Staying Ahead of the Talent Curve—Part 1

Talent Challenges Facing Colorado Law Firms

BY GENE COMMANDER

A new era of uncertainty has dawned in the legal profession, and it could represent a tipping point for business operations and profitability in law firms of all sizes as the demand for legal services fluctuates.[1] The pandemic accelerated several trends that had been reshaping the legal industry since the Great Recession, including increasing rates of attorney attrition, shrinking law school enrollment, and growing reliance on advanced technologies, such as those that enable remote work. As the pandemic eased, law firms faced a record level of legal demand, yet found themselves without the productive talent needed to meet the demand. To make matters worse, a nationwide price war for talent began to hobble many firms. Looking ahead to the next three to five years, even when the economy recovers and demand for services stabilizes, law firms will likely continue to face a challenging labor market due in large part to generational shifts, law school enrollment trends, and increasing workforce mobility.

Talent supply difficulties across the legal market are endangering law firm profitability, according to the Thomson Reuters Institute,[2] the nation's leading experts on the business of law. Productive employees—including partners, shareholders, associates, and also business management staff like paralegals, firm administrators, and legal assistants—are the most valuable assets of every law firm. Yet the risk of being unable to hire and retain quality talent has never been greater. And without the bench strength necessary to satisfy client expectations while grinding out sufficient billable hours, law firm profitability can collapse with little or no warning. Law firms that choose not to tackle these challenges now with future-focused strategies will do so at their own peril.

This article will help current and future law firm business leaders understand the state of the labor market for Colorado firms by explaining the economic, demographic, and professional trends that are contributing to the shortage of affordable and productive talent. Part 1 also outlines why traditional business models are proving inadequate to manage the impending talent crisis. Part 2 will introduce sustainable business growth strategies to help Colorado law firm leaders navigate the mounting talent challenges.

Emerging Economic Trends

During the exceptional decade-long economic growth cycle that predated COVID-19, US law firms' investments in human capital and commercial office space—historically their two largest business expenses—rose to new highs in most major metropolitan areas, including Denver. Law firms took advantage of historically low interest rates and dormant inflationary forces to grow their businesses but ignored the legal industry's growing dependency on a dwindling supply of affordable talent.

Then, seemingly overnight, came COVID-19 and the near collapse of the US economy. But the pandemic proved a boon to the business of law. Firms enjoyed revenue windfalls in 2020 and 2021 courtesy of the federal Paycheck Protection Program and state and local stimulus programs. Firms also reaped extraordinary rewards from the governmental lockdowns. Remote and hybrid workplace accommodations eliminated traditional work-life boundaries and enabled talent to serve their clients' needs 24/7/365 from their work-from-home billing stations. This allowed law firms to slash operating expenses while enjoying a dramatic increase in billable hours and cash receipts.

But in 2022, law firms saw their profitability level off or decline, partly due to mounting overhead expenses.[3] For instance, business travel and marketing costs reentered the picture. Office rental rates remain in flux, as many businesses have realized they can downsize their footprint to adjust their expenses. Perhaps not coincidentally, since 2021 at least nine of the largest Denver law firms have signed new leases for smaller office spaces.[4]

Furthermore, law firm business leaders increasingly see big-picture economic concerns—spiking inflation and interest rates, Russia's war in Ukraine, chaos in supply chains and energy markets, and Wall Street's paranoia, to name a few—as a threat to their profitability.[5] Indeed, the US stock market recently closed its worst year since 2008.[6]

The Rocky Mountain region and Colorado's Front Range may be better positioned than other areas of the country to withstand an economic downturn, but a recession would be a major drag on the state's robust economy. The demand for legal services is not inelastic, so clients who critically evaluate their legal spend may scale back their legal representation or choose less expensive alternatives if times get tough.

Colorado law firms, then, are in a tenuous economic position as they confront serious talent shortages.

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Shrinking Talent Pool

Supply-chain problems are not limited to manufacturing companies.[7] And a new brand of supply-chain disruption is rippling through law firms—large and small—across the country. Shifting demographic forces and the eroding allure of a lifelong career in private legal practice have resulted in an inadequate pipeline of affordable and productive talent in the associate and midlevel talent ranks of Colorado law firms.

The lack of human capital with proven legal skills and strong entrepreneurial instincts threatens to upend Colorado law firms' financial sustainability. And as shown below, this dilemma will not simply vanish when inflation rates, interest rates, and the stock market stabilize—it is here to stay unless firm leaders pursue new solutions.

Generational Shifts

Senior talent ("baby boomers," ages 59 to 77) continues to depart the profession upon retirement, disability, and death. Law firms are rapidly losing the economic value senior attorneys have consistently produced through their personal cash receipts and business origination. In addition to these direct financial consequences, the baby boomer exit is draining invaluable experience, wisdom, and insight from the profession. These senior attorneys have been the glue that held small and midsize law firms together. This inevitable generational change is also depleting the ranks of productive paralegals, firm administrators, and legal assistants as younger generations pass over these once-prized career opportunities for attractive jobs in other industries.

Attorneys at the tail end of the baby boomer cycle, who have less than 10 years of active practice ahead of them, may hesitate to embrace major law firm changes that impact the twilight years of their careers. Either way, their roles will need to be backfilled with capable talent who are prepared to carry on their legacy. And the sustainability of the law firms the boomers helped build will be in jeopardy if firm leaders fail to prepare for the boomers' departure from the profession.

The next generation of talent in line to serve as law firm leaders ("Gen X," ages 43 to 58) is about half the size of the baby boomer generation. The raw numbers alone signal that there simply is not enough talent in Gen X to fill the revenue generation, leadership, and ownership roles that will be vacated as boomers step aside. Law firms should both empower their Gen X talent to fill the essential roles held by the departing boomers and plan for longer-term human capital solutions.

The crop of talent coming up next ("millennials," ages 27 to 42) is the US labor force's largest generation.[8] Millennials' values and perspectives often differ from those of their older colleagues[9]—with flexibility, transparency, collaboration, and personal meaning as chief drivers—so successfully integrating this generation into firms will require strategic shifts in firm management, compensation, and culture. Law firm leaders should be prepared to rapidly develop their millennials to fill the revenue generation, leadership, and ownership roles that will soon be open to them—or be willing to look outside the firm and pay a premium to fill talent gaps.

Then comes the talent born since 1997 ("Gen Z," ages 26 and under)—the most diverse generation in US history[10]—who will become a vital part of the legal workforce in coming years. The Gen Zers' viewpoints in many cases diverge markedly from the ethos of current law firm leaders. Further, the use of advanced technology is second nature to them, and their focus on state-of-the-art business solutions will only increase the demand for savvy investments by their law firms. The comparatively small size of Gen Z compared to the millennial generation—a gap that is particularly wide in the Denver metro population—is likely to exacerbate the talent shortage in the long term.[11]

Educational Trends

In addition to the challenges posed by generational shifts, educational trends signal that the cost of talent will continue to climb. After plummeting from 2010 to 2017, enrollment rose at law schools accredited by the American Bar Association (ABA) from 2018 to 2021.[12] Yet enrollment was far lower in 2021 (117,305) than at its peak in 2010 (147,525).[13] And the number of law school applicants seeking to enroll in 2022 decreased by 11.7% compared to 2021, according to the Law School Admission Council.[14] Many college graduates may find law school unappealing given the prospect of paying off undergraduate debt, which now averages $28,000 for law students,[15] combined with law school debt—particularly at current or higher interest rates.

Undergraduate enrollment trends suggest that law school enrollment figures will not fully recover. College enrollment slumped in the face of COVID-19, and in 2025 first-year enrollment is predicted to plunge by up to 15%.[16] This should not be surprising given that the US fertility rate sank during the Great Recession (a downward trend continued by millennials).[17]

Meanwhile, large numbers of those who do attend law school are opting to pursue the growing career opportunities for law school graduates in corporations, government, and legal technology companies, among others.[18] If the current trends continue, only half (or less) of future law school graduates will still be working for law firms just three years after graduation.[19]

The Great Resignation

The modern work environment has seen a dramatic realignment since the pandemic, with record numbers of US workers quitting their jobs amid strong labor demand and low unemployment rates. The legal profession's vital workforce—including law firm business management positions—is not immune. The Thomson Reuters Institute has found that large law firms are at risk of losing 125% of their associates over the next five years—a spike above those firms' 50% pre-pandemic level.[20] While larger firms often have the resources to replace departing human capital by drawing from midsize firms, midsize firms then in turn pull valuable talent from smaller firms, which often lack the means to fill their talent gaps.

New research by McKinsey & Company cites the following factors to explain the startlingly high rate of attrition across many industries:[21]

- lack of career development and advancement
- inadequate total compensation
- uncaring and uninspiring leaders
- lack of meaningful work
- unsustainable work expectations
- unreliable and unsupportive people at work
- lack of workplace flexibility
- lack of support for health and well-being.

McKinsey's findings are echoed by the ABA's 2022 Practice Forward Report, "Where Does the Legal Profession Go from Here?" which cites work-life balance, compensation, welcoming and collaborative culture, and quality of work as among the factors most important to attorneys—particularly those who are female or persons of color—when deciding whether to switch jobs.[22]

The McKinsey and ABA research strongly suggests that to stem attorney attrition, law firms cannot simply increase compensation but should also adopt holistic strategies to foster a magnetic law firm culture, as discussed further in part 2.

Loss of Attorneys in Underrepresented Groups

The attorneys quickest to exit law firms are typically women and people of color. In a recent survey by Above the Law, half of female associates at firms of varying sizes plan to resign within one to two years, while just one-third of male associates plan to do so.[23] Yet 74% of male attorneys in an ABA survey believed firms are succeeding at retaining experienced women, compared to just 47% of female respondents.[24] When it comes to people of color, far more white, Hispanic, and Asian associates report that they plan to stay at their firm in expectation of partnership than Black associates.[25] As addressed in part 2, this data suggests that investing in equity and inclusion measures is a key strategy to sustain a pipeline of up-and-coming talent.[26]

Price War for Talent

The nation's largest law firms reacted to their talent gaps by throwing money at first-year associate salaries in 2021,[27] with comparable increases given to their more experienced talent, although firms' aggressive hiring practices appeared to slow in 2022.[28] New attorneys who graduated in 2021 are enjoying record-high salaries and employment rates, according to the National Association for Law Placement.[29] Relatively flat law school class sizes and law firms' strong efforts to recruit summer associates led to predictions of a robust labor market for law graduates in the 2022 and 2023 classes, as well.[30] Higher enrollment in 2021, however, will produce a notably larger graduating class in 2024.[31] Despite the fluctuations in entry-level talent, the rising cost of living nationwide makes it hard to imagine that associate salaries will drop substantially anytime soon, though large firm layoffs are not out of the question if the economy tumbles.

As the Colorado economy diversifies and expands, the Denver area is becoming an integral part of the national legal landscape. Not surprisingly, the price war for talent has made its way into the state through the national law firms with Denver branch offices. Data recently published by *Law Week Colorado* suggests that at least 47 law firms with out-of-state headquarters (of which at least 24 have international offices) employ roughly 1,600 attorneys in their Denver offices. In comparison, the 10 biggest Denver-based firms employ about 1,100 attorneys, while the top 200 firms responding to the survey employ about 3,200.[32] Although the number of attorneys in national firms is small compared to the nearly 17,500 active attorneys in private practice licensed in Colorado,[33] national firms have the financial means and labor market influence to attract and retain capable talent in ways that other Colorado firms cannot.[34] Large Denver firms have lost talent to the national firms and thus have raised salaries for their first-year associates and midlevel talent to stay competitive. The price pressure will increasingly be felt throughout the Denver legal market and around the state.

Furthermore, the remarkably strong demand for legal talent in Colorado will continue to drive salaries up. Colorado ranks 19th in the nation in the "ABA Profile of the Legal Profession 2022" for number of attorneys residing in the state.[35] The Denver-Aurora-Lakewood metropolitan area has the eighth highest demand for legal talent in the nation, with Boulder following at 39th and Colorado Springs holding the 98th position.[36] And as a prominent national and international economic and transportation hub, Denver's presence on the national stage is likely to grow. Among national law firm leaders recently surveyed, 61% said that their firms are targeting Southwestern states for further domestic growth.[37]

As significant salary increases take hold statewide, Colorado firms that do not follow suit will be at risk as their talent begins to feel overlooked and undervalued. When recruiters and higher bidders come calling, the firms that do not counter those offers will watch both associates and highly productive midlevel talent walk out the door. Loss of talent in turn will cut into the billable hours and cash receipts that are needed to achieve firm financial goals. It will also make it more difficult to satisfy client service demands. Once that happens, profits per equity partner (PPEP)—the legal industry's chief indicator of financial success and sustainability—will decline. This will disappoint the firm's most productive business generators. Top talent and future-focused clients will start exploring their options.

Colorado's high percentage (from a nationwide perspective) of relatively small law firms—and the businesses that depend on them—face the greatest risks from the rippling effects of the price war. Recent data published by *Law Week Colorado* and the Office of Attorney Regulation Counsel suggests there are hundreds of Colorado-based firms that employ fewer than 50 attorneys (not to mention roughly 5,500 solo practitioners with active licenses).[38] These firms are a vital segment of the profession, serving the needs of countless local and family-owned businesses and adding tremendous strength to the state's economic backbone. The ill effects of the price war will be felt throughout the profession and the Colorado economy for years to come—unless the legal industry remedies its talent conundrum.

Shifting Business Models

Traditional law firm growth strategies will struggle to adapt to the talent problems that accompany this new era. This article focuses on the two models that Colorado firms have become reliant on: organic growth and lateral hiring.

Organic Growth

The preferred, longstanding practice for growing successful law firms has been an organic approach that depends on attracting a sufficient pipeline of talent coming out of law school. The firm offers inexperienced talent the opportunity to hone their legal skills and business acumen while they grow their books of business by performing meaningful legal work for high-quality clients and serving their communities. Through this approach, firms endeavor to develop, reward, and retain talent throughout their legal careers. But the approach relies on the assumption that talent is ready and willing to dedicate the greater part of their professional lives to a single firm. That is no longer the reality.

Indeed, the traditional year-round law clerk and summer associate programs used by law firms to attract talent out of law school have never guaranteed long-term staffing success. Even before the Great Resignation, the best and brightest talent frequently left their first associate position within a few years. That is even more true today. Only 51% of 2018 law graduates surveyed were working in law firms three years after graduation.[39] Moreover, 67% of 2018 graduates had already held two or more sequential law-related jobs between graduation and December 2021.[40]

Once the novelty of private practice wears off, new hires often struggle to feel included and valued by law firm leaders and their colleagues. They become frustrated, disillusioned, or opportunistic for a variety of personal and professional reasons. Eventually, they may choose to leave the firm despite its generous compensation package and the substantial amount of time colleagues have invested in their career progression. Traditional organic growth strategies have proved particularly ineffective in retaining young attorneys who are female and/or people of color.

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It takes an enormous investment of time (at least five to seven years) on the part of firm and practice group leaders to develop rookies into skilled attorneys and productive midlevel revenue generators—much less proven rainmakers and business leaders. The lost opportunity costs incurred by firms that rely on organic growth strategies can take a significant toll on PPEP when homegrown talent well-groomed for success—and their clients—walk out the door.[41]

While organic business growth strategies standing alone have failed to satisfy law firm talent needs from one generation to the next, a well-managed organic strategy can still play a valuable role in supporting Colorado firms' long-range financial and professional stability when coupled with other future-focused growth strategies and investments to ensure the firms' legacy, as discussed in part 2.

Lateral Hiring

Since the Great Recession, hiring talent away from competitors has become a widespread business growth strategy among Colorado law firms. Lateral moves have involved talent with experience levels ranging from junior associates to senior rainmakers and from entry-level to seasoned business management staff. In fact, law firms have become increasingly reliant on lateral hiring practices as a workaround when unable to satisfy their human capital needs through organic growth strategies alone.

Lateral hiring of experienced attorneys typically involves two ingredients: first, a law firm that is willing (or desperate) to invest in the future success of an attorney who has proven legal skills, an established reputation, and a book of transportable business; and second, a dissatisfied attorney who is willing (or desperate) to leave a law firm that is no longer providing the comfortable financial and professional fit that was expected.

Lateral moves give the acquiring firm an opportunity to add bench strength, new practice areas, and new clients, while providing the incoming talent an opportunity to achieve greater financial and professional success by joining a firm with a more desirable business model, talent pool, and client base.

But before long, lateral hiring transactions commonly disappoint the participants for reasons that often can be traced to their unrealistic and loosely defined expectations.[42] Simply put, it is human nature for one or both sides to stretch for what they want (or desperately need) by overpromising. What's more, these transactions are normally quasi-secret (both internally and externally) and based only on an informal exchange of unverified information about the candidate's book of business and the opportunities the firm can offer. With the benefit of hindsight, the acquiring firm frequently concludes that it overpaid for the gains it received, especially when a recruiting fee was part of the firm's investment equation. In the end, speculative lateral hiring strategies simply reshuffle talent between law firms, contributing to the profession's skyrocketing cost of talent without providing a dependable return on investment.

Luring individual attorneys or small groups away from local competition via a bidding war of sorts can also have other serious repercussions. For example, a lateral hire seen as an obvious failure by the firm's loyal talent, top prospects, and savvy clients can cause serious reputational damage to the firm and its leaders.

As a practical matter, the speculative lateral hiring practices seen of late among the larger and midsize Denver-area law firms may have run their course as a solution to short-term talent gaps. With the scramble for lateral talent that has occurred in the past three years, the supply of candidates may have been depleted. Regardless, from a forward-thinking perspective, law firm business leaders should insist on more dependable and cost-effective smart growth strategies to satisfy their human capital needs.

What's Next

This new era of uncertainty is showing signs of becoming a more lasting brand of financial and professional disruption to the business of Colorado law than firms have experienced during prior volatile business cycles. Law firm business leaders cannot overcome the current economic, demographic, and professional challenges merely by convincing their colleagues to work harder—doing so would only increase attrition. Nor can law firms manage the rising costs of their business operations by simply raising hourly rates or slashing overhead expenses. Instead, wise investments in high-value human capital and the tools that talent needs to be competitive will be the keys to Colorado law firms' success over the next three to five years.

Notably, these investments will require significant changes in firm business models, which will be complicated by the generational shifts explored above. Full consideration of the challenges Colorado law firm leaders will face in navigating multigenerational workplaces is beyond the scope of this article.[43] Suffice it to say, for some baby boomers it will be difficult to relinquish control over the law firms they helped build and the rewards they have come to expect from their hard work and success over many decades. They may feel as though they are being elbowed out and may hold strong opinions about how the business should continue to be operated, making it difficult for them to recognize the importance of elevating younger talent. Meanwhile, younger generations may also be resolute in their preferences, possibly blinding them to the value in making common cause with those who have paved the way for them. But it is in the mutual best interest of talent of all ages to seek middle ground to ensure the firm's lasting prosperity through continuity and smart growth planning.[44] And indeed, forging a new path can bring a fresh sense of purpose to a vibrant, intergenerational mix of talent.

It will not be easy or inexpensive, but law firm leaders should not shy away from tackling these challenges head on. To move ahead in a way that benefits all generations, law firm leaders should embrace repeatable, ethical, responsible, and profitable smart growth strategies,[45] in keeping with the findings of McKinsey, Thomson Reuters, and the ABA. Colorado law firms will enhance their competitiveness by (1) establishing innovative nontraditional short- and long-term staffing relationships to supplement organic strategies; (2) exploring merger and acquisition opportunities with like-minded, future-focused firms to reduce their dependence on piecemeal lateral hiring practices; and (3) fostering a magnetic law firm culture to attract, develop, reward, and retain the right talent. Part 2 of this article addresses in greater depth the exciting opportunities offered by these forward-looking strategies.

Gene Commander has more than 40 years of experience in the legal industry while practicing construction law with small, midsize, regional, and national firms. He formerly served as managing shareholder in the Denver office of Polsinelli PC. Commander is now an executive business counselor for the legal and construction industries, with a special focus on business growth strategies for Colorado law firms—gene@genecommanderinc.com. The author thanks Ginette Chapman of Legal Edits, LLC for her research and editing assistance.

Coordinating Editor: Jeffery Weeden, jlweeden@weedenlaw.com

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43. *See* Pollak, *supra* note 8.

44. *See* Commander, "Staying Ahead of the Succession Planning Curve," 51 *Colo. Law.* 8 (Apr. 2022), https://cl.cobar.org/departments/staying-ahead-of-the-succession-planning-curve.

45. *See* Miller, "What Does Sustainable Growth Really Mean?" *Forbes* (Aug. 16, 2018), https://www.forbes.com/sites/rickmiller/2018/08/16/what-does-sustainable-growth-really-mean/?sh=7fc7d14e7a98.

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