among his conclusions, which are consistent with Burlingham’s view that big is not always better, is the observation that law

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firm mergers often result in rate increases that are not tied to added efficiencies or other client benefits. In addition, he noted that “most of us” hire law firms for their expertise and the quality of their lawyers, not their size and reach. He concluded that when firms grow very large they find it difficult to maintain their culture—one of the things that made them attractive to the client in the first place. Sager added that post-merger conflict issues often create an environment in which a client can no longer work with a preferred firm or attorney. Thomas Sager, *Bigger Isn't Better*, Am. Law., March 1, 2007, at 89.

Many middle-market firms are ramping up their recruiting.

In private discussions with the author, legal recruiters confirm that these issues are already beginning to play out in favor of middle-market law firms. These consultants report that many middle-market firms are ramping up their recruiting capabilities in direct response to the fallout from increased megafirm merger activity. After spending their careers building their middle-market portfolios, many partners suddenly find themselves working for a much larger firm. With that dramatic shift comes the possibility of losing their clients due to conflicts, cultural-fit issues and higher fees. These and other factors can drive talented attorneys to search for a new middle-market firm to call home.

In addition, many lateral recruits recognize that their clients might be more valued at a middle-market firm. They know that such firms often offer more opportunities for advancement, as well as the ability to do more substantive work earlier in their careers.

It is noteworthy that two major law firms announced recently that they are terminating or de-equitizing large numbers of partners. In both cases, law firm officials have said that

profits per partner (PPP) are driving their moves. Leigh Jones, “Downsizing: Who's Next?” NLJ, March 12, 2007, at 1. The rationale is that high PPP metrics will suggest high quality to clients and help the firm lure the best talent. But sophisticated clients don't necessarily believe that. They understand that shedding less profitable attorneys—and their clients—doesn't make the remaining lawyers any smarter or more efficient. Certainly, well-managed firms need to make strategic decisions that will help them become stronger businesses. But the focus on PPP clearly is driven in large part by the obsession with growth.

Meanwhile, the gigantism trend among large law firms consistently minimizes what should be the most fundamental tenet of all firms: to be intensely focused on client needs. When growth for growth's sake—or for profit's sake, no matter how it is rationalized—becomes the primary focal point of a firm, clients are relegated to the back seat, regardless of who they are.

Among the characteristics Burlingham attributes to “small giants” are that they “cultivate relationships with employers, customers and suppliers,” and that there are common purposes shared by all. The greatest strength of the best middle-market firms lies here. Those that have chosen to remain independent have thereby committed to their clients that they will be tomorrow what they are today—only better. The clients' loyalty, trust—and yes, their business—will continue to be held in the highest regard.

Similarly, attorneys in independent middle-market firms will not wake up one day and realize that the clients they are devoted to are no longer welcome due to a post-merger conflict, or a sudden shift in business priorities, or because their books of business are not quite large enough for the new firm's model. The attorneys know that what is expected of them by their firm will not change due to merger-focused business priorities.

Reason to celebrate

Certainly, many firms that grow through mergers and acquisitions remain successful and

retain talented lawyers who value their clients. Likewise, there are plenty of global companies that require the resources and deep international platforms that the megafirm model provides. But it is time to reconsider the blanket admiration with which the marketplace views the growth-focused strategies that some of these firms have adopted. At the same time, as middle-market firms go about their business on behalf of their clients, many actually welcome the continuation of the merger trend. Every time a news item appears on this topic, or a managing partner announces that his or her firm is de-equitizing partners in order to improve profitability, there is reason to celebrate for the client-focused middle-market firm.

As the gigantism trend continues, other realities in the business and legal arenas not only support the future of middle-market firms, but suggest that they will become ever more vital. Despite the prevailing perception that survival is the issue at hand, middle-market firms will continue to thrive as an important alternative for clients and attorneys who feel left behind by mergers and

Blanket admiration of law firm growth may be misplaced.

the strategic direction of the firms that engage in them. In fact, as these trends play out, middle-market firms should expect to receive calls from larger clients as these companies grow increasingly dissatisfied with merger mania.

By continuously delivering excellence, rather than concentrating on growth, great middle-market firms committed to remaining independent are setting the gold standard for how and where all law firms should be focused. **N.L.J.**

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