Preparing For The Worst

QUESTION:

I am seeing some managing partners comment that 'Firms will see their work slow down this year, there's no question about it.' And according to Dan DiPietro, who works with large law firms as the client head at Citi Private Bank Law Firm Group: 'We have an uncertain environment for revenue growth in 2008, and that is the kindest thing I can say,'

Conversely, following the herd is no way to exercise leadership or gain an advantage on your competitors. I assume you all noticed Latham announce the simultaneous opening of three new offices in the Middle East. This is clearly not batten-down-the-hatches behavior.

That said, as a relatively new managing partner I've not been involved in the management of our firm at any time that experienced a downturn in the economy. Do you have some advice for those of us who are going through this for the very first time? How do we manage our partners' expectations given the ever-increasing compensation that they have all been enjoying over the past ten years and what are some prudent actions to consider in preparing for the worst-case economic scenario?

RESPONSE:

The questions posed here were presented to the members of the Managing Partner Leadership Advisory Board (The LAB), and what follows is a synthesis of the thoughtful input received from the eight long-serving managing partners who serve as members of The LAB:

Are we already in a recession, headed for one, or will we avoid a full-scale downturn? While economists busily debate these points, one thing is clear: An economic slowdown can be a particularly challenging time, and one in which many new firm leaders are both inexperienced and unprepared.

The question of preparing for an economic slowdown raises a number of interrelated issues that we would like to address.

1. Investment Philosophy

Great law firms have an investment schedule that is a continuous process that proceeds through good times and bad. You may slow the schedule to respond to adverse market forces, but you don't turn on the investment spigot in good times and shut it off in bad times. This is one of the great lessons of some of the most successful law firms

The message you need to get out is that this is a time when a strategic vision, at the least, and better yet, a strategic plan are important. Your message needs to be that we stick with our plan, taking into account that it needs to be continually reevaluated, and not make any precipitous decisions that do not make sense when looking at the long-term.

While it is never a good idea to just follow the herd and it may be a good time to be more selective and conservative, you should continue to look for investment opportunities that are complementary to your firm's strengths and advance your strategic plan. In fact, during downturns in the economy, opportunities may be presented that would not otherwise be available. Of course, you must be mindful of cumulative investment costs and their impact on current partner earnings, but abandoning a well-conceived investment strategy should not be done without considerable thought.

In tight economic times, clients are more likely to flee to quality. This is a time to gain ground on your competitors. How do you do that? **Intensify business development efforts**, position yourself as a high quality provider, and get out and **visit with your clients.** When partners are not as busy, they need to get busy on business development and solidifying client relationships through personal contacts.

There are investment **opportunities in lateral partners** who are available today precisely because times are uncertain, and these opportunities won't be there when the sun is out and the skies clear.

The last downturn was the corporate scandal period, resulting in Sarbanes Oxley. The one before that was when the dot.com bubble burst. In both cases, many law firms came out of the dip better than when they went in. Perhaps more caution and prudence are suggested in selecting investments in uncertain times, but many of your best investments should and will be made in times of economic uncertainty.

2. Pruning Philosophy

Gardens need regular pruning and weeding. Just as you have an investment philosophy that is a continuous process, you should have a pruning schedule. You don't let weeds flourish in the garden just because the sun is out and the weeds are growing. Constant personnel management is an ongoing process. Just as you may slow the investment schedule to respond to adverse market conditions, you may gradually increase the pruning schedule in difficult times. **Pruning mediocre talents** and clearing out the "jerks" makes for a healthy law firm in the best of times. Partners who are not contributing at an acceptable level are easy to overlook when times are good. It is not a luxury a firm can afford in more difficult times. It makes the downtimes less severe and makes it unnecessary to announce wholesale layoffs that make you appear to be a weak and troubled firm. Never forget that bad firms are always proud to attract even weak partners from strong firms.

It is also a good time to prune a lot of excess expenses and improve your operating systems. The expense structure in any organization tends to get fat in good times. No matter how lean you think you are running, there are always ways to attack the expense side and improve the operating efficiencies of the business.

Here are some areas that always require attention:

• **Crunch the numbers**. At first blush it will appear that most expenses are "fixed" and that, in any event, they are inelastic downwards. But this does not mean that expense savings are impossible. Look at whether you can consolidate and then lease out any vacant office space. Closely scrutinize your outside suppliers – when was the last time you obtained a competitive quote on the firm's printing requirements? In good times, support staff functions tend to increase in size, but do you really need all of those report writers and data gatherers, or could some of these functions be outsourced? With a possible recession looming, do we really need every practice group to have their own little retreat . . . at some exotic locale – and if we are having multiple retreats are they resulting in any specific action plans? During good times we tend to sprinkle money on all sorts of projects that seemed to be good ideas at the time, but perhaps now is the time to rigorously prioritize each of these.

• **Inventory management.** If there is room to do it, reducing inventory/ improving billing and collection cycle times can smooth out revenue drops.

• **New matter intake**. Softer times raise the temptation to take in marginal matters and clients. On balance, the marginal revenue seems more valuable. We usually forget why we did this after the slump has passed, and we are managing the backend problems – collections, unworthy clients, etc. On balance, you might favor some relaxing of financial standards, but not client standards.

• **Fee concessions**. As a statement of fact, rather than advice, your clients will not overlook the opportunity to press for concessions. Developing a sensible process to rationalize how your firm responds will be more important than ever.

• **Rationalize your practice priorities.** Cutting across the board assures that no one is going to yell — how could anyone possibly object to sharing the pain equally. But suppose that instead of cutting everything by 10%, you use a downturn as a chance to get out of initiatives that aren't working well? Cutting off funding to your laggards would free up money to back the one, or possibly two, major practice areas where you have been working on developing a preeminent position. So for example, while capital markets practices are stressed right now, other practices are thriving. It may be time to reallocate resources, either temporarily or permanently, depending on your firm's long-term strategy.

• **Improve utilization**. A low ratio of billable to billed hours may be the result of excess staff. Also, scrutinize carefully all unbilled time for inordinate excess. Next, look at the realization ratio. Here again, if it is inordinately low, there may be a lot of "make work" going on. A few percentage point increases in these ratios also produces a multiplier effect on profit since there is no expense associated with the resulting revenue increase. Likewise, increasing billable time by not filling attrition vacancies can have a significant effect on profit since the associated costs are likely to be relatively small.

• **Emphasize leverage**. Let people know that hording work will cost them, and that this is the time to be out expanding their horizons since they might have more time to do it than when work was flooding in.

When economic news suggests that a budget shortfall of some significance is possible, it is always prudent to have a set of options available. Work with your senior staff to propose a set of options now for each level of shortfall that might occur. Then, if the shortfall actually occurs, the possibilities, priorities, etc. have already been established and you are in a position to move quickly.

There will be a tendency to go on an expense-cutting rampage. If your firm has legitimate belt-tightening that it needs to do, you should do it, regardless of the economic cycle, but such measures as laying off associates or cutting the marketing budget, two measures you will certainly hear proposed, can have long-term negative economic consequences. This is not the time to cut marketing expenditures or dispose of valuable resources.

One history lesson: In the dot.com downturn, a number of firms made the mistake of letting their associates sit idle, then lost almost all the people they had recruited in 1999 and 2000, only to find that in 2002 and 2003 they desperately needed those people. These firms lost the money that they had invested in recruiting those people and left money on the table on the upswing that followed because they were not able to staff adequately. Encourage your partners to fill the bucket from the bottom up as much as possible. The tendency will be for your partners, who are not as busy, to hold onto work that should be pushed down simply to keep their hours up. You need to avoid that if you can and then be sure they are not punished in compensation if they do push down the work.

3. Managing Expectations

The art of managing partner expectations may be your most difficult job. In recent years, partners have come to expect ever-increasing profits. Few partners will ask you to cut their pay. Everyone wants to make more and more in each succeeding year. But if you feed that beast, you'll be eaten by that beast.

You need to be very forthright with your partners about the financial challenges your firm faces and the prospects for the coming year. This should be done early (read that to mean: now) and often. Partners seem conveniently to forget messages they do not like to hear and end of the year surprises are not well received. Partners will be better able to accept a flattening or downturn in earnings if they know it is coming. Neither painting an overly rosy picture nor suggesting doom and gloom is a good idea. An honest, **balanced communications approach** is the best. Sharing the burdens of the business cycle with one's partners, in an open and honest way, builds character, institutional muscle, and durability. A sense of shared sacrifice is what produced what Tom Brokaw called "the greatest generation."

This is also a good time to get partners to realize that business and compensation will not always go up, and to make the adjustments in individual compensation that are hard to make when times are good, and there is plenty of money to go around. It is hard to maintain discipline in the face of plenty and unending partner "needs." A potential downturn is a good time to use the inherent political support of potentially 'hard times' to **say no**. Hiring freezes and accelerated 'weeding' at all levels are better than layoffs in the long term.

Restraining salary creep is easier in harder times. The associate salary / cost / productivity issues should get a lot of attention. When the money is a little tighter, it is necessary and easier to talk to people about their **opportunities to improve performance**, and how it is going to cost them if they don't make the necessary adjustments. This is when you learn who the team players are, and who "understands the tough business situation, but what about me?"

Acknowledging, communicating, and letting people know that management is watching and evaluating the situation can go a long way toward calming the waters.

4. Creating Optimism

An essential leadership role to help overcome bad times is to create a sense of optimism and energy within your firm. In a time when every issue of *The Wall Street Journal* points to more economic problems, your partners want to hear about a new marketing effort, an innovative new idea, a clever response to assist a significant client, something that exemplifies positive action.

Now is the time to do a series of **one-on-one and office visits**. Make yourself available to answer questions and offer support to each of your partners and practice groups. Get out in front of your troops, and be a creative resource. One way to influence mood is to be the role model, but you can't do this unless people can see you in action. You've got to be seen to be involved in the nuts-and-bolts of the business.

Create optimism by **rewarding small successes**. This is a time to increase the number of celebrations, however small. Treat your partners like winners, and they will turn out to be winners.

The natural (and often self-defeating) propensity that comes with an economic slowdown is defensively to "circle the wagons . . . and fire inward." Difficult times cause people to focus on their personal anxieties. Performance, commitment, and dedication soon decline, while uncertainty, insecurity and helplessness increase. It is precisely in these tough times that it is often forgotten that your key job is to create energy, excitement, and enthusiasm - to ensure that each of your partners is working at the peak of their capacity.

The LAB was formed as a resource to provide pragmatic advice to assist new managing partners with their critical burning issues and help them succeed. **The LAB** is comprised of the following distinguished current and former law firm leaders: Angelo Arcadipane (Dickstein Shapiro LLP); John Bouma (Snell & Wilmer LLP); Brian K. Burke (Baker & Daniels LLP); Ben F. Johnson, III (Alston & Bird LLP); John R. Sapp (Michael Best & Friedrich LLP); Keith B. Simmons (Bass Berry & Sims PLC); William J. Strickland (McGuire Woods LLP); Harry P. Trueheart, III (Nixon Peabody LLP); together with Patrick J. McKenna (Edge International).