

Recession Resistant: Does your firm have what it takes to survive the next big downturn?

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Save for Silicon Valley and emerging company practices, the legal industry has experienced an extraordinary economic boom, enjoying 15 years of robust growth without a major recession. Many firms have taken advantage of these flush years to prepare themselves for the next bust. That's a stark contrast to the years leading up to the last law firm recession, in the early '90s. When that recession hit, depressed profits and artless associate layoffs were the order of the day. Entire practice areas were purged of their associates.

Those layoffs left a sour taste among law school recruiting officers for years and made it difficult for firms to re-staff and win increased market share when the economy roared back.

The wounds from that recession were deep and slow to heal—severe enough to justify today's leaders asking themselves whether they are doing enough to recession proof their firms.

To be sure, things were different in the years leading up to the last recession. In those days, firms beefed up on equity partners. At too many firms, associates became equity partners just by sticking around for seven or eight years. Today's coin of the realm—an "ownership mentality"—wasn't required. Ability to service a client was enough. If rainmaking skills were there, too, that was a nice bonus. When the bust hit, a long-term, massive purge of non-rainmaking equity partners began. That purge was the tipping point that transformed large law firms from collegial partnerships to Friedman-esque, profit-driven businesses.

It took many of the industry's best-performing firms a solid five years to recover from the dark days of the early '90s. Well-run businesses would have been better positioned to take advantage of the opportunities that result from the failure of weaker players during a downturn. Although economic indicators remain strong today, experience mandates that firm leaders ask themselves how well they are positioned for the next recession. Are they ready to adjust to a downturn quickly and to capitalize on the opportunities at the other end? Here are a few key indicators:

Vision and strategy. Twenty years ago, these were dirty words in law firms. I remember listening to a leading law firm consultant *pooh-pooh* the notion of a vision for a law firm at a managing partner conference I attended in the mid-'80s. In boom times, it is relatively easy to survive and even prosper without a clear sense of direction—a sharp focus helps, but it doesn't determine success. In a recession, a firm without a clear vision and a strategy for achieving it will quickly lose its way. Partners today are much more mobile than they were in the early '90s. In a recession, even the best partners will become insecure and look for a firm that knows where it's going and how to get there.

Partnership structure. Although many firms learned their lesson the last time around and have been sparing in their admission of equity partners, there has been a worrisome trend toward multi-tier partnerships. They were created for at least four good reasons:

- To softly lengthen the partnership track;
- To allow management to make more informed up-or-out decisions about the business development skills of young attorneys;
- To provide a career track for lawyers with narrow expertise in an area, such as tax or ERISA, that some firms need but do not want to expand; and
- To provide a haven for highly valued partners who want to work reduced hours.

In recent years, too many firms have strayed from the sound origins of non-equity partnerships. They have allowed power partners to push associates across the line into non-equity status, arguing that they need them to service their clients. The economics appear attractive at first, because clients correctly perceive value in having these highly trained lawyers available at less-than-equity-partner rates to run deals and litigations, most often as second and third chairs. And what better way to improve retention and morale than to make every associate left standing after seven or eight years a partner, albeit non-equity?

There has been a clear domino effect at these firms: Once an exception is made for one partner's pet associate, other partners want their own. Why not? It is much easier to assign a senior, well-trained lawyer to a client's matter than to have to train a young associate, writing down (and then writing off) the partner's and the associate's training time.

The result has been a bulge of aging, expensive, second-tier income partners who were once profitable but are now entering years of reduced productivity with compensation that creeps higher and higher. This comes at the expense of profits per equity partner. And the impact isn't just financial. These income partners block opportunities for Generation Y associates to cut their teeth on challenging work and cause the brand dilution that occurs when a firm has platoons of senior lawyers running around with the title "partner" but firing on less than eight cylinders.

This bulge of income partners is even more threatening than the swollen equity partner ranks were 15 years ago. Non-equity partners are an aging class of salaried employees. They are fixed overhead with protection against age discrimination, and in the next recession, they will be a powder keg. Firms that have been disciplined in maintaining trim non-equity tiers for narrowly defined purposes are infinitely better prepared for the next recession than those that have not.

Focus on profitability. Fifteen years ago, it was a cardinal sin to measure profitability at the practice group level. Imagine a business trying to make hard decisions in a declining economy with only anecdotal knowledge of which of its products are most successful and which are losing money, and why. That describes much of the legal industry in the early '90s.

Today, most firms are beginning to use software to determine profitability at the practice group level, and they are moving toward measuring it at the client, engagement and individual-lawyer level. They have gotten religion about regular rate increases, daily time entry and shortened billing and collection cycles. Fifteen years ago, partner billing rates were set by class year. Today, individual partner rates are more often fine-tuned to market demand. The days when a partner had sole discretion to knock down his billing rate, offer a discount, write off time or write down a bill are quickly disappearing. (At successful firms, they are already gone.) Instead, partners are expected to fine-tune leverage and utilization with the goal of maximizing profits.

For many firms, attention to detail on such things as staffing mix has brought hundreds of thousands of dollars to the bottom line. This focus on profitability has led to great financial strength, allowing many firms to make long-term investments and reduce their reliance on debt. Both have made them stronger going into the next recession.

Talent mix. As recently as five years ago, white-shoe firms shunned temporary attorneys out of fear that they would reduce quality. Today they rely heavily on temporary and contract attorneys to meet short- and even midterm fluctuations in demand. This leads to a much more flexible, productive and profitable talent mix. Flex staffing is a proven business tool for dealing with economic cycles, and it will serve the legal industry well the next time the economy weakens. Firms that are already adept at it stand to benefit greatly when the economy slows.

Practice mix. Learning from firms that prospered in the early '90s, many firms have built countercyclical practices. Heavyweight corporate firms have expanded and strengthened what were once backwater litigation practices. To balance M&A practices, firms have built restructuring practices. They have gone into private equity to provide balance when the capital markets cool. And firms are gazing over the horizon with keener eyes. They are no longer content to simply catch the current wave of hot practices like white-collar

defense and private equity work. Instead they are looking at global economic trends and investing early in practices once thought dead.

Firms have also focused on building "known-for" status and market share in core practice areas. Although driven by marketing considerations and the ability of "leading" practices to charge higher rates, market share leaders typically benefit most in a recession, as the weaker players fall by the wayside, leaving talent and market share to be grabbed by the well-known players.

Focus on critical mass in strong markets. Over the past 30 years, many firms have grown from local players to global ones. Along the way, they have opened offices in small markets that are no longer critical to their growth strategy. The proliferation and maintenance of these offices weakens firms. In the best of times, they are a distraction. In a recession, they are real albatrosses. The lawyers with local practices can't command the high rates paid in significant markets. The space is hard to sublet, and the lawyers aren't as mobile. Only a handful of firms have avoided or moved to get out of non-strategic markets, and they will feel the pain in the next recession.

Governance and leadership. Many firms have made great progress in governing themselves more like businesses. Among the key changes firms have made are empowering their chairmen and managing partners to make key decisions formerly reserved for the partnership, such as bringing in lateral partners, paring unproductive partners and closing offices.

These firms have installed management-savvy lawyers in key leadership positions, particularly as the heads of important departments and practice groups, instead of using those positions to reward seniority and rainmaking. Pushing management down to the practice group level has also provided management with a better ear for the market.

They have also undertaken practice group leader training, and a handful of them are going a step further, working with leading business schools to educate promising leaders on management of a professional services firm. These programs focus on the broad array of challenges that firm leaders face. As a result of these changes, firms are more nimble in their decisions to open and close offices; launch, expand and shut down practice groups; and deal with underperforming partners. They have greatly enhanced their ability to analyze and move quickly on market downturns, efficiently make the tough decisions that recessions mandate and take advantage of the opportunities they present.

Firms have come a long way toward recession-proofing themselves over the past 15 years, with the market leaders showing the way. Those that have focused on and been disciplined in building financial strength in order to make long-term strategic investments in leadership and growth of critical mass in core geographic,

industry and practice area markets will be the winners in the next recession. The others have work to do if they want to emerge from the next downturn stronger and ready to capitalize on opportunities.