



In the balance

By 30 April 2009 most law firms had substantially completed a round of cost cutting which saw trainee solicitors deferred, associates and support staff made redundant and partners either exited or reduced to a fix share or consultancy roles. After this unprecedented upheaval in law firms, many law firm leaders are now hunkering down and waiting for the market to return to “normal” and for the good times to roll again. Such an approach will be a mistake as, despite the recent recovery in the world’s stock markets, there is still likely to be a relatively sustained period of uncertainty before a level of stability returns to the legal market.

Law is traditionally a lagging indicator of the economy. Although, this time, there was only a short time lag before law firms felt the effect of the recession it may still be 12 to 18 months before the legal market returns to a level that can be described as normal. This is caused by three factors:

- first, normal counter cyclical areas of work such as litigation and insolvency have not grown sufficiently to compensate for the dramatic slow down in transactional work;
- second, the residential and commercial property markets are at or near bottom and the relative dearth of new financing is likely to make any recovery, both in prices and activity, slow and tentative; and
- third, many corporate and financial clients need to rebuild their balance

sheets and to fund the repayment of loans due over the next two years before they will feel sufficiently confident to embark on a range of acquisition and financing activity. Any leader of a law firm who considers 2007–08 “normal” may be very disappointed when the market finds a new equilibrium.

So what should law firms be doing now?

Communicate

All in a law firm have witnessed an unprecedented period of uncertainty and insecurity. Many of their friends and colleagues will have been let go.

The promise of job security at all levels has been broken. It is essential that the leaders of law firms get out of their bunker and communicate at all levels in their firm. This will necessitate face-to-face meetings and regular emails and voicemails. Communication may be by formal presentations and question and answer sessions and may be conducted on a firm wide, office or practice group basis or in any form which engages as many people as possible. In any such communication the leadership needs to be upbeat, optimistic and realistic.

Undue spin and wishful thinking will soon be met with disbelief and cynicism. However, news of better performance, client wins, new matters and new hires should be given openly and clearly and put in the context of what the firm is trying to achieve. This is a difficult and

Tony Williams suggests how law firms may be able to recover from the recession

uncertain period and leaders are not expected to know all of the answers. Individuals need guidance as to what they can and should do to help.

If encouraged and properly motivated they will respond and the position of the firm will improve. If there is radio silence the bush telegraph will take over and morale will continue to decline or at best stagnate.

Allocate work

In a downturn there is a natural tendency for lawyers to hold onto work in order to appear busy. This may even be the case if the work could be done by more junior lawyers. In this period it is essential that work is passed down the organisation not only to ensure that the younger lawyers are kept busy and have the training and experience they need but also to ensure that the work is carried out in a cost effective manner.

More senior lawyers, including partners, should be encouraged to get out and about, to meet their clients and prospects, to understand the issues they are facing and to tailor their legal offering to ensure that it meets the clients needs and budget.

Understand the client

Law firms often claim to understand their clients and the businesses in which

they operate. Unfortunately, most lawyers, at best, have only a superficial knowledge of their clients and their businesses. Now is an opportunity to do better. Lawyers can spend some time researching their clients and their businesses and the industries in which they operate. Many general counsel are facing unprecedented pressures. The legal team may have been cut, they may have been told to reduce their external legal spend by 20% or more and to make it more predictable. They may also have been instructed to manage their organisation's legal and reputational risks more proactively and effectively so as to reduce problems in the future.

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Understanding the pressure the client is under and what their concerns are will strengthen the relationship with the client and could well identify potential areas of new work.

Understand your pricing

In this market firms are facing considerable pricing pressure. This ranges from the greater use of fixed fees even for large and complex transactions to major reductions on hourly rates. Firms are acceding to these demands in an effort to keep their client relationships and to maintain activity levels and cash flow but, in many cases, without fully understanding the effect of such deals on the firm's profitability. If a firm usually works on a model of 90% utilisation and 90% recovery of headline rates and this produces a margin of 25%, if utilisation is in fact 80% and the recovery rate is also 80% the profit margin may fall to 8% which represents a reduction of PEP of about two thirds. Whilst agreeing fixed prices or reduced hourly rates may be a business necessity, firms need to consider how

they can rescope or reengineer their work in order to improve their profit margin. Business as usual will be a very unprofitable course.

Many law firms now analyse the profitability of individual practice groups and offices. Some also analyse the profitability of specific client relationships and individual matters. In a period where reduced profit margins are a reality, firms need to fully understand the real financial drivers of their business if they are going to survive and thrive in the new market. Some leaders are assuming that the current pricing pressure will pass as the economy improves. This is a complacent and naive assumption. The buyers of legal

services now recognise that they have buying power and are prepared to use it. It is unlikely that this genie will go back into the bottle when the market eventually improves.

Understand your cash flow

With reduced levels of activity, firms need to understand and closely monitor their cash flow in order to avoid any unpleasant surprises. Some remedial action may be necessary as cash flow deteriorates, including reducing partner drawings and calling for more partner capital. Work in progress and debtors need to be monitored and where possible improved. The banks may remain reluctant to increase their exposure to the legal sector and when they do they are likely to require high facility fees and margins.

Be open to opportunities

During such an unsettling period it is natural to want to put a firm's ambitious strategy on hold whilst dealing with the storms shaking the firm. However, businesses can make far more strategic

progress in a downturn than in a boom. Management is likely to have more "permission" to address difficult issues, reorganise practice groups, close unprofitable practices or offices and deal with problem individuals. Leaders should never waste a good recession. In addition to internal issues, there are plenty of external opportunities. Target client relationships may be up for grabs.

The market share of work from existing clients can be expanded. There are also some exceptionally good partners and associates who, for a variety of reasons, have been let go from their existing firms or who are capable of being lured away from their existing firms. Detailed due diligence is essential but good quality individuals and teams can help to reposition a firm for the better. There may also be some greater merger opportunities both domestically and internationally which can enable a firm to achieve many of its strategic ambitions. None of these opportunities are easy, some will be unsuitable and all will require hard work and rigorous processes but the prize could be substantial.

A tough year

Inevitably the last year has been extremely challenging and exhausting for many law firm leaders. Those working in a law firm feel battered and insecure. It is easy and understandable for a leader to want to keep his head down until things improve. However, a clear sense of direction, clear communication as to what is required from everybody in the firm and some real drive and energy can enable the very exciting opportunities that are beginning to emerge to be grasped for the long term good of the business. Leading a law firm even in good times is never easy. Leading a law firm now is even more challenging but the strategic, able and brave will emerge from this period with stronger, united and well-positioned firms. NLJ

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