Navigating the perfect storm

Strategic options for law firms in challenging times

An unprecedented convergence of external and internal forces is generating gale-force winds of change in the legal marketplace, testing the skills and courage of law firm leaders to their fullest. How can you drive profits in these economic conditions without abandoning long-term strategies or sacrificing collegiality? Here is a guide for navigating the stormiest seas on record.

By Tony Bash

We are clearly in the middle of extremely challenging economic times. Business stands at the forefront of the waves that are pounding the economy, and law firms are certainly not immune from the dangers. I wish to review, input and outline the strategic options available to law firms, with the express aim of generating further discussion and input into firms' responses to these serious economic pressures.

Myriad industry and business indicators point to serious problems facing the business community worldwide. Here are just some of the pressures now being exerted on both the wider economy and on law firms' specific environment. Consider the degree to which any of these will have relevance to and impact upon your firm.

Global macroeconomic factors:
- Currency fluctuations
- The price of oil and precious metals
- The rise and fall of "real" jobs and where they are performed
- The political stability of job locations
- Foreign relations as they affect business
- Balance of trade between countries and regions
- Housing markets: not just prices, but also demand
- Credit levels (or perhaps more accurately, "debt levels")
- Interest rates, which may well rise from the threat of inflation
- The largely unregulated hedge fund industry and the major pensions that invest in it

Legal marketplace factors:
- The disparity of views between general counsel and their outside law firms
- Associate starting salaries and their consequential impact on all salaries
- The continuing trend of de-equitizing partners
- The anticipated arrival of publicly owned law firms in the UK
- Partners' obsession with short-term remuneration
- Ever-increasing expectations around revenue, PPP and PPL

Batten down the hatches

7 strategic steps to "recession-proofing" your firm while continuing to build and enhance profits.

1. Display strong leadership.
In both good and bad times, strong leadership is critical if hard decisions are to be taken and actually executed. This is an area where most law firms struggle, so if your firm can succeed here, you'll have established an early lead over your competitors.

2. Ramp up the frequency of financial data reporting.
Things can change fast in a recession. Clients, under financial pressure themselves, terminate engagements. Revenues may contract. Debtor payment periods and write-offs may deteriorate, putting pressure on liquidity. The firm's key financial metrics must be monitored far more frequently than in boom times.

3. Make the hard decisions humanely and fast.
Layoffs, if required, must be quick and humane, not only to preserve capital, but also to get the firm past this trauma quickly and focused on moving forward again. Continued employment of underperformers must be carefully assessed. Where the market is no longer buying specific services, there are two choices: retool (quickly) or separate. (This is not a suggestion to rush to layoffs; this is a last-resort option for all personnel, except those who ought to have been asked to leave years ago.)

4. Focus on short-term action plans.
Responses to recessions must be designed for rapid implementation. Plans must be focused, systematic and disciplined. Those personnel who will actually implement the plans must be integrally involved in crafting them and managing their execution. Feedback and accountability measures are critical to ensure that the plans are executed, especially when they relate to the hard, courageous decisions.

5. Involve your clients.
Client mobility increases in recessions, since client needs evolve more quickly as new threats and opportunities emerge. Firms need to go beyond simply expressing empathy and assuring continuing loyalty; they need to actively position themselves to meet emerging key client needs. This cannot be done without actively discussing business (not just legal) issues with clients. If you don't have client teams in place for your key clients, now is not too late to create them.

6. Manage internal expectations.
"Business as usual" could be lethal: procrastination has been the death of too many good firms. You need to explain internally what the firm's leaders are doing to weather the recession and the likely impact on people's financial positions. This knowledge will motivate your people to do what is expected of them, rather than default to "business as usual."

7. Stay balanced.
You need to maintain a balance between your long-term strategy and decisions about whether and where to cut short-term resources. Retaining some temporarily unprofitable practice areas and individuals may be advisable if they are important to your long-term goals. On the other hand, a recession is an excellent time to re-engineer or sever areas that have become less profitable but have been tolerated to avoid conflict.

- The surreal financial expectations of new lawyers
- The emergence of legal process outsourcing as a competitive factor
- The growing client demand for fixed, flat or non-hourly fees
- New technology capable of performing lower-level legal tasks

All these factors and more add up to what many in the legal industry are calling a "perfect storm." Every law firm faces these tough market conditions, coupled with changing competitive behaviors and the never-ending drive to increase profitability.

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We are not trying to make managing partners pessimistic or cast them into a pit of despair. Rather, we provide this perspective in order to emphasize the extreme importance of having contingency plans in place.

It is reasonable to assume that despite the factors outlined above, most law firms will continue to bill hourly for the most part and will plan for an extension of historic linear revenue and profit-per-partner growth trends, perhaps fine-tuning the engine slightly by de-equitizing some partners or closing an unprofitable office or two.

It is the rare firm that will have a contingency plan for dramatic drops in demand for many traditionally profitable practice areas, widespread overstaffing at all levels and in most practice areas, and the cancer of internally competitive behavior as the revenue pie continuously shrinks. We recommend that our client firms be among that rare elite.

PREPARE FOR ROUGH SEAS

As Bill Gates once said: "Success is a lousy teacher. It seduces smart people into thinking they can't lose." Many law firms have enjoyed unprecedented periods of success that lasted years, if not decades; it would be very risky for them to assume that will continue.

Law firm leaders, to do their jobs properly, must ask and answer some hard questions. We would like to suggest two such questions, and to provide frameworks for answering each one.

CHALLENGE 1:

How can we improve profits in these economic conditions while maintaining a long-term outlook?

To my mind, there are three routes law firms can take towards meeting this challenge: growing revenue, reducing costs, and investing in innovation.

A. REVENUE

Growing revenue is an obvious element of increasing profitability, but many law firms often relegate it to secondary status behind cost-cutting, since it requires both a longer lead time and possibly some upfront investment. Nonetheless, we consider it the key element of meeting this challenge. Investing time and money in revenue growth is crucial to improving profits, market share and long-term viability.

For example, firms could look into accessing untapped markets. Markets should be segmented either by sector or discipline to understand whether any pockets of growth or unaddressed areas exist that offer expansion opportunities to support the revenue line (*e.g.*, expansion of employment law).

Simultaneously, consider serious investment in practice development. Given that many partners are not busy with client work, this could be an opportunity to undertake practice development, working with clients to develop future revenue opportunities. Consider McKinsey's 2/4/8 rule: every McKinsey partner is required to be working on two assignments, be in the process of proposing four more, and be in communication with eight more prospective clients.

B. COSTS

Cutting costs is an obvious short-term way to increase profits. The key is to do so strategically and quickly, so as not to damage morale within the workplace. The drive to cut costs must be balanced with the need to keep an eye on the future and ensure adequate capacity for large revenue-generating projects.

Aim for broad cost-cutting measures, reducing headcount (humanely: see #3 in the sidebar on page 6) and offering packages where possible. In particular, pay raises and bonuses likely have some scope for reduction without creating long-term problems for the firm's reputation. If temporary measures are available, take them: offer sabbaticals or secondments to clients or other offices overseas, temporarily reducing the cost base in an expensive HQ city while leaving that office well positioned to scale up as markets recover.

Also, give serious thought to outsourcing: While there has been some resistance to this option in the past, it will prove to be a necessary step if revenues continue to slide. Try to obtain agreement in advance regarding what functions would be outsourced and how, cutting the lead time if this step proves to be necessary. India is a natural choice due to its highly qualified labor force and relative cost base, but smaller onshore locations in the US, Canada, Northern Ireland and Wales are increasingly attractive.

Many firms have already outsourced their transaction processing. Tasks that are neither key nor customer-facing should be effectively grouped, possibly reduced, and certainly offshored, potentially reducing costs by up to 75%. Quality and service levels must be high to mitigate the obvious criticisms, and key learning from others should be a necessary element in ensuring a high success rate.

C. INNOVATE

More could be said about this subject than we have space available, but it is critical that firms do more than simply increase revenue and reduce spending. An economic downturn is in many ways an ideal time to rethink many of the firm's traditional practices and processes.

Set up brainstorming opportunities across the business. Make it constructive, asking all areas of the business for their ideas for efficiencies and growth opportunities. Create small, mixed focus groups across different disciplines and levels, and ask them to come up with suggestions and ideas. These groupings should not only generate ideas, but should also identity those most likely to get buy-in and generate employee enthusiasm for implementation.

CHALLENGE 2:

How can we survive these challenging times without sacrificing partner collegiality?

First and foremost, help out the managing partner. His or her client-facing strengths need to be maintained, so there could be some benefit in transferring HR-type responsibilities to another partner to ensure sufficient challenge and active management of collegiality. This could be done by creating a COO role for a partner, ensuring that he or she has credibility within the group.

In addition, look to change the measurement and reward of partner performance. These factors influence behavior, so there might be a way of changing rewards to encourage a focus on collegiality and teamwork. This must be an objective measure such as joint revenue, given that subjective measures are relatively easy to manipulate.

This might also be time to review your communication strategy. While the grander gestures around team building are well covered, there might be scope to review the communication received from the managing partner and assess whether it's sufficient for employees to feel included and part of the team. This is particularly important during difficult times, where communicating problems can reassure people more than trying to hide them.

Finally, consider reallocation of roles. To encourage teamwork, it might be helpful to change working environments to encourage conversations between silos. One consideration might be to arrange people by sector rather than function, to create manageable groups within which to encourage interaction.

It might also be helpful to speak with other firms or other offices within the same firm, to understand whether these issues are common and to generate ideas for addressing them. A suggestion box or blog may be useful for gaining further ideas and enabling additional upwards communication in the office. Some incentive plan will be necessary to encourage employees to communicate in this way. •

Intelligent business

Tony Bash *draws on 25 years' experience with law firm finance to provide his clients with a unique and practical perspective on financial strategic issues. He specializes in helping firms implement "killer" business intelligence to guide future decision-making. He also helps senior management monitor the law firm's performance in targeted areas through timely and accessible data.*

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