Deconstructing “Overcapacity”

You keep using that word. I don’t think it means what you think it means.

by Jordan Furlong, Edge International, Law21

The legal industry’s newest buzzword is “overcapacity.” It’s constantly invoked in reports of flat revenue and declining profits in law firms, usually as the reason for and precursor to cuts of all kinds, from secretarial firings to partner de-equitizations. I’d like to drill down a little deeper on that word.

“Overcapacity” comes to us from the industrial and manufacturing sectors. Overcapacity, in that context, compels companies to shut down plants and lay off workers because low demand is generating insufficient cash to pay the workers and keep the assembly lines running. It infers a dramatic misalignment between labor and inventory, one that must be re-balanced if the business is to remain viable.

When we talk about “overcapacity” in the law firm context, we similarly mean that a law firm has more lawyers than it needs to handle its available work, that supply has outstripped demand. But does that equally imply that the viability of the business is imperiled? That the firm’s lawyers aren’t generating enough revenue to even cover their own salaries and expenses? That dramatic cuts are needed to keep the firm afloat? In almost all cases, I contend, the answer is “No.”

Take a simple example: the #100 firm on the 2012 AmLaw 100 list reported an average profit per equity partner of $890,000 and a roster of 179 equity partners. That works out to a total ownership profit, in 2012, of $159,310,000. No industry that includes businesses with profits like that — not to mention 99 profits even higher — should be using the word “overcapacity” with a straight face.

You might argue that falling average profits do threaten a firm’s viability, even if that fall is from “stratospheric” to “very comfortably well-off,” because top rainmakers may bolt the firm if PPEP drops too far. But a firm with a solid identity, a defined strategy, and competent leadership shouldn’t fear such departures: if anything, the self-interested partners who bolt for higher ground may well be performing addition by subtraction for their former firm.

I suggest we draw a clear distinction between “doing enough work to generate our desired level of profits” and “doing enough work to meet payroll and keep the lights on,” and that only in the latter context should we be talking seriously about “overcapacity” and taking draconian measures to address it. Let’s not use euphemisms about demand when what we’re really talking about is profit.

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