

## Lawyer Insights

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### A New Approach to Law Firm Rankings

by Madhav Srinivasan

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The Am Law rankings reveal the largest firms in the US legal market. Higher revenue, though, does not necessarily equate to superior overall financial performance. Indeed, firms with lower revenue often have enhanced performance metrics. Consider DLA Piper, which ranks 4th on revenue, but 78th on revenue per lawyer and 85th by profit margin. On the other hand, Quinn Emmanuel ranks 1st on profit margin and 3rd on revenue per lawyer, but places only 21st on revenue. Firms with similar revenues may have very different financial profiles, as with Skadden Arps and Baker McKenzie; or Jenner & Block and Fox Rothschild.

Is there another way to rank firms in line with their financial performance? Our quest for an answer led us to a multi-dimensional approach, where we combine revenue with two reasonably non-correlated metrics: revenue per lawyer (RPL) and profit margin. Together, these fully describe the financial condition of any law firm. Revenue measures a firm's size, RPL measures the market value of a lawyer and profit margin the ability to convert revenue to profits. In other words, size matters, but so do equally lawyer value and profitability. Our construct is built on fundamentals, in assuming that individual lawyers with revenue generation capacity aggregate to form a law firm, which then manages costs to eventually generate profits.

While multi-dimensionality is appealing, combining revenues in millions of dollars with RPL in dollars and with profit margin in percentages is tricky. Our solution was to standardize each metric, by dividing each firm's value by the highest value achieved by any Am Law 200 firm – which produces a score between 0 and 1. Once standardized, these metrics can be easily added. Let's illustrate this for White & Case:

- **White & Case's Revenue Score:** White & Case's 2018 revenue of \$1.804 billion divided by Kirkland's revenue of \$3.165 billion (the largest in the Am Law 200 last year) yields a score of 0.57
- **White & Case's RPL Score:** White & Case's 2018 RPL of \$885,000 divided by Wachtell Lipton's RPL of \$3.13 million (the highest in the Am Law 200 last year) produces a score of 0.28
- **White & Case's Profit Margins Score:** White & Case's 2018 profit margin of 40% divided by Irell & Manella's 66% (the highest in the Am Law 200 last year) yields a score of 0.61

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In our methodology, we call each score an index. Thus each firm has three indices:

- **Revenue Index** = Revenue of firm / Revenue of highest-Revenue firm
- **RPL Index** = RPL of firm / RPL of highest-RPL firm
- **Profit Margin Index** = Profit Margin of firm / Profit Margin of highest-Profit Margin firm

We then construct a composite performance index as the sum of these three indices:

- **Performance Index** = Revenue Index + RPL Index + Profit Margin Index

Ranking on performance index blends in other metrics with revenue. Firms with a higher performance rank have more revenue, their lawyers have a higher market value and are more profitable – all combined, they indicate higher financial performance. Conversely, firms with a lower performance rank have lower revenue, their lawyers have a lower market value and are less profitable, together they point to lower financial performance. Each individual index has a moderating impact on the overall result. A firm can overcome a lower level on one index with higher levels on other two indices. And of course, vice versa. In our approach, we have purposefully omitted leverage – as this reflect how a firm is internally organized; as also PPP – as partner profits are the end-result of a firm's business structure.

Figure 1: Performance index calculations for various firms

	White & Case	Orrick	Baker Hostetler	Schulte Roth
<b>Am Law 2018 Performance</b>				
Revenue (\$m)	\$1,804	\$975	\$647	\$424
RPL (\$k)	\$885	\$1,037	\$715	\$1,188
Profit Margin (%)	40%	23%	21%	49%
<b>Index Scores</b>				
Revenue Index	0.57	0.30	0.20	0.13
RPL Index	0.28	0.33	0.23	0.38
Profit Margin Index	0.61	0.35	0.32	0.75
<b>Performance Index</b>	<b>1.46</b>	<b>0.98</b>	<b>0.75</b>	<b>1.26</b>

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How did we devise our method? Our approach was pragmatic – we recognized revenue needed to be combined with other factors. Revenue per lawyer and profit margin turned out to be most relevant and non-correlated. Standardization was required to facilitate comparison. Further experimentation led us to a process which produced robust results, yet was simple and repeatable.

Now we can re-rank the Am Law 100 firms on the basis of decreasing performance index. We highlight three key findings from our analysis:

**Performance Index Rankings and Performance in Key Metrics Correlate:** Ranking on the basis of decreasing performance index does truly correlate with firm performance. To illustrate this, let's divide the 100 firms into 4 quartiles of 25 firms each and look at the average of each quartile. When ranked by performance index, it is evident that the performance in key metrics distinctly drops off as firm rankings increase (see Figure 2).

**Figure 2: Performance index rankings and performance in key metrics correlate**

*Average performance in key metrics*

	Average Revenue (\$m)	Average RPL (\$k)	Average Profit Margin	Average Profit Per Equity Partner (\$k)	Average Performance Index Score
1 <sup>st</sup> Quartile of Firms in Performance Index Ranking	\$1,658	\$1,274	48%	\$3,069	1.67
2 <sup>nd</sup> Quartile	\$902	\$1,090	42%	\$2,142	1.28
3 <sup>rd</sup> Quartile	\$585	\$884	34%	\$1,294	0.98
4 <sup>th</sup> Quartile	\$513	\$701	27%	\$960	0.79

**Revenue rankings and performance in key metrics do not appear highly correlated**

*Average performance in key metrics*

	Average Revenue (\$m)	Average RPL (\$k)	Average Profit Margin	Average Profit Per Equity Partner (\$k)	Average Performance Index Score
1 <sup>st</sup> Quartile of Firms in Am Law Rankings	\$1,780	\$1,107	44%	\$2,634	1.59
2 <sup>nd</sup> Quartile	\$913	\$1,133	39%	\$2,180	1.25
3 <sup>rd</sup> Quartile	\$567	\$818	32%	\$1,290	0.92
4 <sup>th</sup> Quartile	\$398	\$891	36%	\$1,363	0.96



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When we conduct a similar analysis for Am Law 100 firms ranked only by revenue, it's not fully clear that performance is highly correlated with rank (see Figure 2). Indeed, we see that profit margin for quartile 4 is higher than quartile 3; and the RPL for quartile 2 exceeds that of quartile 1. The direct correlation between revenue rank and overall performance is not fully evident.

**Peers Close to Each Other:** Rankings firms on overall performance ranks law firms in such a way that firms with similar performance indices turn out to be the close financial peers. As we have illustrated earlier, this is not the case for revenue-based rankings. Figure 3 shows the top ten peers for two example firms Akin Gump and Katten Muchin. The performance index for their peer firms are seen to be close to these two firms.

**Figure 3: Performance Index Rankings and Rank**

*Peers for Akin Gump*

Firm Name	Performance Index	Performance Rank
<b>Akin Gump</b>	1.39	28
Goodwin Procter	1.36	32
King & Spalding	1.39	27
Proskauer Rose	1.37	31
Dechert	1.31	34
Wilmer Cutler	1.50	17
Cooley	1.33	33
Covington & Burling	1.29	35
Paul Hastings	1.49	19
Davis Polk	1.52	15
Debevoise	1.39	26

*Peers for Katten Muchin*

Firm Name	Performance Index	Performance Rank
<b>Katten Muchin</b>	<b>1.06</b>	<b>55</b>
Drinker Biddle	1.00	60
Troutman Sanders	0.97	62
Alston & Bird	1.13	50
Faegre	1.01	58
Jenner & Block	0.95	66
Nelson Mullins	0.96	63
Venable	0.95	64
Sheppard Mullin	1.03	57
Wilson Sonsini	1.12	51
Fish & Richardson	1.11	52

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Another interesting outcome of our exercise is that the rankings reflect gradations in qualitative similarity. Said differently, firms close to each other are quite similar; and firms far apart are quite dissimilar. If we start from our top ranked firm at number 1, Kirkland and Ellis, we find as the rank increases, firms become increasingly dissimilar. Thus, Wachtell is most similar firm to Kirkland in terms of financial performance, while Lewis Brisbois would be the most dissimilar.

**Ranking Matches Intuition:** We discussed our approach with several legal industry observers, who concurred that results generally matched their own rankings of firms on the basis of performance. In their qualitative judgment, higher ranked firms did have performance superior to lower ranked firms. Indeed, our top 5 performing firms are Kirkland, Wachtell, Latham, Skadden and Quinn Emmanuel. For Wachtell

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and Quinn Emmanuel, their strong showings in RPL and profit margin offset their lower revenue based rankings of 48th and 21st. Conversely, Baker McKenzie, which places 3rd on revenue ranks 14th on performance; and DLA Piper's 4th ranking on revenue takes it to 21st on the basis of performance. Firms with lower performance rank are not only smaller but also have lower RPL and profit margins. In many cases, the indices offset each other – a larger but a less profitable firm may rank lower than a smaller but more profitable firm. We are hopeful our readers also find this ranking more closely aligned with their internal constructs.

**Visualization of Firm Trajectories:** We can plot the performance index of a single firm over the years as a nice visual representation of its overall performance. We find that each firm does have its own unique trajectory, and analysis of such trends will be explored in detail in our next article.

## Summary

We are suggesting a more robust method to rank law firms, which supplements, rather than substitutes for, traditional rankings. We believe it is more reflective of overall financial performance as it equally weights key metrics. The added advantages of peer grouping and comparison across years make it an attractive framework. Further, the stronger correlation between ranking and performance would argue that comparison to say a Performance Index 25 may be more insightful than the Am Law 25. In other words, the comparison benchmark would be the top 25 firms by performance rather than the top 25 firms simply by size. As we have shown earlier, simply aggregating firms based on their size mixes up firms with superior and inferior performance and makes comparisons less meaningful.

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