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## **Measuring Law Firm Performance: A US (Economist's) View**

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In recent years, articles and discussions focused on measuring law firm performance have increasingly centered on a single, and I will argue simplistic, number commonly believed to make accurate and robust comparisons across firms. That number is annual profits per equity partner, or "PEP."

Unfortunately, the fixation on PEP has had a number of deleterious unintended consequences:

- Intended to increase transparency
  - It has led to gaming the numbers and obfuscation
- Intended to measure relative financial strength across firms
  - It has led to economically short-sighted behavior
- Intended to enlarge the discussion around law firm performance
  - It has shrunken the conversation to a single cramped point

Being of a practical turn of mind, I find myself asking what PEP can contribute to informing decisions facing the senior leaders of law firms, and I am forced to the conclusion that it is at best of no help and at worst is corrosive.<sup>1</sup>

The longer I'm a student of our industry, the more I believe leadership matters—in distinguishing firms from their peer group over time and in generating and reinforcing the virtuous circle whereby top talent can be attracted to a firm, enhancing the quality of work product and client satisfaction, permitting premium rates to be charged, attracting in turn more talent, and so on. It may be a truism to observe that our world is increasingly competitive, globalized, and operating on a 24/7 basis,

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<sup>1</sup> Lest you think "corrosive" is too strong an indictment, I should remind you of Mayer Brown's infamous decision in the spring of 2007 to "de-equitize" some 45 partners, presumably in aid of juicing their PEP figures. Can you imagine a move more powerful at destroying morale, killing incentives, and at a simple human level of humiliating the victims? If PEP leads to management behavior that takes 45 of the firm's relatively senior and presumably competent and productive individuals and relegates them to the professional equivalent of Siberia, it cannot be a healthy guide to action.

This has an analog in the corporate world, by the way: The behavior associated with beating Wall Street's quarterly earnings estimate by a penny or so. Of what possible social or economic utility is that?

but those trends are none the less true and in this environment, leadership matters as never before.

And since PEP has no advice to offer leaders—not, certainly, on the key question, “What do I do Monday morning?,” it is irrelevant to the leadership challenge. QED.

We have seen presented six factors believed intrinsic to measuring how leadership of a firm measures up:

- Strategy
- Innovation
- Clients
- People
- Social capital
- Efficiency

If these are being nominated as replacements for PEP, it’s only fair to ask whether they provide a guide to action. It’s my belief that deploying people—your firm’s core asset—against the six factors essentially answers the “Monday morning” question: Who/what/where/when/how, and of course the all-important why, which boils down to *incentives*. The power of incentives means that “you get what you pay for” (and otherwise recognize and reward).

Let us take the six factors in turn, and see what pursuing each of them might mean senior management would actually do.

- Strategy: If your firm is serious about strategy, you would encourage people to think hard about possible practice and client options, caucus, study, and perhaps draw out scenarios. All of these are concrete things that can be consciously intended and pursued.
- Innovation: Again, guides to action are ready to hand. For example, cross-fertilize some departments and see what emerges: IT & Marketing, Knowledge Management & Business Development, or Structured Finance & Insolvency.
- Clients: Institute powerful CRM programs; imagine clients giving presentations to your firm instead of just vice versa; send a team to a client for a “free day.”
- People: This is an especially easy one: The investment you make in training and planning career paths today will pay off most handsomely in the long run.
- Social capital: These are the “corporate social responsibility” behaviors that we all know we should do, even if the resolve is honored in the breach. But your firm can get serious about increasing diversity, its commitment to pro bono, its insistence on advancing equal access to justice and the rule of law.
- Efficiency: Again, an easy one. Our clients increasingly demand efficiency, and the Darwinian logic of the marketplace is such that if a peer or competitor can provide it, we will in quite short order find ourselves compelled to match or best their offering.

Again, getting people to actually *do* these virtuous things comes down to aligning their incentives with the desired behaviors and letting *homo economicus* loose.

Now, at this point you may be about to object that this may all be well and good—may be quite lovely, in fact—but isn't it just dreamy, evanescent cotton fluff? How on earth can you expect lawyers to ever do any of this?

As an American and an unreconstructed capitalist, I submit this is not at all “fluff.” Consider that lawyers are:

- Competitive and analytic
- Skeptical and curious
- And devout believers in evidence.

These traits ensure the following:

- Competitiveness and an analytic turn of mind mean that all the “Type A” personalities on your team will want to emulate the high performance of anyone else in the firm who seems to be deploying the six factors to their greater success.
- The traits of being simultaneously skeptical and curious—which are confessedly on the surface in conflict—mean that much as lawyers’ initial reaction to an innovation such as these six factors will almost surely be one of skepticism and doubt, they will not be afraid of seeing what results they might actually produce if faithfully followed.
- And lastly, if these six factors are indeed the superior guides to action that we believe them to be, then in the long-run results will out and converts will be made.

I would like to close by making a strong claim: That PEP is worse than mistaken, it's *irrelevant*. After all, for any given individual at your firm, the only thing that matters is what a friend jocularly (but acutely) calls “profits per *me*.”

In other words, none of the unique individual practitioners who make up your firm should or will be automatically paid the firm's average “PEP” as published in some annual ranking. Their compensation will instead reflect the value of their own personal human capital in the marketplace for talent. This is a unique, and quite strongly non-fungible, asset. Their ability to extract value from their own human capital, for the benefit of both clients and your firm, is not remotely reflected in any reductionist “PEP” figures—nor can they materially change their value by walking across the street or across town to a firm with a different PEP.

Finally, on a critical level—and one with almost spiritual or ethical overtones—our professional human capital is all we have in this life. It's too precious to be confused with an accounting artifact such as PEP.

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