



## THE ECONOMY IS JUST ONE BIG HYDRAULIC SYSTEM

### ***What Should Lawyers And Accountants Worry About In The Current Economic Downturn?***

So here we are in the midst of an economic downturn, and as associates – and even partners – are flying out the door in quantity, there are still vigorous debates about whether this is a recession or depress or just a phase of the moon.

The problem with the debate is not what the semantic tag should be, but what firms should do about it. One thing is true, face it or not – the halcyon days are over for awhile. There goes that marvelous pyrotechnic display of associate salaries that would cross a wise man's eye. There go the perks...the bonuses...the first class flights.

And still the semantic debate goes on. Lawyers love to debate and accountants love to measure, while the talking heads in the media bloviate. Debating, it would seem, is better than action.

Elementary economics gives us a clue, which is that an economy is an hydraulic system – a closed system in which pressure at one end translates into pressure elsewhere in the system. In other words, nothing happens in an economy without reactions elsewhere in the system. In economics, there's the added element of fear. Fear of the known and fear of the unknown, which is the worst kind, and adds to the pressure.

What happened? Well, after several decades of rising housing prices, the housing bubble burst. Housing prices kept going up, inflating housing values. In that environment, mortgage lending was so safe that banks, never brilliant at understanding long term risk, thought housing values would continue to rise, so they kept lending, skyrocketing away from traditional lending practices by not bothering to vet the borrowers.

In the meantime, in the giddy neverland of mortgage financing, the banks bundled the mortgages, which were purchased by shrewd (Hah!) investors and sold to the public as mortgage backed securities.

But then the sub-prime adjustable rate mortgages matured, and ran into higher interest rates, which a great many of the borrowers couldn't afford. Defaults proliferated. The securities predicated on the mortgages plummeted. Those stocks are significant in the portfolios of very large investment banking firms and hedge funds, and so their losses were overwhelming. Think Bear Stearns and Merrill Lynch. Those others of the mighty that didn't fall are at least diminished.

More pressure, which keeps coursing through the system.

Meanwhile, back at the banks that issued the mortgages in the first place, they still have mortgages to sell – but with no buyers. Tough. Bankers aren't very good at the real risk game.

Now comes the real problem with the hydraulic effect. People high and low lost their jobs, even in the firms that didn't go under. Unemployment rose. The businesses that depended on a strong financial system, even those themselves not in the financial industry, began to feel the pinch of having lost customers. These support services – everything from the coffee wagon vendors on Wall Street to the limousine services that took the investment bankers home every evening – began feeling pain. In a sense, they joined the army of those home buyers who lost their homes in lost or diminished income. The hydraulic pressure went right down to the local grocery store, and to the suppliers of raw materials to the manufacturers whose products aren't selling, and continues to hit every area of the economy.

Now...the punch line. The lawyers and the accountants.

There are people in this world whose income is so low that they are, unfortunately, always so close to the line that financial trouble is a frequent companion. But lawyers and accountants? Many are surprised to find themselves within the hydraulic system. There is much denial, but the reality is there. And the alarm. Thus, the departure of the associates and the paralegals, throwing off the back of the sled to slow the pursuing wolves. The hydraulic pressure keeps coming through the system. For some, no place to hide.

Are there defensive measures to be taken. Yes (except maybe for those lawyers and accountants invested in mortgage backed securities). The answer lies in firm management. And do it now – before the deluge hits your firm.

- First, reassess the situation. Check your client list for potential weak companies. Weak companies that may be caught up in the economic downturn become slow payers, and then no payers. Either increase collection methods, or be prepared to let them go and cut your losses.

- Second, check your firm. You don't want to give up real talent, but in today's climate, you don't want to carry staff (including partners) who aren't carrying their share of the load.
- Third, think productivity. Review all your management processes, from partnership agreements to cash flow management to marketing. Make sure your electronics are up-to-date, and are really saving you money. Look for potential return on perks and club memberships. Preserve capital as best you can. And take your banker to lunch – you may need him or her.
- Fourth, look to your marketing. It's not an expense, its an investment. If you use it wisely, and give the marketing professionals a chance, sound marketing may give you the best return on your investment.
- Fifth, pay closer attention to the industries your major clients are in. That's where the early warning signs will be.

And finally, the economy really is like an hydraulic system, which means that anything that happens at one end will eventually get to you. Pay attention and avoid surprises. You may come out ahead of the economy, whether it's a recession, depression, or phase of the moon.

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