Recession Proofing — Why Now?

Perhaps the Better Response is Why Not?

Obviously, it is best to first address why it is important law firms should even be thinking about recession-proofing in 2018. The reasons are based on identifiable trends both internal (within the legal profession) and external (world events).

Stephen Mabey, CPA, CA
Principal & Managing Director

Trends identified in the recent 2018 Report on the State of the Legal Market, prepared by *The Center for the Study of the Legal Profession at the Georgetown University Law Center and Thomson Reuters Legal Executive Institute and Peer Monitor*, clearly support the premise that the profession has failed, for the most part, to fully recover from the 2008 - 2009 recession.

The following trends in question deal with key areas such as

- demand;
- productivity;
- realization; and
- profitability:

> *Demand growth for law firm services was essentially flat in 2017 which continues a seven-year pattern (with the exception of a brief uptick in 2011 and a slightly negative turn in 2013).*
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> For all lawyers, the current level of billable worked hours per month is some 13 total hours below the level at the beginning of 2007. That represents a total of 156 billable worked hours per year which, if multiplied by the average hourly worked rate for all lawyers in 2017 ($475), indicates that the decline in productivity over the past decade is costing firms about $74,100 per lawyer per year.
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> *Collection realization as measured against standard rates continued to decline.*
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> As a result of flat demand, declining productivity, and continuing downward pressure on realization rates, law firm profit margins on average across the market were essentially flat during 2017, and with the exception of a spike in 2011, the trend for profit margins has been slightly downward over the entire decade.

Turning to external trends a fundamental underpinning to the belief that a recession is coming is that expansions don't last forever and when they end recessions tend to follow. Reportedly, there have only been two expansions that lasted as long as the current one we are in. To match the 120-month boom in the 1990s, we'd need the economy to keep growing past January 2019, an occurrence that The Wall Street Journal deems "a very tall order." Clearly, the depth and shape of that recession will depend on the event triggering it, which is uncertainty that no one "crystal ball" is any better at accurately predicting.

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The next indicator that a potential recession could be on the near-term horizon is the unprecedented period of deregulation that North America in general and the United States in particular, is going through. So what you might ask? A new working paper from the International Monetary Fund provides “empirical support” for the idea that large-scale deregulation generates a financial crisis. And we remember (or should as it was less than 10 years ago) what financial crisis triggers!

The last indicator that, if it doesn't act as an indicator that all is not right with the world, certainly speaks to the likely exaggerated impact of the next recession, is the level of debt — at both a personal and government level. The USA economy and resulting debt levels play a significant role in the economic health of the continent. The credibility of figures is driven in large part by your perspective but recent statistics that are being quoted indicate that - a third of Americans “could not cover three months of expenses, even if they sold assets, dipped into retirement accounts, and asked friends and family for help”; The country's debt burden as a share of the overall economic output” has skyrocketed from 63 to 104 percent; and “Interest rates remain near scratch,” which means the Feds can't cut them to spur growth. And given recent tax cuts, the ability to use future tax cuts as stimuli has been significantly reduced.

While unable to even hazard an intelligent guess as to the likely timing of the next recession, it is not a huge risk for me to suggest it could be in the next 2 - 3 years, or sooner!

Having struggled through laying out disturbing trends that may well be the bearer of bad tidings, I finally get to the theme of the article - *why would law firms not focus on some "recession proofing" exercises over the course of the next 12 - 24 months?*

Beats me, especially if there is no downside to the firm! Ensuring your firm is fiscally healthy in good or bad times just seems to make good business sense.

The list of recession-proofing steps that firms should be contemplating and, where it makes sense, acting upon is not meant to be exhaustive (nor in order of importance or ease of execution) but rather are for the most part initiatives that will be viewed as positive in the current economic environment.

Differentiation — now is the time to create a real sense of service differentiation in the minds of your clients and potential clients. Like most entities, they will be pressed for time in any recession and will defer to existing perceptions rather than taking time to gain new ones.

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Service Offerings — while reviewing the existing offering as to both viability and aptitude, firms need to subscribe to the hockey analogy of focusing on “where the puck is going not where it is.” Speak to your clients today about what their needs may be in the future (in both good times or should a recession happen).

Zero Sum Budgeting — cost cuts / reductions in a recession have a far worse negative connotation than being seen to be acting in a fiscally prudent manner in good times. This means that budgets are started from a zero-base, with a fresh decision on everything being spent every year.

Morale — two general conditions of human nature — happy / engaged people are significantly more productive, and they generally remember in bad times those that treated them fairly and with respect. Getting the productivity now and loyalty in bad times is a winning strategy so pay extra attention to the treatment (and it is not necessarily money) of both the legal service and support teams.

Complement — now is the time to review your complement of legal and support personnel as it is always prudent to service clients with the strongest possible team. While freeing up someone's future is never a simple or easy task, doing so in good times is actually more humane than waiting until a recession when they will have fewer opportunities.

Client Face Time — person to person time in a recession is a critical component of communicating the value the firm puts on the relationship (more than just a file), but it comes off a tad phony if it is only seen to occur in tough times. It is always easier to create a positive engagement when you focus on clients when things are good.

Credit Facility — even if not scheduled, it is always better to deal with your banks when things are positive and so no better time to discuss increases in limits (whether needed or not as a goal to create latitude when challenging times hit); decreases in transaction fees and interest rates. It is important to remember most banks deal with multiple law firms so you should consider spreading the firm's business between more than one bank — particular advantageous during a downturn.

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Cash Management — while draws are being paid and clients are paying (somewhat timely), this is the time to take a “cradle to grave” review of a firm's approach to cash management, including granting of credit; billing policies including write-down of lawyers' time / fees; collection process; write-off process; payment of accounts payable; partner draw distribution; etc. Having strong cash management procedures in place will assist in navigating any recession.

Pricing — the pressure being placed on the pricing of legal services will only be exacerbated in a recession (as if it is not sufficiently challenging now). Two steps that firms may wish to consider is actually meeting with clients and actually describing and discussing their pricing methodology and even locking clients into a “loyalty” program whereby fees are fixed now for some period of time-based upon their commitment to using the firm exclusively for the services it can best provide them.

Leadership — while some leaders can lead effectively irrespective of the economic times, it is not always the case. Now would be the time to look at the firm's leadership to make sure they can “captain” in “rough seas” and, if not, the firm has a contingency plan how current leadership can be augmented, so the firm has the best chance of being provided with the leadership required to prosper in tough times.

In encouraging firms to undertake recession proofing measures now, it is hoped that firms having done so will avoid Thomas Fuller's concern that “*we never know the worth of water till the well is dry*.”

Comments or Questions?

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