TGO CONSULTING

MERCENARIES ON THE MOVE

The new reality of Big Law

An in-depth analysis of partner mobility in the German market

FOREWORD

This is the first report that presents an in-depth analysis of lateral partner moves in the German market over a longer period of time. It covers the hiring activity of the 25 top-ranked law firms in the German legal market since the start of 2011. For the first time, it is revealed that the German lateral hiring market has evolved to reach an unprecedented high and that partners are shifting across the board. An analysis of the data provides an insight into the practice areas that are most concerned and which type of firms are hit the hardest by equity partners seeking opportunities elsewhere.

In a sector where the hunt for talent is fierce and law firms are scrambling to shape themselves for the opportunities to come, top lawyers are simply in too high demand to be loyal. The results of this report can be seen as a sign of the times we can expect ahead. With Brexit on the horizon firms will jostle to position themselves in order to benefit from a shifting market. In an ever more competitive playing field the fittest will survive.

TGO Consulting is an international boutique for business strategy, positioning and boardroom counselling in the legal sector. TGO Consulting operates globally and specialises in working with large and mid-size business law firms. Based on over a decade of experience the firm has unparalleled knowledge of the legal sector and its ownership structures.
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YESTERDAY 'NOBILE OFFICIUM' TODAY MERCENARIES

In London, we have in recent years witnessed a war for talent between US and Magic Circle firms, which have sent the latter scrambling to review their rigid lockstep system that prevents lucrative signing fees or other incentives that lure rainmakers the way US firms can offer. The Magic Circle firms often argue that lockstep directly incentivises partners to cooperate for the greater good of the firm. But lockstep is also arguably a weakness when it comes to attracting and retaining top partner talent, especially in competition with firms offering merit-based compensation systems. Even in the wake of the spectacular failure of Dewey & LeBoeuf, UK top firms are reviewing their compensation systems.

FIGURE 1

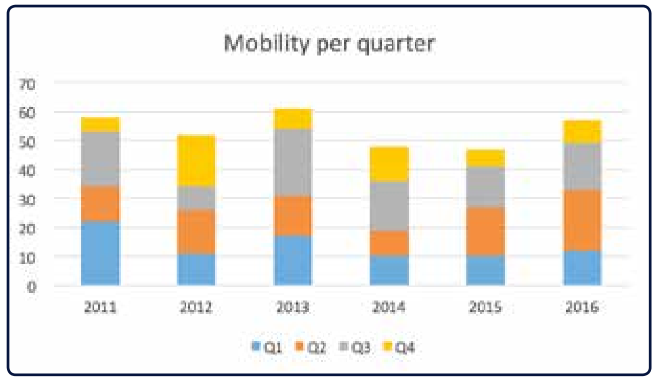


FIGURE 2

Two decades ago partners did not jump from one firm to another. Firms were true partnerships kept in shape by the rigid scaffolding of a more or less egalitarian lockstep system. Being a lawyer meant exercising a profession very much like a doctor. You do not work as a lawyer; you are a lawyer. In the meantime, law firms have realised that they have to operate as businesses, guard their profits, compete for talent and strive for growth. At some point the law firm as a company became more important than the profession itself and, today, law firms are struggling to keep their most successful partners. Once a nobile officium, today mercenaries.

The reality of increasing partner mobility means that an entire team can depart, perhaps even triggering a 'run on the bank'. But it also means that lateral hires become ever more expensive and, in order to compete, law firms might be forced to review and revise their lock step systems. There is, perhaps surprisingly, a comparison to be made with football. Originally, the players of a club were citizens of the country in which the club was located and probably even recruited from the very city the club was in. Today, the entire world is the job market for talented players. But it comes at a price for the clubs. What's more: they have no choice. If you want to play in the professional leagues you have to attract the best talent, regardless.

TGO Consulting has been the first to make an in-depth analysis of lateral partner moves in the German market over a longer period of time. Our analysis covers the hiring activity of the 25 top-ranked law firms in the German legal market since the start of 2011. It reveals a near 20 percent rise in lateral equity partner moves in 2016 compared with 2015 as a whole.

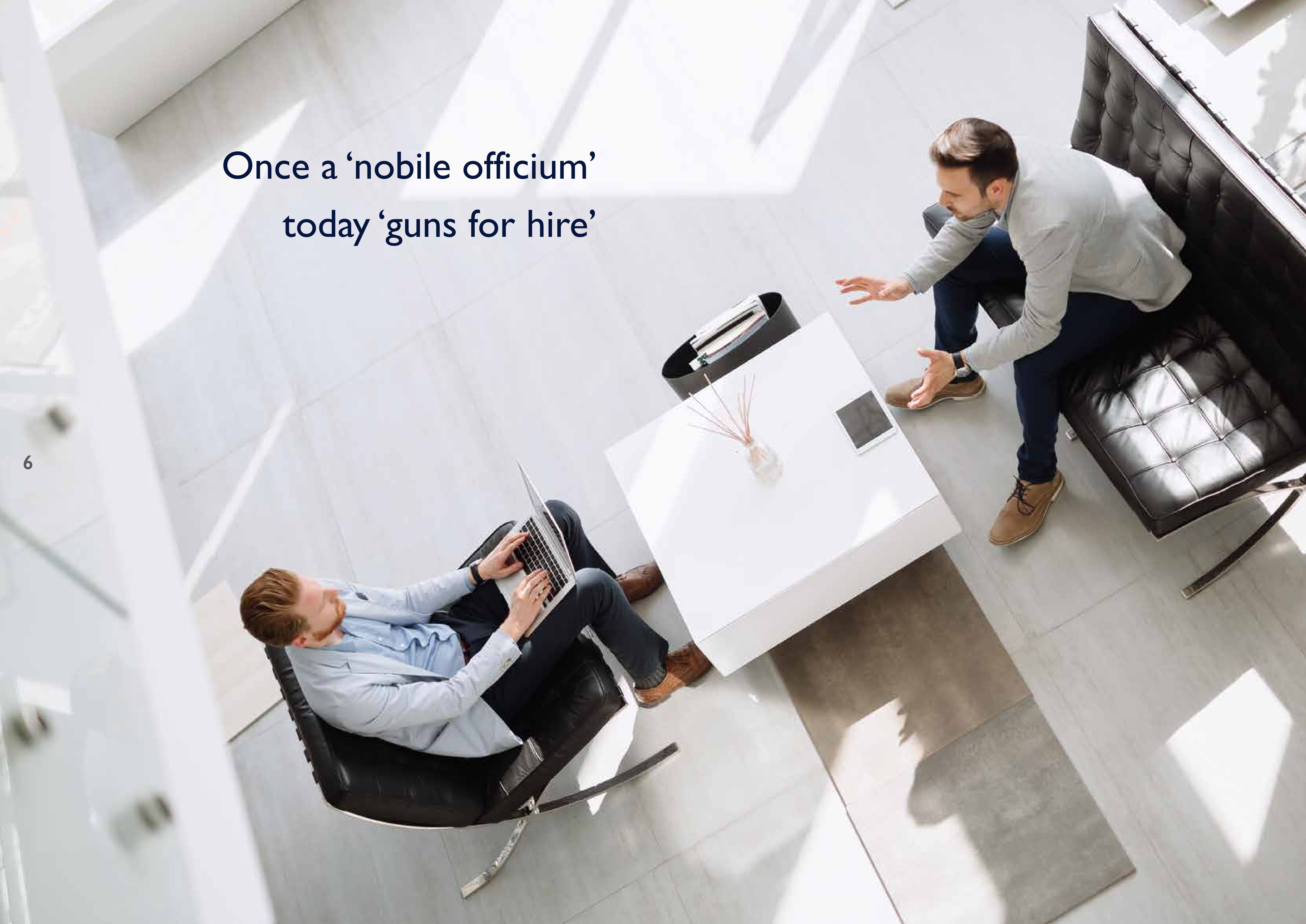
Looking at the past six years, the data shows that the total number of lateral equity partner moves has been steady, except for 2014, which saw a dip in moves. However, the partner mobility in year 2016 has reached above any previous year. The data reveals that during 2016 an unprecedented number of equity partners moved from their law firm. (Figure 1)

There is not a single firm that skewers the results with a hiring spree or where a large partner group jointly departs. Partners are shifting across the board. Even Hengeler Mueller, the German equivalent to Cravath in its partner loyalty, saw a partner leave for Kirkland & Ellis.

For the purpose of this research a selected group of 25 law firms has been defined. This selection consists of the highest tiers from the JUVE Handbuch 2015/2016 top 50 list, which ranks law firms according to the highest overall reputation in the German market. JUVE is a Germany based publisher focusing, among other, on the German legal market. When it comes to German legal market information, JUVE is widely considered as being the leading media house.

Foreign observers of the German legal market tend to note that it is very complex and dispersed over more centres in comparison to their own market. In the UK, London is the only place for international business law firms and, similarly, Paris is the only location that matters on a cross-

Once a ‘nobile officium’ today ‘guns for hire’



Mobility is increasing in other markets as well. In the US legal market there were 2,890 lateral partner moves at AmLaw 200 law firms in the year ending September 30, 2015, according to a survey conducted by ALM Legal Intelligence (ALI) and published 2016. According to ALI, that represents a 5.6 percent increase from the same period last year and about 43.5 percent more moves than in 2010, when 2,014 moves were recorded, a post-recession low. Similarly, in May 2016, the Legal Week could report that lateral hiring by US firms in London has soared 20% to highest point in four years.

border level in France. In Germany, the hubs of great and highly competitive legal activity are many, including Berlin, Frankfurt, Munich and Düsseldorf. Lateral hires in London will literally lure lawyers across the street. Recruiting talent in the German market will involve many more hurdles. And yet, this seems to put little in the way of the flow of lateral moves observed in the data gathered for this report. Partners are in some cases shifting from Munich to Frankfurt or from Düsseldorf to Hamburg and back.

One might argue that the numbers of 2016 will not increase noteworthy in Q4 since general beliefs has it that mobility becomes subdued in the last quarter of the year. Indeed, the data since 2011 supports this theory. Although both 2012 and 2014, respectively, saw more partners move in Q4 than in Q1, the data of all the years together confirm that the last quarter of a year will on average have less partner mobility than any of the three previous quarters. (Figure 2)

New entrants in the market causes lateral movement. In 2012 Pinsent Masons entered the German market in Munich. The year 2013 saw Morrison & Foerster open its first office in Germany by snatching just about the entire Hogan Lovell equity partner group in Berlin. That same year Herbert Smith Freehills opened in Frankfurt as well as in Berlin. Akin Gump arrived in 2014 by taking the entire Frankfurt office of Gingham. The next year, 2015, saw Goodwin Procter make an entrance by luring over four Ashurts partners, and US litigation firm Hausfeld entered Germany via Berlin. Furthermore, Greenberg Traurig entered the German market with the help of the entire Berlin office of Olswang. In 2016, Clyde & Co arrived in Düsseldorf.

At the same time, there have been office closures and shrinking firms. Shearman & Sterling shrank to one office in Frankfurt (2013) and King & Wood is undergoing a restructuring (practice area restructuring began end 2015 and a 15% partner cut in UK, Europe and Middle East was announced beginning of 2016), which is causing movement amongst all tiers of firms. Sidley Austin proclaimed their intention to pull out of the German market in 2014 and Freshfields revealed in 2015 that they are planning to shut their office in Köln. Orrick Herrington & Sutcliffe announced closure of their Frankfurt and Berlin offices in 2015 to concentrate on Munich and Düsseldorf only, while White & Case decided to close their Munich office.

THE FADING MAGNETISM OF THE FOREIGN LAW FIRM

FIGURE 4

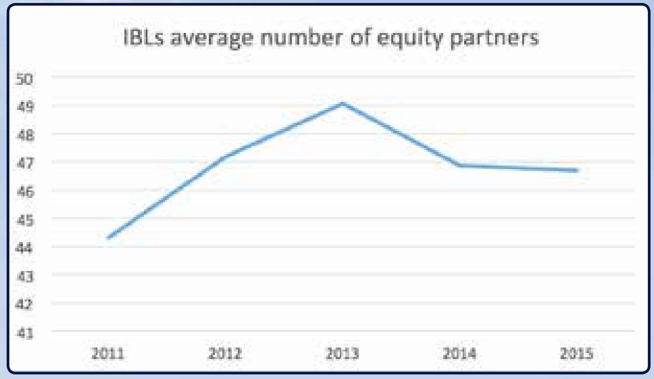


FIGURE 5

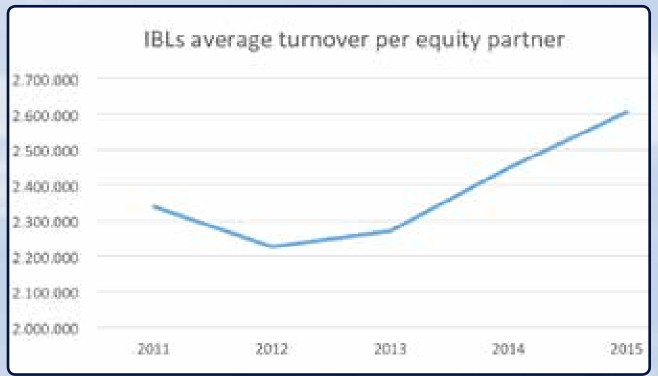


FIGURE 6

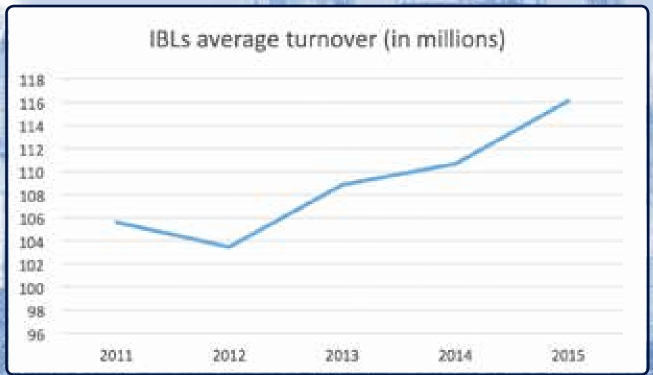


FIGURE 7

In total, this research analyses 323 equity partner moves. This number is the total of all equity partners leaving as well as all equity partners received by the top 25 firms. This research concentrates on lateral moves only, meaning that the number of hires exclusively include partners that were equity partners also in the firm they departed from. Our research shows that 232 equity partners have left and 170 equity partners have been hired since 2011. This apparent net loss of equity partners amongst the top 25 German law firms calls for a closer look at the numbers.

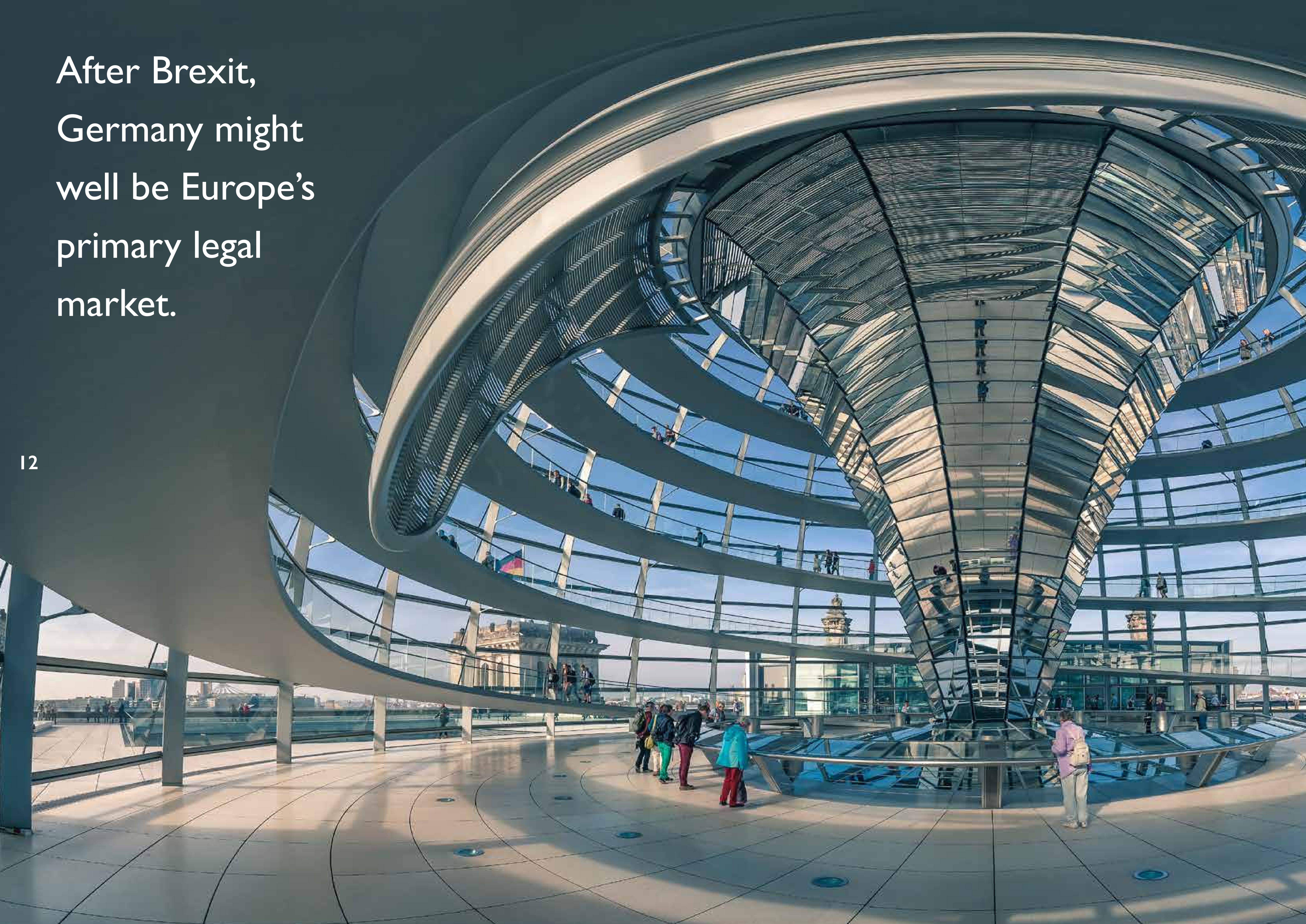
Among the top-ranked 25 firms that serve as basis for this research, there are 16 international business law firms (IBLs) and nine independent national law firms, so-called national champions. Looking at the IBLs and the independent local firms as two separate groups, both have on average received an equal amount of equity partners over the past five years. However, looking at the average amount of equity partners lost per firm in either group, the IBLs have lost three times more than the national firms. It appears that IBLs are net losers of equity partners, while German firms show a net gain. What is happening? Is there less 'loyalty' in the partnerships of IBLs? Or are they simply trying to maintain profits per equity partner by shedding dead weight? (Figure 3)

Where do the net loss of the IBLs equity partners disappear to? As pointed out, 25 top-ranked firms serve as the defined group for the purpose of this this research. The data shows that a quarter of the partners leaving the IBLs moves to one of the other 25 firms in the selection. The other three quarters of partners moving from IBLs shift to firms outside the top 25 firms. The partners leaving the top 25 end up in German firms as well as IBLs in equal parts. A number of partners have also set up boutiques, which is examined further in this report. Although not included in the data

	German firms	IBLs
Number of firms in list	9	16
Total number of equity partners received 2011-2016	59	111
Total number of equity partners lost 2011-2016	36	196
Average number of equity partners received per firm	6.6	6.9
Average number of equity partners lost per firm	4	12.2

FIGURE 3

After Brexit, Germany might well be Europe's primary legal market.



The UK firm Herbert Smith Freehills and German firm Gleiss Lutz announced a 'Best Friends' alliance in year 2000, of which Dutch firm Stibbe also formed part of. Towards 2011 Herbert Smith Freehills entered a restructuring phase, which also set the firm on a course of international expansion. When the UK firm proposed a merger with Gleiss Lutz in 2011, the partnership of the German best friend voted firmly no. The break-up of the alliance was a fact and Herbert Smith started planning its expansion into the German market on its own. In 2013 Herbert Smith opened its first office in Frankfurt with the help of a renown Gleiss Lutz Corporate partner.

Clients are increasingly becoming competitors on the market for legal talent. The Lawyer reported in July 2014 that all in-house teams in the DAX30 have been increasing in size in the past five years. Commerzbank, Daimler, Deutsche Post and Deutsche Telekom, for example, all employ over 200 lawyers in-house. BASF, Bayer and BMW also do a significant portion of their legal work in-house.

for analysis, a fair number of partners also move to in-house positions as well as to the growing legal departments of the large accountancy firms.

How does this 'leakage' of equity partners among IBLs compare to their total number of equity partners over the same time frame? After all, any outflow could be replaced and surpassed by the promotion of 'home grown' partners. Looking at how the total number of partners develop through the years 2011-2015, the data shows that the average number of equity partners of the German firms have grown, whilst the opposite is true for the IBLs. The international firms have year by year reduced their number of equity partners since 2013. This is not to say that all IBLs have reduced their number of equity partners. However, enough IBLs have dropped their number of equity partners, and some of them sharply, to lower the average. No German firm among the top 25 firms has had a noteworthy drop in its number of equity partners. (Figure 4 and 5)

At the same time, the IBLs have nearly all increased their turnover per equity partner between 2011 and 2015/2016, which is not entirely unexpected since the turnover is divided over fewer partners. The costs of law firms are, by and large, of a fixed nature. Shedding equity partners is one of the quickest ways to stabilise or increase the profit per equity partner (PEP). A law firm's PEP is one of its most valuable weapons in the war for talent and attracting key partners. (Figure 6)

Having said that, all IBLs, except one, have also increased their total turnover in the same period, albeit not to the same extent as their increases in turnover per equity partner. Even so, JUVE could report that, although IBLs are in minority on the top 100 list based on turnover, they represent 45 percent of the total turnover. Whether this is a sign of extreme efficiency or the result of benefitting from being international (with a strong US or UK home base) is up for debate. (Figure 7)

The more frequent lateral moves become in a legal market the riskier business it becomes for law firms to invest in building talent. The danger that your home-grown successors will be snatched away by a competitor that is offering him or her 25 percent more than what you are offering is very real. Instead of building talent, many law firms buy talent because it is seen as a more certain bet. At the same time, a law firm must demonstrate to associates that it is possible to make it to partnership. If none of the new partners in the past few years have come from within, but have instead been poached from elsewhere, then loyalty will suffer as a result, adding to the increasing spiral of lateral movement.

Death of a Law Firm, Jaap Bosman

M&A PARTNERS LEAST LOYAL

Analysing lateral movements in terms of practice areas, Corporate/M&A made up the largest share of lateral partner hires in all of the years 2011 to 2016, representing 35 percent of the total moves. (Figure 8)

This number is even higher in 2016, with 37 percent of the partner moves being within the Corporate/M&A practice area. The next most mobile practice area in 2016 is the Financial one, including Capital Markets and Banking, and on third place in 2016 we find Tax. The rest is spread over multiple practice areas, including Real Estate, IP, Insurance, Insolvency & Restructuring, Compliance and Dispute Resolution. (Figure 9)

What does this mean? Admittedly there are more Corporate and M&A lawyers in the market than any other practice area, which makes it no surprise that this practice area also represents the most moves. Having said that, there are also many dispute resolution partners in the market yet they seem far less mobile, as do other practice areas such as competition. Does this mean that if you are, for example, a competition lawyer, you are either very loyal or nobody wants you? Or is it that the more cyclic practice areas, such as Corporate/M&A, will have partners that are used to change and hence will have a higher tendency to move? Surely, with cyclical practice areas, partners would look for support amongst a loyal partnership in the down years in return for sharing the riches in the up years?

However, in an ever more competitive market, where the hunt for talent is fierce and law firms are scrambling to shape themselves for the opportunities to come, corporate lawyers are simply too valuable to be steadfast. Then again, maybe nobody is even asking for loyalty anymore. That would bring the lawyer profession in line with the rest of the labour market, where nobody these days is expected to make a career with the same employer for 30 years straight.

FIGURE 8

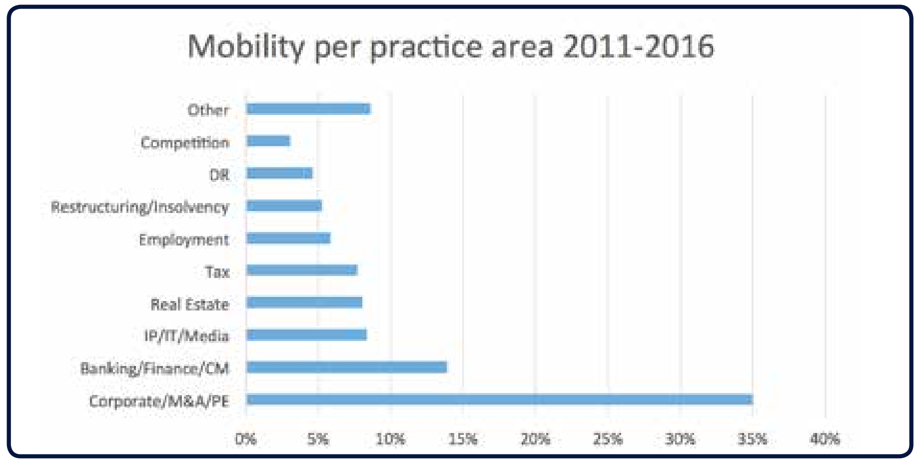


FIGURE 9

Litigators typically
remain where they are.

ARE BOUTIQUES GOING OUT OF FASHION?

FIGURE 10

FIGURE 11

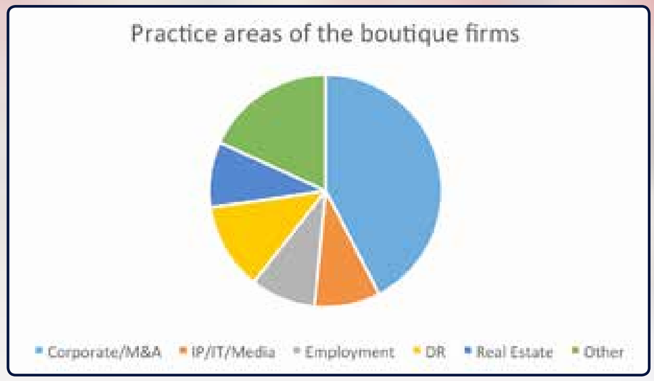


FIGURE 12

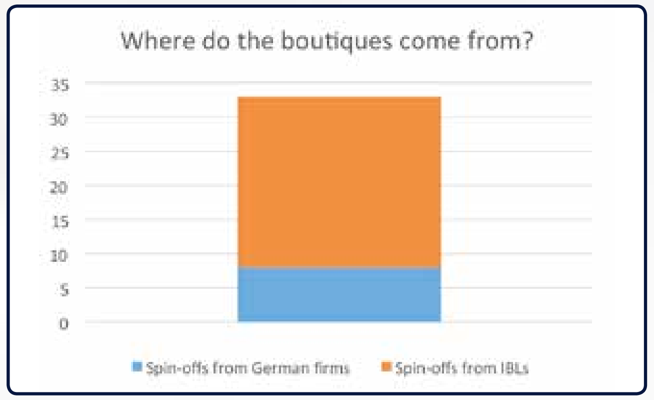


FIGURE 13

Less equity partners have departed to form boutique firms in 2016 in comparison to the previous year. While 2015 saw 11 equity partners leaving to either form a boutique or join an existing one, 2016 has so far had eight partners leaving for the same purpose. Two of them formed new boutiques in the Corporate area, while the other six partners joined or formed firms in a variety of different areas. (Figure 10)

In total 33 boutique firms have been formed in the past six years and 14 of those are focused on Corporate/M&A. Other practice areas cover, among others, Employment, IP/IT/Media, Real Estate, and Dispute Resolution in more of less equal measures. Two new boutiques were also formed, respectively, in the area of Tax and Competition. (Figure 11 and 12)

14 new boutiques in Corporate/M&A in the past six years implicates stiff competition for the established firms and should be a point of concern. The reality today is that boutiques manage to get a significant part of the market by offering more competitive rates due to their lower cost base. The same phenomenon has been observed in other markets in Europe and US.

Looking at from where the new boutiques originate, the majority have been spun off from IBLs. Out of the 33 cases of new boutique firms, eight were formed by equity partners form German firms and 25 were formed by equity partners from IBLs. It can be expected that more spin-offs would originate from IBLs in absolute numbers since there are more IBLs than German firms in the top 25 firms that form the basis of this research. However, even when adjusting the numbers accordingly, German firms have disproportionally fewer partners leaving them to form a boutique. (Figure 13)

Partners can break away from their firms to form a boutique for various reasons. In some cases, conflict of interest may form a constraint for a practice area, such as dispute resolution, and partners leave in order to be free to take the big-ticket cases. In other instances, partners feel their practice area is not given enough backing by their firm. In a full-service firm, many areas are meant to serve as fringe offerings in support of the core areas. The data of our research shows that nearly a quarter of the formed boutiques are in fact solo practitioners. This might be by choice, however, in times of tightening strategies, equity partners that do not fit the objectives set out by firm management could be forced to negotiate a package and leave. Becoming a sole practitioner might be the only option available. Looking at the numbers from this perspective, 2013 and 2015 appears to be tumultuous years where strategy calibrations, or the lack thereof, caused equity partners to leave and form firms of their own. The year 2016 is not far behind in being classified as an equally turbulent year. Having said that, breaking away to set up a specialised firm can give partners the opportunity to offer their clients access to high level specialist advice at lower rates along with improved client focus. With increasingly sophisticated and cost-conscious clients, opting to form a boutique can be a very successful way of competing in today's legal market. The boutique, it seems, is not out of fashion yet.

There is evidence that suggests that once a partner makes the first move, there is nothing but attractive work and profit that will make him or her stay put. A survey conducted by Motive Legal Consulting, encompassing 2,869 lateral partner moves in London from 1 January, 2006, to 31 December 31, 2013, concluded that nearly a third of the laterally hired partners had moved on again. This suggests that once a partner start moving, it is far from certain that he or she will stay put.

FINAL WORDS

Partner mobility is unlikely to subside. Partners have their reasons to either seek higher profits or to transfer their practices from one firm to another in search of better clients or more exciting work. At the same time, law firms need quick ways to grow or are looking to buy their way into the rankings. The results of this research arguably hint at partners becoming more like mercenaries, fighting on behalf of whoever pays the most or provides the most prestigious work. It is no doubt a sellers' market. There are potential ways to build in loyalty in a law firm's compensation model or contractually limit the ability to leave a firm, but this is a path seldom chosen by European law firms.

During the past five years UK firms put into action battle plans that would ensure them a slice of the international market. End of last year, the American Lawyer reported that many US firms had adopted ambitious growth strategies in Germany, shaking up its lateral market. It is safe to say that latest political developments have reinforced these strategies and added urgency. Based on GDP, the German economy is the fourth largest in the world and undeniably looking poised for the future. As Brexit looms around the corner law firms will have to position themselves in order not to lose out if and when the market shifts. This report might just have provided a glimpse of what is to come. The war for talent is about to reach a new level.

Lisa Hakanson
Director of research & operations
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As is the nature of surveys, the outcome is based on specific parameters: it is a limited set of data and results may therefore differ from other reports.
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Methodology
For the purpose of this research a group of 25 law firms has been defined. This selection consists of the highest tiers from the JUVE Handbuch 2015/2016 top 50 list, which ranks law firms according to the highest overall reputation in the German market. JUVE is a Germany based publisher focusing, among other, on the German legal market. When it comes to German legal market information, JUVE is widely considered as being the leading media house. As pointed out by JUVE, their ranking is not purely based on objective facts such as turnover, and the ranking could be argued to look differently using a different method of research. However, it is widely recognised that JUVEs methods are transparent and their research thorough. The 25 firms selected for the purpose of this report are, in alphabetical order, as follows:

Allen & Overy
Ashurst
Baker & McKenzie
Cleary Gottlieb
Clifford Chance
CMS Hasche Sigle
DLA Piper
Flick Gocke Schaumburg
Freshfields Bruckhaus Deringer
Gleiss Lutz
Görg
Hengeler Mueller
Heuking Kühn Lüer Wojtek
Hogan Lovells
Jones Day
Latham & Watkins
Linklaters
McDermott Will & Emery
Milbank Tweed Hadley & McCloy
Noerr
Norton Rose Fulbright
P+P Pöllath + Partners
SZA Schilling Zutt & Anschütz
Taylor Wessing
White & Case

The data has been collected from the publicly available archive of JUVE as well as other publicly available material from other media and the law firms themselves. The data contains equity partners only, moving to, or leaving from, one of the firms in the selection since the start of 2011 and up until including Q3 2016. For clarity, moves whereby a salary-partner or fixed-share partner becomes equity partner in the process of shifting from one firm to another have not been included for the purpose of this analysis. Likewise, equity partners moving to or from an in-house position or the legal arm of an accountant have not been included, although their frequency has been noted. Data for each move includes time of the move, origin firm and destination firm, as well as the practice area. The total number of equity partners and the firms' turnover data are sourced from JUVE.

This report is complimentary to the book Death of a Law Firm – why many business law firms will collapse in the next five years (978-9082427806), a management book for law firms authored by partners of TGO Consulting, available on Amazon.de or www.deathofalawfirm.com.

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