How a Focus on Managing Intangible Assets Drives Performance in Australian Law Firms

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ABSTRACT

This paper looks at the determinants of performance in medium to large Australian law firms in Sydney and Melbourne. The focus is on determining the specific I.C. and human resource management practices that contribute to a law firm’s performance. The opinions of a select sample of some of the most prominent and informed consultants, managers and managing partners in these markets, is used. Decisions to invest in human capital building programs are not taken lightly in these contexts; partners are spending their own money, thus their beliefs around ‘what works and why’ are of great interest to management research. We find that there is convergence in the perceptions of this sample around fourteen key practices. We outline the qualitative method, (convergent interviewing), and directions for future research.

Keywords: Qualitative, convergent interviews, Law firms, legal industry, resources
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INTRODUCTION

The legal services industry in Australia is very dynamic and has experienced massive structural and cultural change over the past 20 years – this is especially so in terms of the organisational design and management practices of the middle to larger firms in the Australian cities of Sydney and Melbourne (Gray, 1998). The growth in this sector has been fueled by a number of factors such as the massive growth in the financial services sector and the sustained period of growth in the Australian economy, the massive changes in legislation such as through the reforms to the Tax Act and the Corporations Act under the Howard Government and the expansion of the market for legal services to offshore locales in Asia. Further the growth has been driven through the provision of domestic legal services to inbound international companies setting up regional offices in Australia. The economic success and growing competitiveness of legal services in Australia has stimulated a concern with the business/management side of running a legal practice. Some of the top firms in Australia have annual revenue of hundreds of millions of dollars. Clearly, law firms are much more commercial than in the past and the partners of these firms are focused on improving their performance across a number of measures, both financial and non-financial. Some large firms are even looking at the issue of incorporation and seriously questioning the future financial wisdom of the partnership model (Schmidt, 2004). Further, law firms in Australia are facing a war for talent, they are acutely aware that to fuel ongoing growth and success they need to attract and retain talented staff and create effective systems for the production of legal advice.

This paper looks at the determinants of law firm performance and reports on the findings from a pilot study into this issue conducted in mid 2006. The key determinants of performance as identified in the research are discussed in the context of the resource based view of the firm. This work gives greater texture and richness to earlier findings and provides momentum to a larger study of law firm performance in Australia.
LITERATURE REVIEW

The following section briefly describes the various approaches to performance through management in the literature which are germane to this study and from which the larger research questions are currently being developed. Our focus here is on intangible assets and strategic human resource management. Much of this work is framed around the search for competitive advantage and thus a unifying concept is the resource based view of the firm and the link between HRM and human capital practices and a firm’s performance (Barney, 1991; Wright et al, 2001). Since its arrival was announced with the publication of Barney’s seminal work 15 years ago the resource based view of the firm has had an important impact upon the fields of strategic management and helped move human resource management onto a stronger conceptual footing. Barney’s view was that organisations should foster assets which are valuable, inimitable rare and non substitutable and that it is these resources which help to form the basis of an organisation’s competitive advantage. This idea has helped give rise to viewing human resource management as a strategic more than administrative/policing function in organisations and created a view of people as assets not costs – thus the now familiar term human capital is now in common use (Wright et. al, 2001). The resource based view has in turn given rise to the knowledge-based view of the firm a view which has in part arisen as many advanced economies have become more orientated toward service industries. The focus of management researchers on the services sector is appropriate given the various estimates which put the number of people employed in the services sector in Australia at around 80% and new approaches to accounting which seek to value the intangible assets of organisations namely their people, organisational structures, intellectual capital, brand and customer relationships (Grant, 1996, Sveiby, 1997). The key idea here is that by identifying measuring and managing intangible assets knowledge intensive firms can leverage their intangible assets to create sustainable competitive advantage (Sanchez et al 2000, Sherer, 1995).

Concomitantly, the field of strategic human resource management has evolved over the past 15 years and as part of this evolution extensive theoretical and empirical work has brought scholars to the
conclusion that certain human resource management practices and policies can be linked to improved firm performance. The focus on performance effects provides a ‘business case’ for expensive and time consuming HR practices such as training, performance management, selective staffing, mentoring and career planning.

According to Wright et. al (2001) consensus has been achieved in terms of how the people dimension contributes to competitive advantage; the elements of this contribution are represented in figure 1. This model reflects their view that no individual component of the system will produce competitive advantage rather; it is from the whole system that advantage is derived. Within this model there are three dimensions: firstly there is the human capital pool, which refers to the knowledge, skills and abilities of the workforce which must either be superior or they should fit with the strategic intent of the organisation; second, there are employee relationships and behaviours, this part of the model refers to the simple fact that employees possess free will and may exercise discretion in the execution of their role that can have positive or negative effects on the firm and finally, the authors describe the concept of the people management system, the ‘multiple practices that impact employees’. These are not necessarily driven by HR departments and they may have developed organically and contain path independencies that make them difficult to imitate and may thus be a source of competitive advantage (Wright, 2001, p.705).

Performance is another important concept in terms of our understanding. There have been many empirical studies in the management literature over the past 15 years which have shown linkages between the presence of high performance systems and HR practices and firm level performance. Performance may be purely measured in objective terms; annual revenues or rates of new product innovation for example (Li & Calantone, 1998). It can also be determined in terms of perceptual criteria such as employee opinions. In public companies objective measures of performance are readily available in annual reports but law firms are more reserved about reporting on their performance to outsiders and thus accurate performance data is difficult to obtain. Perceptual measures are however widely used in studies that look at firm level performance effects of HRM practices and systems (Delaney and Huselid, 1996) and have been shown to be strongly correlated with objective measures (Venkatraman & Ramanujam,
In this study we follow this precedent and are using perceptual measures of performance in the form of opinions derived from interviews. It should be noted that these opinions are from people who are privy to accurate performance data about their own and their clients’ law firms.

**Figure 1. A model of the basic strategic HRM components**

![Diagram of HRM components](image)


**HUMAN CAPITAL AND PERFORMANCE IN THE LAW FIRM CONTEXT**

Specific work has been done in the human capital, knowledge management arena as it relates to law firms and other professional services firms (Boxall & Steeneveld, 1999, Hitt et. al, 2001, Hunter et. al. 2002, Sherer, 1991). This industry specific work is particularly germane to this study. Sherer’s study looked at leverage ratios {number of associates (non partners) working for each partner} as a measure of human capital and a pathway to competitive advantage\(^1\) while Hitt et. al’s study used two proxies for

\(^1\) Sherer’s method and hypotheses entailed had some industry specific nuances for example he demonstrated an awareness of the fact that some areas of the law lend themselves more readily to leveraging, for example litigation, whilst others such as tax law are far more specialised and require greater direct involvement of a senior lawyer or partner and hence are less profitable.
human capital - the prestige of the law school that the partners attended and the total experience (number of years of tenure) of partners at the focal firm – this was a proxy for tacit knowledge or ‘know how’. Here the effect of human capital on the successful execution of service and geographical diversification was proven. In both these studies strong linkages were found between human capital and firm performance. This is somewhat different to the tests in other industries of human resource management systems and performance and according to the authors this provides a more direct test of the resource based view of the firm than studies which looked at the link between HRM practices and systems and firm performance (Hitt et. al, 2001). Another more recent study was undertaken in a small sample of Scottish firms surveying attitudes of partners and professional staff to knowledge sharing, human capital and human process advantage and in this study the findings suggested the firms were focused on attempts to economise on partner’s professional time through I.T. solutions and the greatest focus on tacit learning was at the new recruit level. Partners were less consciously aware of the potential benefits of social capital in terms of cross practice group knowledge sharing or debriefing with the authors citing the technology focus and business drive (revenue focus) as explanations for this approach (Hunter et. al, 2002). Law firms and indeed many professional services environments are therefore proving to be an ideal environment in which to conduct research on the human capital performance link. This is particularly in Australia at present due to the great dynamism, soul searching and the gradual professionalisation of management which is taking place.

**METHOD**

This research employed an interviewing technique called convergent interviewing (Dick 1990). A sample of experts was identified through industry knowledge, networking, preliminary reading and by meeting with key informants who provided recommendations of and access (via referral) to suitable candidates. Of the candidates selected, some, but not all, were currently (or had been until recently) actively involved in the day to day running of law firms, while the rest were consultants to the legal services industry, insiders with a balanced perspective on strategic formulation, management practice and drivers of performance. The sample was ranked in terms of their likely expertise from ‘most expert’ to
next ‘most expert’ (but from a different perspective to the first) and then to the third ‘most expert’, but with an equally different perspective from the preceding two respondents. Each group of three to four respondents constituted a ‘round’ of interviews. There were four rounds (n=11). Respondents were asked an open ended question to start with which was ‘what can you tell me about the performance of law firms and how it is achieved? The open-ended character of this question forestalled the researcher’s bias on the topic and allowed respondents to determine the scope of issues which they considered key determinants of performance. It also allowed them to frame ‘performance’ in whatever terms they deemed appropriate. Following the first interview, each subsequent interview allowed the researcher to follow lines of enquiry which would either confirm previous respondent’s views (and thus signal convergence) or suggest there was a divergence of opinion on the issues. Interviews continued until it was felt that further interviewing would not yield substantially new issues for consideration or shed new light on the topic of research.

RESULTS

There were two key elements to the respondents’ approach; firstly there is how respondents’ defined firm performance according to the respondents a firm’s performance could be gauged by issues which included issues from outside the mainstream such as employee engagement or climate while others deferred to the perhaps more common definition of performance namely financial performance or return to shareholders. The issues in addition to financial performance included: the firm’s reputation in the market (with clients) and in the profession among its peers; its capacity to create a good environment for its employees, reasonable work life balance and pay levels comparable to others; employee engagement, discretionary effort, propensity to recommend the organisation and business development performance or cost of sale Quality control; minimising write offs and timely collection of fees were other issues included.

Next they looked the key determinants of performance and these have been classified into three clusters after Sveiby (1997) and Wright et al (2001) the determinants are:
• **Leadership and fostering accountability** was seen as critical. For several respondents this meant setting expectations of performance and standards of behaviour for partners and holding them to account for breaches of standards. This was also discussed in terms of being able to articulate a vision for the firm and to set high standards of achievement.

• **Retention** – was discussed in general and specific terms. In general terms stable staffing was seen as critical as it creates intangible assets such as trust and ‘know’ how which translate into tangible value in terms of costs saved on recruitment and efficiency in client work. Retention also obviates the need for close supervision and also leads to less write offs. The second more specific need around retention was amongst the younger professionals, many of the especially larger firms are preoccupied with this issue as it is a major problem and a drain on profitability.

• **Management Ownership** The majority of respondents argued that the current partnership model with a managing partner at the helm has great utility. One respondent described it as “resilient”, it was seen as a mutually supportive model. Several felt that to lead a group of highly intelligent and cynical professionals that the leader needs to be a peer – this gives him or her credibility and ensures caution is exercised in decision making. An equal portion of the sample was as passionately against the concept of management by the owners, with one arguing “the intellectual and emotional drivers are incompatible to effectiveness”. Several made note of the fact that managing partners have limited experience as managers of large companies there is a gap between the requirements of leading a company with revenue of 100’s of millions and the sophistication that is needed. Another commented here that they have been exposed to a limited model of management or leadership with most having worked in the one organisation their whole careers. Certainly this is a critical issue with several large firms now being led by non-practicing and professional CEO’s and some medium sized firms employing General Managers. This will be an important leadership decision in the future and an area of interest to researchers.
• **Performance management** in the formal sense was widely agreed to be a critical determinant of performance in law firms, with great leverage felt from interventions at the partner level. Respondents felt that at this level PM focused them on collective goals and on behaviour orientated toward the company’s strategies. One managing partner commented that the positive effects of partner performance management were felt “almost instantaneously”.

• **Diversity** was seen as important to several respondents this was noted in relation to the participation of women at senior levels in the profession (to partner) which meant flexibility in terms of work design. One prominent managing partner held the view that the male/female partner mix in large firms was currently around 80/20, that person’s view was that the firms who move it to 70/30 in the next five years and aim for 50/50 will be approaching the right mix. Diversity was also seen as important in terms of selecting staff from outside of the traditional breeding grounds of elite schools and old brick universities and opening the doors to a wider ethnic mix with language skills and cross cultural flexibility.

• **Attracting Talent and Selective Staffing** Naturally in a knowledge intensive industry such as the law the ability to attract good staff is critical and most law firms in our sample appear to place a heavy emphasis on recruitment particularly at the graduate level. Graduates are reviewed for legal expertise by virtue of their university grades and in terms of ‘fit’ when the firm sees them in action on a summer clerkship (intern program) at the end of their fourth year of law. Sherer (1995) has discussed the reticence of some traditional New York firms to hire lateral hires and the preference of law firms to inculcate and nurture their own lawyers to become partners. While this is a preference in our sample there appears not to be the same taboo around the issue in Australia. The issue is however very carefully managed, the main reason it doesn’t work appears to be when the person does not fit in with the new culture.

• **Sustainability & Flexibility** Managing motivation and sustaining people’s enthusiasm over a long and arduous career is another major challenge that must be met according to the research. Some firms accept that professional burnout is inevitable and encourage partners to plan their
lives around having a short and lucrative professional life that will end somewhere in their 40’s or 50’s, hence they make superannuation mandatory and ensure that partners are not forced to work into their 60’s. Others take an approach of setting realistic revenue targets for the firm and ensuring that daily billable hours are manageable and allow time for work life balance and also time to manage and develop staff. Other suggestions are that firms need to create options for career breaks for valued staff.

**Structural Capital**

- **Collegial Culture** The research affirmed the consensus based collegial culture of law firms with one respondent discussing the need for authority to be built on consensus and respect not absolute power (to dismiss an underperforming partner for example). This structure does however prevent the allocation of human capital to new markets for example in that a partner could not be forced to relocate to a new market to work on an important project, this may place some constraints on expansion.

- **Efficient Processes** Clients it was felt ‘buy’ good processes from law firms they not only buy the individual lawyer’s expertise but they are also buying efficiency and responsiveness and this is the product of good information and file management systems. Efficient process also helps minimize write offs.

- **Team Structures** The research affirming the value of creating small teams which are structured around either client groups or practice groups with particular legal specialties. This it was felt creates engagement so that even though a junior may be working on a routine part of a larger litigation case, discovery for example, they would still feel ‘part of’ the project. This could be achieved with weekly project meetings and updates. Others talked about the value this created in terms of the quality of mentoring received and the opportunity it provides for senior associates to learn how to manage.

- **Managing the Billable Hours Syndrome** – A common problem talked about in the literature of professional service firms is the often problematic issue of the billable hours syndrome (McKenna
& Maister, 2002). This is an issue where an all consuming focus on client work and unreasonable targets create negligible time for managing, mentoring or business development. Two approaches have been seen as a way to manage this concern. One simple but novel approach is to abandon the idea of individual targets and create group budgets – this creates a self monitoring system within a practice group so that individuals may play to their strengths; good managers within the group do more managing than others and good business developers take an external focus on growing the client base. Another approach is to make billable hours targets reasonable with incentives for overachievement. Would the billable hours concept be worth reconsidering? The resounding answer was no in this research; the system is easy for clients to understand and it is easy to administer and build budgets around.

- **Vision & Clear Strategy** – The research affirmed the commonly held view that a clear vision holds great value in terms of the direction it provides. There was consensus across the sample on this point with several firms demonstrating aspects of vision and the strategy to support it. One firm involved in labour law for example has a clear strategy that they only work for employers, another organisation has a no financial institutions or banks policy, still another is focused on internationalisation with a clear strategy to grow their offshore revenue. The presence of this discipline of planning is also valuable at the mid tier end of the legal service market with some eight partner firms affirming the value of processes such as quality audits such as Law 9000 providing discipline to their strategic planning and practice management.

**Relational Capital**

- **Firm Reputation** The firm’s reputation for offering excellent client service and legal expertise is a critical element in how a firm is seen in the market. Clients are seen to highly value the turnaround of legal advice. The market determines the depth or extent of the advice required. In some areas of the law responsiveness is highly valued and legal problems need to be solved quickly with the client willing to accept some commercial risk. In others no risk is tolerable and thus the client accepts they need to pay a premium for comprehensive advice. In commercial law
the big profitable cases such as litigation or mergers and acquisitions, which attract high fees and allow for good leverage, are often the result of being seen as the best and this can be the culmination of doing smaller work with less leveragability but doing it well. Success leads to larger work. Thus on the defendant side security of tenure in terms of the clients represents tangible value in terms of repeat business and the potential for the reuse of information.

- **Corporate citizenship/thought leadership** These issues help define the organisation as a good place to work for potential employees; it positions the brand positively and also attracts clients, particularly well informed clients. This is more common now than in the past as General or Corporate counsels in corporate organisations are informed consumers of legal services and see thought leadership as an indicator of expertise.

These fourteen issues represent the dominant issues around which opinion has converged at this stage of the research. Some divergence (exceptions to the majority opinion) has been found and these areas will need to be explored in the next stage of the research. One issue of interest is the notion of resilience of the law firm as an institution. Several comments stand out here: one respondent said that because of the amount of work in the market at present that many law firms can survive “…without a lot of thought going into what they do” but not thrive. Another made the comment that law firms are “incredibly resilient” and another commented that some survive “in spite of themselves”. None however positioned firms such as these as having a competitive advantage. Another issue of note is around the issue of ownership. The “proprietal mindset” was a controversial issue that stood out in the research and acts as a double edged sword. With the partners at some firms characterized as loathe to invest in their people or to share the benefits of success with the employees in terms of investment or profit sharing. The professionalisation of management is a controversial issue with some affirming the critical role of non practicing managers from non legal corporate backgrounds can play in the success of firms. Having said that several respondents in the survey placed the role of HR Managers under something of a cloud: two comments stand out as telling of the standing of the human resource management function in law firms, one respondent commented that
partners have been largely disappointed by the impact of HR interventions; another commented that HR ‘rarely have a seat at the strategy table’ but that ‘HR managers are paid well in top tier law firms because the partners buy their subservience, they “pay them to be compliant’ so while human capital is certainly seen as a strategic asset in the legal field “…the traditional HRM function has not been thought of as a strategic asset, and consequently is under pressure to reduce expenses and demonstrate efficiency in the delivery of their services” (Becker and Huselid:1998:54)

The performance management system that is built into a firm’s structure is another critical element, yet performance is not always measured in holistic terms. One comment was that that the default measure of performance is in 99% of firms around a partner’s financial performance. Despite this focus there are also major concerns at present for large to medium sized firms around the areas of people management and business development and firms which are widely regarded as successful have made these areas a priority in terms of the development and management of their partner’s performance.

DISCUSSION

Some respondents in this study have a view that law firms have been rather slow to embrace the concept of a well developed plan of action around the management of intangible capital leading to more sustainable performance and this echoes recent findings (Hunter et al, 2002). We could develop a view that corporate law firms are machines which are driven by the principles of exploitation and conformity from pragmatic solicitors who aspire to make partner. This may be a function of inherent conservatism in the field or it may be a function of the “billable hours” syndrome, where professionals are so consumed by meeting strict billable hours targets that they are unwilling or unable to focus on very much else. Other arguments include that professionals are prone to protect their knowledge, they tend to work in a semi-autonomous fashion or as a discreet unit and often they will have insights and methods that they alone possess. The professionals may see this knowledge as their own; some may even regard it as the source of their worth or even their power, or an insurance policy against redundancy (Davenport and Prusak 1998).
behavioural change with the latter particularly focused on the behaviour of partners and there is a clear understanding from all respondents in this research that a focus on intangibles is a critical determinant of success. The execution of policies around this challenge is however clearly mixed.

Retention is a major concern for larger (top tier) law firms particularly in relation to their well trained solicitors in the so called ‘generation y’ age bracket. These young lawyers are attracted away from the firms following an initial period of employment and are especially sought after in places like Hong Kong and London. The reasons for this exodus are many with some commentators claiming a specific retention and management plan is required for this generation due to their idiosyncratic characteristics but certainly one explanation for the trend is the issue of remuneration. Young lawyers in the markets of Hong Kong and London are paid exorbitant salaries. In the domestic market too there is a war for talent for young lawyers, with many young well trained lawyers attracted to the large salaries available in investment banks or to the more lifestyle or family friendly environments of corporate life outside of legal practice. Brand recognition is also a critical concern for large law firms with widespread participation in the profession in an annual customer satisfaction survey conducted by a private consulting group under the auspices of the Business Review Weekly. This annual edition of BRW breaks sales figures for the periodical annually and the firms that score well on the survey make sure their clients and staff are aware of how their firm ranks by prominently displaying their awards.

Mid and large law firms are also keen consumers of management consulting services (strategic planning, performance management systems and executive training), they have thought about the need to formulate organisational structures which foster cooperation and knowledge sharing. Profit, however, remains a driver and large potentially dehumanizing but highly leveraged areas of practice offer great profits. Law firms are also cognizant of demographic trends in Australia and are aware of the need to foster workplaces that are family friendly and which cater to the needs of working mothers and older professionals. There is even talk in the larger firms that it is reaching the time where they may take the final and more daring move to mirroring the corporate organisations they serve by opening their doors to private investment and even to an eventual public listing (Schmidt, 2004). Finally it is very clear that come
of the firms covered in our survey are very conscious of their strategy and have clear criteria around who they will and will not work with and this is seen to be an important consideration in determining their success.

The summary presented so far has not yet mentioned a less positive reality of life for many lawyers working life in a large law firm that is often glossed over and that law firm managers must come to terms with as one respondent put it: “not all lawyers especially partners are easy to co-exist with let alone manage”. Some respondents have characterized performance in some conventional law firms as driven by exploitation and that it is an environment that is structured along a conventional hierarchy and typified by the competitive behaviour of partners who are driven by their need to meet billable hour targets. In many ‘top tier’ law firms partners who are top fee earners ‘get away with’ inappropriate behaviour such as bullying junior staff. These firms may be profitable but there is a question mark in the current climate as to the sustainability of this approach.

This paper has presented a textured view of the management of middle to large law firms in Sydney and Melbourne and argued that the path to competitive advantage lies in the management of intangible assets and through the people management systems that are put in place. The research has identified the scope of issues that contribute to competitive advantage and these may now be investigated in further depth using quantitative surveys and in depth case studies. The resource based view of competitive advantage offers a compelling explanation for what makes a good firm great and in the law firm context these resources are intangible. The challenge lies in presenting compelling arguments for adopting the determinants of competitive advantage outlined in this research and on quantifying the contribution to competitive advantage.

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