PARTNERSHIPS IN THE DOWNTURN

PLANNING FOR THE WORST

Recession has forced many firms to remove partners. If European practices believe this is a problem only for large global firms, they should think again. The market may not bounce back until 2011…

BY TONY WILLIAMS*

THE current economic downturn has hit law firms harder and faster than previous recessions. This has been caused by several factors. Firstly, this recession started in the financial sector and many law firms' largest clients are investment and commercial banks. Secondly, the freezing of the credit markets has frozen any leverage out of M&A and property investment activity and the rapid globalisation of the recession has meant that even (or especially) the larger global law firms have been seriously affected.

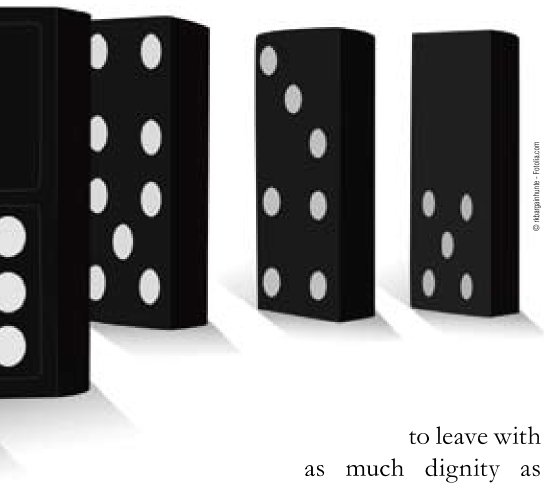
Faced with the downturn law firms envisage a poor 2009, and at best, a difficult 2010. As law is usually a lagging indicator, even if the technical recession ends in late 2009 (which is an optimistic view) it is likely that financial and corporate activity will not significantly increase until at least 12 months after the start of the economic recovery.

Given the prospect of a sustained period of reduced activity many British and US based firms have been actively examining all aspects of their cost base. People are the highest proportion of a firm's costs so we have already seen some significant redundancy programmes of lawyers and support staff as recruitment freezes. Performance reviews and natural staff turnover have proved to be inadequate tools to cope with the rapid reduction in demand for legal services. More and deeper redundancy programmes can be expected over the next few months.

But firms are also looking at partner performance and partner headcount as a means of adjusting the size of their business and mitigating the reduction in earnings of the remaining partners. The larger law firms already have well-established partner review processes and clear financial packages for retiring partners. Indeed, many partners, as a matter of course, 'retire' from the largest firms every year and this attracts very little media attention. What is now clear is that law firms are re-examining their partner requirements for the future and raising the bar for acceptable levels of partner performance. Partner performance is not just based on billable hours or billings but includes attracting and managing clients, training and developing younger lawyers, developing the firm's profile and reputation and management responsibility for practice groups and teams. Traditionally, firms would choose 'soft' targets to be asked to leave such as partners nearing retirement age. However, the introduction of age discrimination legislation means that firms have to be able to show that partners have been selected for removal or de-equiti-

sation based on objective criteria not based on age. The relative lack of immediate career options for departing partners makes the possibility of claims against a firm a real possibility.

It is also important that firms do not make knee-jerk decisions and remove partners of long-term value to the firm or cause a level of fear and resentment that further undermines the trust and confidence of the remaining partners. Accordingly, firms need to approach any partner reduction programme with sensitivity. If there are clear performance criteria these should be fairly and objectively applied. A management or senior partner that protects his non-performing friends whilst removing other partners will soon lose the trust and support of the partners. Departing partners should be treated fairly financially and be able



to leave with as much dignity as possible. Many will have been with their firm over 20 years and a too brutal approach can seriously damage the already strained culture in the firm.

In addition to equity partners, one group that will be in the spotlight in this process will be the non-equity partners. This group grew significantly in the boom times. They were able to

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lead matters unsupervised and they helped to increase leverage and equity partner profits. However, in the downturn they are a very high relatively fixed cost. They probably do not have sufficient client management or client development skills, or they would already be equity partners. With firms facing more pricing pressure there is a business imperative to push work down to more junior and cheaper lawyers. This is also necessary to ensure that such junior lawyers have the necessary experience when the economy eventually turns for the better.

The US and UK firms have enjoyed a very profitable time in recent years and now face at least a couple of difficult and challenging years. Some firms will not survive, some will merge, the culture and leadership of firms will be tested like never before. Many partners will face departure from their firms, de-equitisation or a move to consultant status. It will be a difficult and humbling experience for all concerned.

It would be tempting for many lawyers not in such law firms to deride the business model of the larger firms and the challenges that they are now facing. But this may be premature.

Many UK and US firms have grown rapidly and profitably over the last 15 years. Many have achieved a significant international footprint and are among the leading law firms in many European business and financial centres. But many of the major law firms in Continental Europe have also grown significantly in size and have developed either their own offices or alliance structures outside their home market.

How will these firms respond to the changing marketplace?

Such firms have a number of advantages over their more expansive US and UK based competitors. First, they have a very strong reputation, client list and contact base in their home country so even if activity is down they would hope to obtain a significant market share of the available work. Second, in many countries they are less dependent on the financial sector for their work. All work will be under pressure but the financial sector is most badly hit. Third, they tend to have a lower cost base than the larger firms, salaries for lawyers tend to be lower than in London or the US, they do not have large international operations that need management and extensive IT and information systems and therefore their cost base is unlikely to be as large, as a proportion of revenues, as in the major UK and US firms. Quite simply, the higher a law firms cost base as a percentage of revenues the sooner it has to reduce its costs as revenues fall.

These factors will help the firms in Continental Europe but depending on the depth and length of the recession they may be insufficient to prevent firms considering other cost cutting measures including the removal of partners. The pressure or otherwise for such action will depend on the size of the firm, its client base, its culture and its profit sharing mechanism. Smaller, more collegiate firms may decide to share the pain together rather than to eject a partner. However, many larger firms may find this more difficult. A challenging market starkly demonstrates a partner's drive, ambition, ability to adapt and client getting and keeping skills. In a boom time these skills are often assumed but in a recession they are clearly visible.

"Major Continental law firms have grown significantly in size; how will they respond to a changing market place?"

It is likely that European firms will try to defer taking decisions to remove equity partners or de-equitising them until late 2009 and 2010. Many firms will try to address these issues quietly and incrementally, easing out one or two partners at any one time rather than the larger programmes announced by the larger US and UK firms. Even this approach is not without risks. A prolonged period for partnership departures can destabilise the partnership and damage morale and the culture of the firm. Partners may dread meetings with the managing partner in case they are next for the chop. In a smaller more intimate firm, any partner departures are especially emotional and difficult. Indeed, many firms may not have the power in the partnership agreement to remove a partner without cause and even if they do it may require a super-majority of partners, something very difficult to achieve if all partners are insecure about their future.

It is clear that the larger US and particularly UK firms have been the first to address the issue of retrenchment and the removal of partners. Other more dramatic moves in their markets, and in these firms' offices across Continental Europe, can be expected. Given the size and client base of these firms, it was inevitable that they would need to address these issues relatively early. Many of the independent Continental firms may claim that no such drastic action will be necessary in their firms or that the collegiate nature of their firms makes such action unnecessary or unacceptable. The more far-sighted leaders of these firms will be considering their options and identifying action points if the recession deepens or continues longer than they expect. It is right to hope for the best but always prudent to plan for the worst.

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