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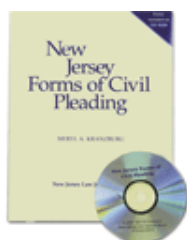
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## NEWS

### New Age Practice Switch to Two-Tier and Boost Profits Per Partner? Not So Fast!

By Bruce MacEwen  
New Jersey Law Journal  
November 14, 2005

I recently attended a presentation at Jones Day's Washington, D.C., office, hosted in their top-floor conference room with a picture-postcard view of the Capitol dome. (I'm not kidding about the postcard view: CBS News has built a broadcast booth on the Jones Day roof, where they most recently installed Dan Rather for Bush's second inaugural, and which they use whenever there's Capitol-centric news.)

The presentation was by my friend, Prof. Bill Henderson, of Indiana University School of Law-Bloomington, and focused on some fascinating - and counterintuitive - empirical findings of his about trends in the AmLaw 200 over the past decade or so. (The law school's dean, Lauren Robel, was also there.) Here are some highlights:

- In the past decade, one-third of the AmLaw 200 has converted from single-tier, up-or-out partnership structures to two-tier structures with so-called "non-equity" partners.
- 160 of the 200 (80 percent) are now two-tier firms; whereas the single-tier model had a virtual monopoly on the leading firms say, 25 years ago, it's now the distinct minority structure.
- The universally accepted common wisdom is that firms moved to a two-tier structure to increase profits per partner (PPP).

So how do single-tier and two-tier stack up?

- Single-tier firms are more profitable (higher PPP, that is);
- Single-tiers have lower leverage; and
- Single-tiers are more prestigious (measuring "prestige" by Vault associate surveys).

All these results are, on a statistical basis, "highly significant" (meaning less than a 1 percent probability that they result from chance).

What's counterintuitive about this?

First of all, if the goal of converting to two-tier status was to increase PPP, by and large it hasn't panned out. True, you get higher leverage, but evidently something else is going on that means that leverage does not translate one-for-one into higher profitability. (In a microeconomic sense, one can say that a "unit" of leverage is more valuable in the single-tier world than in the two-tier world; or phrased differently, that single tier firms do intrinsically higher-value work.)

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One can also say with high statistical certainty that: (a) associates in single-tier firms bill more hours per week and (b) when surveyed by *The American Lawyer*, report that they are significantly less likely to stay for the next two years. In other words, single-tier firm associates work harder and are unhappier with their jobs. Putting aside for a moment the human cost (this is a blog, after all, about economics), this finding invites the question of whether two-tier firms have not introduced an "adverse selection" process into their recruiting.

The theory is simple: Associates who prefer to work a little less and choose a larger measure of "lifestyle" over achievement gravitate toward two-tier firms. Not only will the demands on them as associates be (relatively speaking, anyway) milder than in single-tier firms, but a material proportion of them will ascend to nonequity partner status, earning perhaps \$300,000/year or more with no meaningful client-development or business-generating responsibilities. This is an utterly rational choice for the individual-but it does saddle the two-tier firm with some highly paid people who, by hypothesis, are not bringing in business.

On the other hand, for me the primary take-away from Bill Henderson's presentation is that, while single-tier firms remain a homogeneous category, two-tier firms are extremely heterogeneous, and generalizations across the universe of AmLaw 200 two-tier firms are best taken with a large dose of skepticism. (At the conference, I likened it to averaging Toyota and Porsche and claiming your result equated to a real-world car company - of course, it does no such thing.)

In other words, the real empirical work on two-tier firm-land remains to be done.

*MacEwen, a New York lawyer, is creator and host of the Web log "Adam Smith, Esq.," [www.bmacewen.com/blog](http://www.bmacewen.com/blog), from which this article is reprinted with permission.*

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