



Looking Ahead: 2023 Priorities

Each year we look ahead and make predictions for the coming year. Each year brings uncertainty, and 2023 appears to be bringing more uncertainty than most. Economic headwinds, inflation, the threat of a possible recession, global unrest, and in particular the decline in the corporate transactions that drove much of law firms' success in 2021 and the first half of 2022, are raising questions for many about what the coming year will hold for law firms.

While year-end financial results are still coming in, we expect that 2022 will show uneven results for firms relative to 2021. However, we need to remember that 2021 was a record year for many law firms, and a decline relative to 2021 may still represent strong performance relative to pre-pandemic years. Revenue in 2022 continued to benefit from strong pricing power even in the face of lower demand in the second half of the year. Growth on the revenue side was offset by higher expenses, particularly increases in associate compensation. While the compensation increases were largely instituted in mid to late 2021, 2022 was the first year that firms bore their full year impact.

As we step back and evaluate the current trajectory and pipeline of work in these early months of 2023, unevenness in law firm performance persists. Some firms are maintaining solid levels of productivity while the industry overall is reporting a decline in demand (as measured by gross billable hours). Certain segments, particularly technology and capital markets focused practices, appear to be disproportionately negatively impacted, while other practices, particularly litigation, are seeing increased demand. Given the level of variability in demand shifts across firms and practices, performance for the remainder of 2023 will depend in large part on how well-prepared firms are to adapt to potential changes in demand.

As we look ahead, we have identified the following priorities for law firm leaders as 2023 unfolds.

Smart Performance Management

The announcement of layoffs by a few firms in recent months has received a lot of attention. Managing performance, at all levels, is always important. 2021 and early 2022 allowed firms to take a light touch on performance management because there was an excess of work. 2023 will be a year to reinvigorate performance management.

Some firms may need to go beyond performance management and consider layoffs, if demand is down and is expected to stay down for an extended period. That said, it is important to take a long-term view. Avoid over-pruning and remember the lessons learned in the 2008 downturn when firms made deep cuts and stopped hiring. As a result of these aggressive pruning actions, firms later struggled with holes in their talent pool once demand began to pick up. And of course, firms are currently paying the price in the form of the higher salaries that were required to attract and retain associates just a year ago.

Firms will also need to evaluate income partner performance. The income partner ranks in many firms have exploded over the last decade. There are likely more opportunities to rethink the income partner group than any other category in the firm.

Operational Effectiveness

Some of the recent layoffs have been on the operations side of the firm. We continue to see firms reshaping the business operations and administrative support team. Even with a full or partial return to office, the support needs for firms continue to evolve, with increased needs in areas like technology and data security, business development, pricing and profitability, and client facing innovation.

We expect firms to continue to evaluate their operational needs and adjust the mix, which may result in some necessary layoffs. However, there may be some opportunities for upskilling existing staff to fill new or evolving positions. This requires an investment in professional development for the operations team but should pay off in terms of loyalty to the firm.

Strategic Growth

Despite uncertainty around 2023, growth continues to be a major trend. We saw an uptick in mergers in 2022, and have already seen 22

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mergers announced in 2023, including several mergers of scale. While the scramble for associate talent has cooled, firms continue to make strategic investments in lateral partners and groups.

We are seeing growth becoming a front and center priority for firms at all levels of the legal market. Growth is driven by a need for scale – whether in core practices, adjacent specialty practices, key geographies, or a bigger base from which to make investments. Further, brand recognition, which is becoming increasingly important to clients when making outside counsel hiring decisions, particular for Board-level matters, favors larger firms or practices. The top 20 firms in the 2021 Acritas Global Elite Law Firm Brand Index are all among the largest firms in the world.

Firms who might not have considered large combinations in the past are much more likely to be open to the idea today, and we expect that merger activity and aggressive lateral partner hiring will be on the agenda of many firms.

Evaluate Pricing

As noted, law firm pricing power was high in 2021 and through much of 2022 and rates have increased significantly in the last 2-3 years. In a high demand environment, budgeting and pricing was less prominent. As demand softens in certain practice areas and client segments, pricing power will erode, and firms will once again need to look at how they can deliver services more efficiently. Pricing professionals will be in high demand.

Rethink Culture

Law firms are often very protective of their culture, yet we see signs that culture is not the positive force or glue it once was. Different generations may view aspects of firm culture with skepticism. Some firm cultures may not align with the stated diversity and inclusion goals of law firms (and their clients). We also see a reported increase in mental health concerns among lawyers, which are not always adequately supported in the culture of some firms. And hybrid work is here to stay, so firm culture needs to adapt to embrace it, not just tolerate it.

Some firms are being very proactive about adapting the culture of their firm, and it is time that all firms examine their culture to ensure it is an appropriate culture for today, and not for 20+ years ago.

2023 will present new challenges for firms as the legal industry continues to evolve. Leaders who prepare their firms to take advantage of the opportunities created by those changes will see their efforts pay dividends this year and in future years. As always, we are here to help firms understand these forces and develop plans to address them.

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