fairfax
INSIGHTS

Planning for the Next Downturn

While the 2008 global financial crisis continues to impact many aspects of the business of law, the economy has seen an unprecedented period of growth. If history is any indication, that growth will slow, and a recession is inevitable in the not too distant future. Law firm leaders are generally positive about the outlook for 2019. As reported in law.com, and based on Citi's Law Firm Leaders Confidence Index, overall confidence going into the year was somewhat low, but leaders reported higher levels of confidence for the second half of the year. However, looking ahead, we see some nervousness around what 2020 will bring.

For many law firm leaders and particularly for law firm partners and associates, the challenges of the global financial crisis are a distant memory. In fact, many of the law firm leaders during that period have passed the reins to the next generation. All but the most senior associates were not even in law school when the last downturn hit.

While the precise timing of a downturn may be impossible to predict, it is important for law firm leaders to prepare well in advance, and that time is now. It is unlikely that the next downturn will be as sharp or as lengthy as the crisis of 2008, but law firms are increasingly sensitive to market forces, so preparation is critical.

Lessons Learned in 2008 and Beyond

With the benefit of hindsight there were some warning signs, but the 2008 downturn blindsided many law firms. It hit swiftly and hard, and law firm leaders scrambled to make tough business decisions. Unlike previous downturns, which tended to impact certain sectors of the economy and select law firms or practices – such as the technology focused firms in 2001 – this downturn was felt across the legal industry. As demand dropped, firms responded by cutting expenses, deferring investments like technology, cancelling firm retreats, reducing headcount – particularly associates and staff, and cancelling summer programs and even incoming associate classes. As clients became increasingly price sensitive, firms reduced billing rate increases and increased discounts.

While many of these steps are fair game the next time around, firms learned lessons last time that are worth considering before making the same mistakes this time. These include:

- Firms who stopped hiring associates found themselves with holes in their talent pool when demand began to pick up a few years later. Further, some associates from that period were bitter about the way they were treated, and firms suffered from retention issues as a result. With leverage lower now that it was then, the possibility of talent gaps could be even more significant.
- Firms focused much of the rightsizing on associates and staff rather than partners. As a result, average partner productivity has declined c. 10% or more from pre-recession levels, and the rate pressures were exacerbated because the staffing mix became more partner heavy. Many firms still struggle with underperforming partners.
- Firms cut business development staff and expenses to the bone. While it saved money in the short term, it may have reduced revenue generation opportunities in the medium term. It particularly impacted income partners and younger partners, who were given fewer business development opportunities, which again had longer term consequences.
- Firms deferred technology investments. While this may have been a possibility in 2008, it is a risky move in 2020 or beyond when the practice of law depends heavily on technology and continued investment in innovation is critical for many firms.
- On the flip side, some firms took pride in NOT making tough staffing decisions. While it is perhaps unfair to refer to this as a missed opportunity, some of those firms in fact struggled with underperforming lawyers and staff, and high expense burdens compared to other firms who had streamlined operations.

© Fairfax Associates

Of course, most firms will not be able to use these steps to preserve profitability to the same extent that firms did a decade ago because most are running more leanly and efficiently today. So where should firms focus next time?

Responding to the Next Downturn

While the appropriate response will depend on the nature of the downturn and each firm's current position, firms should consider the following:

Focus on clients

- *Be responsive to your clients.* Some clients felt that their outside law firms were not sensitive enough to the pressures on their own businesses in the last go-round. Clients value firms who partner with them. Get creative about meeting client needs, whether that means on pricing, staffing or service delivery approaches. Firms are even more attuned to client service today than a decade ago, but there may be more you can do that your clients will value.
- *Continue to invest in client relationships.* Get creative about delivering value added services that tie your firm to the client. Maybe that means using some of your excess capacity to deliver in-house CLE programs, partner with clients on diversity initiatives, or work with clients to assess their own operational efficiency.

Evaluate staffing needs

- *Carefully assess associate needs.* As with 2008, rightsizing the associate pool may be appropriate. However, given lean associate staffing in firms today, cutting associates, beyond normal performance management issues, may not be as easy as it once was. Take a long-term view and don't overprune.
- *Evaluate income partners.* The income partner ranks in many firms have exploded over the last decade. There are likely more opportunities to right size the income partner group than any other category in the firm.
- *Don't ignore equity partners.* Partners who have underperformed before a downturn are unlikely to suddenly start performing at a high level during a downturn.
- *Consider the overall legal staffing mix.* Can staff attorneys be used to do work more cost effectively for clients?

Continue to invest wisely

- *Redirect spending on support staff to high value activities.* A downturn can be a good time to look for opportunities to reshape the support team. Make changes to things like secretarial ratios that are harder to do when times are good. But use some of those savings to invest in people and initiatives that will help drive revenue and profits - business development support, pricing support and client facing initiatives.
- *Defer expenses where possible but don't skimp.* Many firms cancelled activities like partner and firm retreats. While lavish retreats may be inappropriate, looking for opportunities for the firm's partners to get together and engage in the business of the firm has significant value and should not be eliminated. Consider an in-office event as an alternative.

We don't know exactly what the next downturn will look like, nor the impact it will have on law firms, but thinking now about how you might respond, and the steps you might take, will allow you to act quickly and decisively when it's needed.

Washington

Lisa Smith
lisa.smith@fairfaxassociates.com
202.365.4180

California

Kristin Stark
kristin.stark@fairfaxassociates.com
415.215.9294

London

Giles Rubens
giles.rubens@fairfaxassociates.com
44 (0)20 3633 3943

© Fairfax Associates