

## HUMAN CAPITAL STRATEGY

**Goal.** Develop a strategic plan that emphasizes human capital—specifically to select, develop, and retain the best talent in the legal industry. Topics to be covered in this talk:

- I. Why is human capital an important strategic objective?
- II. What does a highly effective human capital strategy look like in practice? Historical and current examples.
- III. Principles of implementation.

### I. WHY IS HUMAN CAPITAL AN IMPORTANT STRATEGIC OBJECTIVE?

- A. **Change is inevitable.** The volume and complexity of legal work for global companies is growing significantly faster than revenues and profits. Thus, the future is going to require new methodologies for handling the legal needs of large corporate clients.
- B. **Likewise, a fight over market share is inevitable.** Corporate clients will generally prefer solutions provided by trusted name-brand law firms. *But there are many trusted name-brand firms.* Those with the best talent will take market share.
- C. **The underlying job is much more complex than in the past.** It is not enough to hire smart people. Successful firms will need to optimize their human capital. This requires (1) a model designed for today's market and (2) outstanding execution.

### II. WHAT DOES A HIGHLY EFFECTIVE HUMAN CAPITAL STRATEGY LOOK LIKE IN PRACTICE? HISTORICAL AND CURRENT EXAMPLES.

Here is the paper napkin version. A highly effective human capital strategy has three primary moving parts: (1) selection and recruitment, (2) professional development through a combination of (i) formal training and (ii) challenging, diverse client work, and (3) managers and leaders who inspire and motivate workers to operate at their maximum potential. Further, these parts only work together properly if the interests of all stakeholders—clients, employees, and owners—are aligned for the long-term.

- A. The Cravath system was explicitly designed to create specialized lawyers who could work together as a team to handle the most challenging and complex legal needs of large business clients. See Robert T. Swaine, *The Cravath Firm and its Predecessors Vol. II* (1948) (purpose of the Cravath system was to create “a better lawyer faster”).
  1. Virtually every modern law firm adapted the partner-associates training model.

2. Arguably, decades of demand outstripping supply, and resulting profits, have obscured the logic and primacy of the human capital model. More on this later.
- B. The DNA of the law firm model became the basis for McKinsey, the global consulting powerhouse. See Marvin Bower, *Perspective on McKinsey* (1979).
1. During the late 1920s, Marvin Bowers was a Harvard JD/MBA who worked for Jones Day in Cleveland. (He was initially not hired because he was not a member of the *Harvard Law Review*. After becoming an editor of the *Harvard Business Review*, the firm relented and hired him.) After four years in practice, he went to McKinsey (a small, fledgling management advisory firm; James McKinsey was at the time a professor at University of Chicago Business School.) Bower would become managing partner and drive the firm's dramatic global ascension.
  2. High entry-level standards, professional independence, continuous professional development, and a strict up-or-out policy were all features explicitly borrowed from the law firm model.
  3. McKinsey enhanced the model by articulating the stage-by-stage development of a first-rate professional consultant and requiring the application of that model to all decisions related to firm personnel. See Appendix.
- C. The human capital model was also the key to the rise of the investment banking giant Goldman Sachs. See Charles D. Ellis, *The Partnership: The Making of Goldman Sachs* (2008). To date, Goldman has evolved itself three times to adapt to market conditions and the growing scale of its operations.
1. **Rainmaker-based**, during Sidney Weinberg's era. Weinberg took Ford public in the late 1950s, at the time the biggest IPO in history. He was known as "Mr. Wall Street." Arguably much of the legal industry still operates on the Rainmaker model. Is this in the long-term interest of law firms?
  2. **Team-based**, starting with the Gus Levy era. Essentially teams were built around very large institutional clients. One of the hallmarks was "going joint," which meant that partners *asked* to be measured as teams, not individuals. This system in turn became contagious because of its effectiveness with clients. The firm's selection criteria subsequently were changed to focus on MBA candidates who (a) loved team-based competition and (b) had a passion for client service. During this era, unwanted attrition was near zero. *This is a model ripe for application by law firms to very large corporate clients.*
  3. **Proprietary methods-based**, during the Robert Rubin era (essentially Goldman became its own client with capital supplied through its IPO). I would argue that the team-based approach was a necessary precursor to this stage.

D. Another example of the human capital model is CF Braun & Company, which was an engineering firm that built oil refineries during the early and mid-20th century (merged into Kellogg Brown & Root in the early 1980s).

1. Founder Carl Braun's systems for communications and management / workforce development were nothing short of spectacular. They maximized the potential of the company's workforce and inspired unparalleled loyalty, efficiency, and quality control. Over thirty years after the CF Braun was sold, a LinkedIn group of alumnus still celebrates the company.
2. These principles made an enormous impression on lawyer Charlie Munger, who has applied Braun's principles for decades at Berkshire Hathaway.

DI. Google is destined to be a classic example of the human capital model. This model explicitly relies on the quality of managers. See, e.g., Walter Chen, *Why Google's Best Leaders Aren't Stanford Grads With Perfect SATs*, Inc., ([online](#)), July 17, 2014.

*NB: Cravath, McKinsey, and Braun each memorialized their human capital models in books for private distribution to their firms. We all appreciate the enduring value of their brands. Yet, they left behind step-by-step roadmaps for how they built their organizations. The strategy is not complex. But successful execution depends upon intellectual humility and disciplined and focused leadership.*

### III. PRINCIPLES OF IMPLEMENTATION.

A. A human capital model is *a system* based on logic and refined through experience. The model requires:

1. **Clarity.** Everyone in the organization can understand and remember the underlying principles. The model can be put on a single sheet of paper.
2. **Values beyond profit.** The drive for profits is mediated by the need to maximize human potential and to advance socially responsible outcomes.
3. **Respect for data.** Preconceptions are tested against data so the model can be refreshed and improved. This will be a challenge for lawyers, whose job it is to argue successfully from a limited set of facts. Here we don't need argument; we need more reliable facts. See Nobel Laureate Dan Kahneman, *Thinking, Fast & Slow* (2011) (discussing how high cognitive ability professionals are at greatest risk of overconfident judgments based on limited, unrepresentative data).
4. **Faithful execution.** A human capital model is expensive to implement (in time, money, emotion, and intellectual focus), but the returns are enormous. The model devolves quickly if an organization permits short-term or individual interests to trump faithful and consistent execution.

B. Despite the fact that virtually every AmLaw 100 law firm has its origin in a human capital model, few partners today understand its elegant logic. This is because the

model itself created tremendous forward momentum—momentum that has lasted for decades. This enabled partners to forget (or never learn) the underlying logic.

1. Now that law firms are fighting over market share, the human capital model is destined to be rediscovered and reapplied. *See, e.g., Milbank@Harvard.* Indeed, the values of the human capital model are near ideal for today's Millennial generation.
2. Once implemented and successful, a refreshed human capital model will be copied by others. Cravath 1.0 may be replaced with [Your Firm] 3.0.

## Appendix. Excerpted from Marvin Bower, Perspective on McKinsey (1979) (private printing)

### The Building Block Concept of Selecting and Advancing McKinsey Consultants.

Study of our experience over many years shows that an associate with the Basic Qualities [Block A below] can build on this foundation to (1) learn everything he needs to know to become an outstanding consultant; (2) advance to principal, director, and practice leader; and (3) be a Firm leader generally.

Therefore, we should not employ anyone who lacks the Basic Qualities, regardless of prior experience, knowledge, technical skills, educational degrees, language, competence, or urgent need for his [or her] services. ...

In interviewing associate candidates and checking their references, we are evaluating potential. In making advancement decisions, however, we are evaluating demonstrated performance of Basic Qualities (A), Basic Consulting Skills (B), and Essential Knowledge (C). ...

### Qualities, Skills, and Knowledge of an Outstanding McKinsey Consultant—Based on Successes/Failures of Real McKinsey People

(Read from the bottom up)

<b>C</b>						
ESSENTIAL KNOWLEDGE (The individual with the Basic Qualities and a real interest in becoming an outstanding consultant with the Firm can acquire this knowledge.)						
<b>1. Special technical competence</b>	<b>2. Superior judgment</b>	<b>3. Firm managing philosophy and knowledge</b>	<b>4. Firm/office strategy</b>	<b>5. Caring leadership of firm personnel</b>	<b>6. Clientele building</b> (developing and attracting clients)	
<b>B</b>						
BASIC CONSULTING SKILLS (The individual who has the Basic Qualities and a real interest in becoming an Outstanding consultant with the Firm can learn these skills.)						
<b>1. Professional approach</b>	<b>2. Management fundamentals</b> – business or government	<b>3. Interviewing, fact gathering</b>	<b>4. Firm problem-solving approach.</b>	<b>5. Effective Relations with client and firm personnel</b>	<b>6. Client communications and persuasion</b> (oral and written)	
<b>A</b>						
BASIC (FOUNDATION) QUALITIES (With these qualities, the individual who is interested can learn everything needed to become an outstanding consultant with the Firm.)						
<b>1. Character.</b> The No. 1 quality.	<b>2. Personableness.</b> Favorable appearance and personal impression	<b>3. Personality.</b> Forceful, mature, self-confident, and emotionally stable	<b>4. Mental Equipment.</b> Outstanding analytical and creative ability.	<b>5. Ambition.</b> Achiever with a zest for learning	<b>6. Personal Effectiveness.</b> Vigor, initiative, drive, capacity to get things done.	<b>7. Interpersonal competence:</b> Capacity to attract and persuade others.