

Riding the Economic Roller Coaster: What NOT to Do in the Downswing

The key to managing a law firm during difficult economic times is to focus on its long-term best interests rather than on this year's distributions to the partners.

BY EDWARD H. FLITTON



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When you're riding a roller coaster, it's nearly impossible not to look in whatever direction the ride is going. When the roller coaster is heading up, you're physically aimed up with it, and the sky is all you see. Likewise, when it's going down, your sights go with it to the bottom of the track, and it's hard to imagine ever swinging up again. Riding the economic cycle as a law firm leader has much the same effect. Whether times are good or bad, it's hard to imagine them being otherwise.

Without question, the current economic downturn is affecting the financial performance of most law firms, be they large, midsize, or small. Here's just one statistic: Those measuring the performance of the largest law firms estimate that this will be the biggest downturn for those firms in the past 15 to 20 years. Yet no one is predicting a permanent downturn in the demand for quality legal services, and that is where firms should steer their sights. In fact, even small businesses will increasingly have to compete internationally, deal with intellectual property and labor issues, meet more energy-related regulations, and have other needs that will continue to grow dramatically. Meanwhile, even as our law schools continue to pump out the same number of graduates, fewer of those graduates want to practice law. So the real long-term challenge will be to fill the increasing need for quality legal services.

It's critical for law firm leaders to bear these facts in mind when managing their firms through today's economic crisis. The key is to manage the firm for its long-term best interests rather than for this year's distributions to the partners. To guide you toward that goal, here are suggestions regarding what not to do when dealing with the tough times.

DON'T MERGE BECAUSE OF NERVES

I am not against mergers. On the contrary, with businesses of all sizes requiring more and more expertise from their law firms, a well-thought-out merger can provide the depth and sophistication to keep the best of your clients. But when the economic roller coaster seems to be going ever downward, some partners will argue that a merger is the prime way to bail out of the situation. This is the classic example of taking a long-term step to solve a short-term problem.

Take a very hard look before you make the leap. If the other firm is doing as poorly as yours, could this be a case of two dinosaurs merging to create one big dinosaur? Or,

if the other firm is doing better, is it because it's uniquely situated to prosper in this particular crisis? If it really does have a better business plan or is better positioned to compete in the future, a merger may be attractive. But having those negotiations now, while your billable hours and profits-per-partner statistics are unfavorable, may require you to make long-term concessions that are unfavorable as well. It may be better to wait or at least go slowly. You need to be sure that this merger will help the firm be where you want it to be in five years, rather than simply pacifying partners' nervousness about the current downturn.

DON'T SHOOT THE ASSOCIATES

The first impact of a downturn is a shortfall of work, and in law firms the first instinct in response is to reduce the associate corps. Rumors are that some large firms are asking their fall hires to report in November rather than September. Can you imagine a step that does more damage to a firm's reputation at the law schools – and for so little economic gain? It is also said that firms are either terminating associates outright or letting them go owing to “heightened” review standards, while others will put a freeze on hiring new associates, at least for the next few years. Five years down the road, though, when the roller coaster is going back up, these firms will have a severe shortage of midlevel associates who are critical to the ability to deliver work to clients on a profitable basis. In your hiring decisions for the coming year, consider where you want the firm to be in five or 10 years, not just in the near term.

There is one exception. Every firm has a few associates who most partners know are not partner material, but who nonetheless are “attached” to given partners who, personally or professionally, are fond of them and therefore blind to their faults. This downturn is the perfect time to confront those partners and resolve the problems.

Convey to your partners the importance of not moaning to associates and junior partners about the downturn and its hit on their pocketbooks. Instead, they should be talking about the firm's great long-term prospects.

DON'T FREEZE RATES

A downturn seems like a perfect time to avoid the painful process of yet another rate increase. And especially when you're trying to hang on to their business, it's nice to be able to tell clients that you're helping them through the downturn with your rate freeze. But are they freezing their prices? Has the rate of inflation declined to zero? Hardly. You will continue to face increasing costs, especially in the areas of staff and associate salaries and benefits.

Moreover, are your competitors freezing their rates? Just where are your rates in relation to your true competitors – meaning the other providers of high-quality legal services in your field? If you are at all behind in this regard, freezing your rates now will make it even harder to catch up when times are good, because a one-time big rate increase can truly shock and antagonize clients. Regular smaller increases are much less noticeable to them.

If you want to convey a sense of savings to your clients, cut out some of the peripheral costs you're passing on to them. Nothing annoys them more than nickel-and-dime charges for photocopies and the like. Or you could freeze rates for a few key clients who are especially hurt by the downturn, but maintain the freeze for only a year.

DON'T OFFEND THE TALENT WITH PENNY-ANTE CUTS

Just like clients, firm leaders and administrators have certain costs that drive them crazy. Usually this relates to entertainment or meals. Let's say, for example, a small firm's partners and associates have breakfast together once a month, and the firm has always picked up the bill. Now, using the downturn as an excuse, management announces that attendees must pay their own bills. From the partners' perspective, the impact on their distributions will be miniscule – and even though they know it's coming out of their pockets one way or another, most will take offense at the firm adding this personal expense even as their distributions decrease. As for associates, they will feel that another "perk" has been taken away while they are short on work.

Remember that cutting back on expenses other than salaries or fringes rarely has a significant impact on partner profits. It can, however, have a noticeable impact on how your lawyers feel about the firm and the way it treats them.

DON'T IGNORE THE WORRIES OF YOUNGER LAWYERS

The firm's more senior partners will have been through tough economic cycles before. But associates and younger partners will not have had the benefit of that experience. Oh, yes, the associates will know that partner distributions are down. In fact, they usually know more about such developments than the partners. They will also worry more about the impact on their futures. Remember, too, their loyalty to the firm is still being built, and the good ones have many opportunities to move elsewhere. Consequently, it's critical they be included in all communications about developments in the business cycle.

It is imperative to persuade them that this downturn is both temporary and affecting all law firms, not just your firm.

The latter point is particularly important for those who have just joined the firm, only to see results below projections. Official communications from firm management can help make the case for calmness – but the day-to-day conversations with senior partners in the hall or over lunch will have an even more direct and important effect. Convey to your partners the importance of not moaning to associates and junior partners about the downturn and its hit on their pocketbooks. Instead, they should be talking about the firm's great long-term prospects.

In addition, one of the inevitable impacts of a shortfall of work is that the partners in charge of clients keep more and more of the work to themselves, rather than delegating it to junior partners and associates. This heightens the uncertainty and distress among the younger folks. The ones you care about want to be kept busy. To do so, it could be worth taking on pro bono work or work that cannot be billed at full rates.

DON'T CUT BACK ON MARKETING COSTS

An upside of a downturn is that it's easier to convince partners of the need to market, because no longer can they claim that they have no time to market or to work for any new clients. Hence, this is the perfect time to stage a major new marketing effort.

Plus, one of the benefits of getting partners more engaged in marketing is that it can lead them to delegate more of their work, helping to keep up morale among the junior partners and associates. To achieve this result, though, management must ensure the partners that their roles in the new marketing effort will be taken into account at compensation time.

DON'T LET THE ECONOMY POSTPONE CONFRONTING OTHER ISSUES

Lastly, it is important not to let the downturn mask underlying problems in other areas. One example is the apparent reduction in litigation, or at least in cases that go all the way to trial – which is a continuation of a trend that predates the economic slump. To avoid the burgeoning costs of litigation resulting from e-discovery and other developments, clients have been steadily engaging in early settlement, mediation, or arbitration, so that the normal uptick in litigation, which offsets a downturn in transactional work, has not occurred at many firms, making times more painful for them.

This is an area where a reduction in associates hiring may be warranted, because when the number of cases involving major discovery diminishes, the achievable leverage may also diminish. An additional tactic for firms to consider is enhancing expertise in mediation and arbitration and providing clients with methodologies for early settlement.

THE BOTTOM LINE

I am not suggesting that this list of ideas will solve all of your problems in the downturn. What I am suggesting is that all considerations for change be viewed through the lens of the firm's long-term interests. If there are short-term cutbacks in expenses or investments that will not impact the firm's long-term interests – such as delays in computer upgrades or office remodeling – then by all means, make them. Just remember the roller coaster, and be sure all your decisions are taken with an eye to having maximum strength at every stage of the ride.

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