Hildebrandt interprets impact
Of economic crisis on legal industry

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The recent economic crisis has had a significant impact on everyone – including most law firms. In 2007, profits at many law firms were up a healthy ten percent. By late 2008, profits were down between five to 20 percent. In 2009, year-end profits will likely average between flat to down 15 percent from 2008.

"For most law firms in the current economic environment," said Kristin Stark, "'flat' is the new 'up' – although there are notable variations by size, location and practice area.

"Things have stabilized but, at this point, we do not expect much change for the last quarter of 2009," said Stark. "We do not anticipate a dramatic upswing in firm performance in 2010. It is likely to be a slow recovery.

"Larger law firms operating in major financial centers have suffered the most," said Stark. "Smaller firms and those located in secondary cities (like Denver) have been affected – but not as significantly."

Bankruptcy remains the most in-demand practice area, increasing by 18 percent during the first three quarters of 2009. Demand for litigation has increased slightly -- 1.3 percent. Transactional practices like capital markets, real estate, tax, general corporate, and mergers and acquisitions have been hit hardest and continue to struggle.

Stark is a senior director in Hildebrandt International's Strategy Group. Hildebrandt (www.hildebrandt.com) specializes in professional services firm management and publishes the quarterly *Peer Monitor* index of law firm performance, which provided all the data cited in this presentation.

Stark spoke at the monthly educational meeting of the Rocky Mountain Chapter of the Legal Marketing Association (www.legalmarketing.org/rockymountain), held Nov. 10 at Maggiano's Little Italy in Denver.

"In addition to a sharp decline in demand, declining profits are due to slow collection cycles (realization is down four percent), rate pressures (financially strapped clients are very resistant to rate increases in a buyer's market) and declining productivity (especially among non-equity partners)," said Stark.

Law firm response

Law firms have responded to these market conditions by making sharp cuts to overhead. As recently as 2008, total law firm overhead expenses increased 8.2 percent. Due to intensifying focus on expense control, total overhead expenses decreased 0.6 percent from the previous year in the first three quarters of 2009.

An analysis of the percentage change over a rolling 12 months indicates that expense increases for occupancy fell from 9.2 percent in 2008 to 8 percent in 2009; expense increases for technology fell from 9.5 percent to 2.1 percent; expenses increases for library fell from 11.8 percent to 2.2 percent.

Law firms actually cut expenses in the areas of non-lawyer compensation (from an increase of 8 percent in 2008 to a decrease of 0.5 percent in 2009), marketing (from an increase of 6.4 percent to a decrease of 9.7 percent) and office expenses (from an increase of 7.9 percent to a decrease of 14.8 percent).

"I am puzzled in particular by the dramatic cuts in marketing expenditures," said Stark. "Wouldn't you think that in an environment defined by less demand and high client frustration, lawyers and law firms would be expanding marketing efforts rather than making cuts? This clearly demonstrates the (unfortunate) historically low value placed on marketing."

The traditional way for law firms to weather economic downturns – cutting overhead and raising rates -- are no longer enough. "Law firms must expand their efforts to understand the marked shift in client attitude that is the product of this economy," said Stark. "After ten years of a 'seller's market' we have rapidly shifted to a 'buyer's market.'

"Clients now hold the power where pricing is concerned," said Stark, "and these clients are angry and frustrated. This downturn has quickly compounded long-term client perceptions of poor value and misalignment of resources in exchange for high rates.

"The most market-savvy law firms understand that clients currently enjoy a growing number of options to get legal services cheaper and faster," said Stark. "These firms are actively pushing 'big moves' to reshape their firms – and the legal industry."

These include:

- Corporate clients are currently focused on cost, value and predictability. In the ACC Value Challenge, for example, in-house lawyers are able to grade law firms' performance on six "value" criteria – and view the grades of others. Use a formal interview process to understand what your clients want.

- The long-standing debate over alternative pricing has reached a “tipping point.” Clients expect fixed fees for commodity work and flexibility when pricing all but the most critical “bet the company” work.

- The trend towards convergence is accelerating. In order to exert pricing pressure and encourage better partnership, clients will cut their roster of outside counsel and give more work to those who are willing to be flexible.

- There will be no client tolerance for rate increases for “business as usual.” Any rate increases must be justified by obvious increases in value.

- Increasingly, contracting for outside counsel is being handled by skilled corporate procurement departments – not general counsel. These decisions will be based more on cold cost and less on warm law-school relationships.

New roles for marketers

Traditionally, the role of marketing in law firms was reactive and focused on marketing communications.

To keep pace with emerging trends sparked by the current economy, the role of marketing in law firms must follow a more progressive and proactive model – and add new capabilities in research, strategy and sales. “You will see fewer generalists and more specialists – dedicated to a particular practice or industry segment,” said Stark.

In the area of research, marketers will be responsible for market/client analysis, internal analysis, competitive analysis and client feedback programs.

“Marketers will proactively identify client concerns and develop methods to address these concerns,” said Stark. “Good ways to do this include ‘deep dive’ in-person client interviews, secondments (where lawyers spend time working at a client’s site) and inviting clients to speak on panels at law firm retreats.”

In the area of strategy, marketers will participate in planning and targeting, development of new products and services (including the hiring of laterals to provide those services), and creation and maintenance of referral alliances.

“In particular, you will see marketers fully participating in pricing and profitability decisions,” said Stark. “In many cases, they will come to the table with financial expertise or advanced degrees in these areas. It takes a lot of skill and research to price profitably on a non-hourly basis. Do it wrong and you can lose a lot of money.”

In the area of sales, marketers will focus on the retention and growth of existing clients, the targeting of new business opportunities, and sales training and coaching to help lawyers (or dedicated sales personnel) turn these opportunities into new client relationships. "What is really new in this evolving model for a competitive marketplace is the strategic identification and 'poaching' of clients from other law firms," said Stark.

"All in all, this is no time for law firms to be cutting back on marketing expenses or personnel," said Stark. "Be sure that your lawyers understand the real value being added by the marketing function. Proactively drive strategic marketing approaches to help your firm differentiate itself from the competition. Communicate and demonstrate value in order to support your closer involvement in critical client issues.

"By taking aggressive steps now, you can position your firm to come out of this economic crisis well ahead of its competitors," said Stark.