

Making Lemonade:

Just as adversity builds character, the current downturn, played correctly can create a stronger law firm.

© Peter D. Zeughauser 2008

(first published in *The American Lawyer*, May 2008)

With the U.S. economy clearly in a recession (and teetering on something worse), the mood in law firms is anxious. Firm leaders feel tremendous pressure to continue to produce solid short-term gains in profits per partner. They are trimming budgets with sharpened knives. This is wise, no doubt.

But recessions challenge weak firms more than strong ones. Healthy firms can actually increase their market share during a downturn. However, to take advantage of what appears likely to be a deep recession, you'll need a strategy.

At its heart, strategy involves making choices about the investment of a firm's two principle resources—time and money. In a recession, it is more important than ever that firms devote their resources to investing in their brands and talent, and to building financial strength. Even in good times, prioritizing the investment of resources requires tough decisions. But prosperity masks bad choices. In a downturn, the choices get harder, and the consequences of bad choices are exacerbated.

- **Brand.** The firms that successfully confront the downturn will be the ones that enhance their market position and strengthen their brands. Their task is to favorably distinguish themselves from competitors in the eyes of their key constituencies—clients and talent. A strong economy over the better part of the last generation has allowed too many firms to succeed without doing this. The result has been the perpetuation of a highly fragmented marketplace in which few firms have significant market share or positions. It is well-acknowledged that a firm can't be all things to all people. A less-practiced corollary is that choosing a market position allows a firm to better marshal its limited resources toward developing “known-for” status.

Over the last ten years, the largest and most profitable firms have been increasing their market share and profitability faster than the rest. Their growth has come at the expense of others. Some of these firms have

global breadth and depth in core practice areas that they are structured to exploit financially. Others have go-to corporate and litigation practices for public-company clients, from whom they can command high rates. Some firms combine the two. But all of these firms have built brands that embody high levels of expertise and service on a significant volume of complex matters.

These top firms own their market positions, but they've left the rest of the work for others. Firms that choose wisely among this remaining work are the ones that will come out of this downturn stronger than their competitors. To make the right choices, a firm must assess its strengths, weaknesses, opportunities, and threats to determine what it can reasonably aspire to build. Then it must develop and implement a strategy for achieving that goal and align its practice mix, footprint, and structure (including management and leverage) with its strategy. This is time-consuming. It means building depth and breadth in some practice areas and enduring the pain of getting out of others. But over the long haul, this is likely the single most important strategic play these firms can make as they battle the downturn.

There are also tactical moves firms can make to attract work and build market share during a recession. Retooling lawyers is one. M&A lawyers can be recast as restructuring lawyers, commercial litigators can become bankruptcy litigators, and environmental lawyers can become alternative energy, climate change, and natural resources lawyers. Micropractices can emerge: Private equity lawyers are held out to the world as sovereign fund and state-owned enterprises lawyers; a team of finance and restructuring lawyers can become subprime debt lawyers. Such labels better tell the marketplace how a firm's skills and strengths are distinct from and more attractive than those of its competitors.

Another tactic involves promotion. Achieving top-of-mind status is a daunting task in a fragmented marketplace. Smart partners invest in marketing activities that build such a profile early in their careers. The best keep at it over their professional lifetimes. But the vast majority fall prey to the demands of their practices. They don't spend sufficient time building their profiles by publishing and speaking, and by networking in community, professional, and industry groups. They put client care visits on a back burner. In a recession, many lawyers will suffer from a decline in billable hours. Their firms should ensure that they make a concomitant increase in nonbillable time building top-of-mind status.

Firms, meanwhile, should step up promotion work with their most desirable clients by making heavy investments of time in client care programs. Their first step is segmenting clients according to how much they contribute to the firm's profitability and their potential for growth. Partners should make systematic visits, not related to pending matters, to the firm's most valued and highest-potential clients. Firms should also conduct client satisfaction and service needs assessments aimed at learning more about their clients' businesses and industries; design customized offerings for targeted, specialized newsletters; and provide on-site customized CLE programs for their clients' in-house lawyers, among other things. Such efforts add value,

cement relationships, and distinguish a firm from its competitors. At worst, they maintain a firm's top-of-mind status; at best, they generate substantial new work.

- Talent. At the strongest firms, lawyers often say that they stay not for the money, but because of the bonds created by building strong practices together. Struggling through hard times together often makes firms more cohesive. The key is in not letting stress weaken the bonds. For firm leaders, this means taking the time to communicate thoughtfully, clearly, and candidly about the choices the firm makes.

No doubt about it, the recession will stress weak firms. This stress will show itself in greater difficulty in retaining top talent, particularly partners. Many firms have stretched their partner compensation ratios to a point of near inelasticity, with senior associates earning more than new partners, and top partners approaching the limit of what the marketplace will tolerate. Cherry-picking opportunities for strong firms will be unprecedented.

Weak firms find themselves where they are in part because they have failed to weed out underperforming partners, choosing instead to deal with them by limiting their pay. These firms are going to have to rationalize their compensation structures and refuse to tolerate underperformance. This is going to result in a glut of weak talent on the market.

Avoiding lateral recruiting mistakes will become imperative. Even in flush times, firms can barely afford their usual .600 batting average on lateral partner recruiting success; in a recession it simply won't work. Several years ago our company benchmarked a group of about 30 firms on their lateral recruiting practices and learned that many of them had developed useful questionnaires to vet laterals. The better firms asked laterals for recent tax returns and correlated them with book-of-business and compensation claims. In the boom, when lateral recruiting was frenzied, some firms didn't even use their own forms for fear of delaying the hiring process or offending or scaring off laterals. (Of course, the better laterals were impressed by strong vetting practices and wanted all the more to join a firm that used them.)

Firms can also rationalize lawyer workloads. During the boom, many firms began outsourcing routine associate work or funneling it to associates who were not on a partner track. They also began trimming nonequity partner ranks in an effort to enhance profitability and increase the flow of challenging work to associates. Firms that continue down this path will be stronger when the economy strengthens. Bright, hard-working associates are a firm's lifeblood. Although there have been associate layoffs (and there will surely be more if the recession deepens) firm leaders should remember the lesson of the recession in the early nineties, when many firms cut associate ranks too deep and weren't able to meet demand when the economy recovered. Firms are probably going to need to temper profits per partner as an investment in associate retention.

- Finances. Budget cutting is not the only financial alternative in a recession. The key lesson on the revenue side of the recession in the nineties was that building countercyclical practices helped even out performance across economic cycles. In this downturn, we are already seeing firms with countercyclical practices faring better than the pack.

This is not to say that belt-tightening and continuing to get the blocking and tackling right won't make a firm stronger when the economy recovers. Managing leverage, paying down debt, closing or downsizing offices, shortening the collection cycle, and avoiding discounts and write-offs are all more important in a downturn and will position a firm for a stronger turnaround. Partners often fear rate increases in a recession, but falling behind your competition on rates is unforgivable. It costs ground that is hard to make up, no matter how strong the economy becomes. In a downturn, clients will clamor more loudly for discounts. The temptation to buy market share this way will be strong, but in the end that causes brand erosion, which takes generations to rebuild—if it can be done at all.

There is a beacon of hope in the current downturn. Globalization is far from over; indeed, it is likely the large U.S. law firm's best friend. The American-style free market, regulated by public and private interests, including nongovernmental organizations, is emerging as the economy of choice in developing countries around the world. It has launched a golden era for large law firms that is far from over and that will provide a softer bottom and higher arc for all who learn the lessons of each downturn.