1

What Are We Going to Discuss Today?

- Our focus today is on macro threats/changes accelerated or magnified by this recession.
  - Not every issue applies to every firm: Pick and choose the ones that fit your firm.

- We will try to save time at the end for questions.
  - But if we run out of time here, you can join us for the separate Q&A session later today called **Current Issues, Trends and Challenges Facing the Next Normal in the Business of Law.**
  - Alternatively, you are welcome to email us at **MesaFive** with any follow up questions and we will answer you privately.
  - You can also email us for a copy of the final version of this presentation.

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2

Wasn't 2008 Supposed to be Our "Once In A Lifetime" Event?

- We have experienced perhaps the most traumatic period ever in the legal profession, all in four months:
  - Record unemployment, salary/lawyer/staff cuts, gyrating stock market, conflicting advice about the pandemic and economic recovery/resurgence.
- **Where does that leave us today?**

• Widespread uncertainty.

• Little optimism among CEO's for a quick economic recovery.

• Virus is still here, and outbreaks will continue, on both a micro/macro level.

• Law firms have adapted better than most industries but are not immune.

• Most firms will experience *more* problems in the coming months.

• Many firms will be forced to make *more* changes in the coming months.

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#1: People Don't Change That Much

- When do most firms/organizations/lawyers/individuals change?
  - **"Only when they have to."** Not a criticism, just an acknowledgment of human nature.
- *Most* major shifts in the profession coincide with recessions.
  - Hourly billing '45, monthly billing '73, layoffs in '02, and alternative pricing '08.
  - But pressures build/potential changes broadcast long before *most* firms change.
  - Most of the changes we discuss today will not be new but will gain traction.
- Hard part? Distinguishing trends from fads.
  - And there are a lot of pundits selling fads.

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#2: The Widely Varying Impact of Covid-19

- The effects of the Covid-19 Recession are amazingly varied:
  - Some firms are up 4-5% in collections over last year.
  - Some saw 20%+ **reduction** in collections within weeks of Shelter-in-Place (SiP) orders.
  - Some have relied on debt to carry them (a delaying tactic, not always bad).
  - Overall, law firms adapted better than many industries.
    - So well that many firms will extend some measure of Work-From-Home (WFH) forever.
- First Lesson: **Don't beat yourself up too much. Or feel too *Smug*.**
  - The top factor in your recession vulnerability is your client base (industries).
  - But as noted earlier, many of the real effects of the recession will be revealed in the coming months. Production/collection gaps. Trailing workloads.

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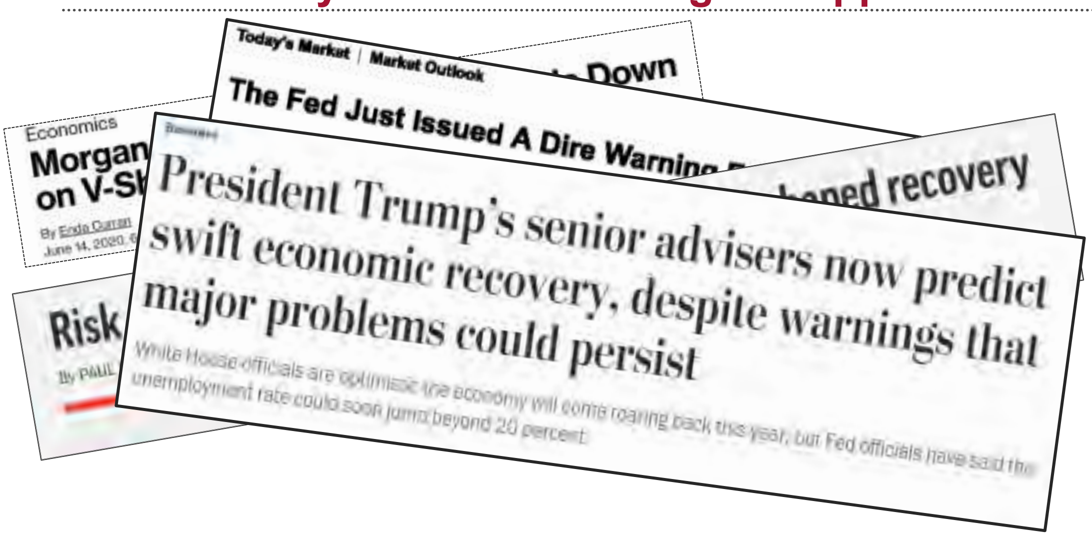
#3: Recovery: When is it Going to Happen?



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Solution to #3? Less Crystal-Ball/More Nimble

- We don't predict the future - we learn from the past.
  - Are V shaped recoveries common, or a pipe dream?
    - V shape might describe the stock market, but stock market is **not** the economy.
    - 1953/1954 Recession: Mild recession, unemployment increased by 2.5%.
  - Oddly, unemployment rates are a rough *directional* correlator of law firm activity.
    - It took 7 years for employment to recover after the Great Recession.

- Be cautious in how quickly you ramp up and expand for a recovery.
  - We have **never** seen a firm fail because they were too busy, or because they were short on space, or because they didn't have enough lawyers. They get in trouble when they grow without sufficient work.
  - Sellers' markets led too many leaders to mistakenly believe they must be **First To Market**.

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#4: Dangerous Habits From a Sellers' Market

- Law firms have grown accustomed to a **Sellers' Market**.
  - Lesson learned from prior recessions? Most law firms do not switch gears well.
  - The good news is that the imposed SiP requirements of this downturn forced many firms to recognize and adapt.

- Seller's markets often breed a mentality of invincibility and encourage ego over facts.
  - Business leaders everywhere confuse a *desire* for a recovery with the actual situation.

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Three Critical Tips - #1

1. Quality declines in a sellers' market and gets laid bare in a recession.

"When the tide goes out, you see who was swimming hard and who was just standing in the shallows."

- The challenge facing many firms is that they grew accustomed to *some* poor lawyering/poor lawyers/underproductive lawyers and became numb to the issues.

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Three Critical Tips - #2

2. The problem in law firms isn't in figuring out ***who*** their problem lawyers are, it is in doing something about it.
   - In a Seller's market, a firm can avoid dealing with problem lawyers.
   - In a Recession, a firm may be putting the larger firm at risk by not acting.

"You are as well known for your worst lawyer as your best lawyer."

- Last year was the better time to cut weak lawyers (and several national firms did so despite publicity), but the majority are now facing issues they ignored.

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Three Critical Tips - #3

3. If you are cutting lawyers, don't forget to talk to your clients simultaneously.
   – We are already hearing complaints from in house counsel:

"My law firm issues press releases about cutting lawyers, but they don't bother to tell us. Are they cutting our team?"

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#5: Consider Your Capital Situation

- Heavily capitalized firms have fared dramatically better so far.
  – Large capital reserves meant more patient, thoughtful responses.
  – Whether causation or correlation, well capitalized firms tend to be more successful, have more engaged partners.
  – Is there a right amount? Ranging from 20% to 40% of profits.
  – Response: Firms now increasing their capital or planning on raising it (for many, the worst and most difficult time).

- Capital is poorly understood in law firms.
  – The money partners contribute to fund cash flow. **Not** money to buy assets.
  – But "*no capital*" is sometimes claimed as a strength – but it can be good, or bad.
  – Capital is NOT the same as a buy in/buy out, even though firms use the terms interchangeably. True buy in/buy out systems are rare except in small firms.

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#6: Single Most Common Success Factor?

- What is the single most common factor among best performing practices, practice groups, committees, offices and firms?
  - **Great leaders**.
- Even mediocre leaders look great in an up-market, but not so great in a down market. That's not a moral flaw, just a fact of style.
  - Don't treat leadership positions as a merit badge or rotate it like Thanksgiving dinner. **If there was ever a time to replace weak leaders, it is now**.
- Don't compensate for bad leaders with bigger management: More people/representatives in firm management doesn't equal success.
  - More communication is needed in the bad times, **but not more people**.
  - Don't make long term structural changes to fix short term problems.

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#6: Great Leaders (continued)

- Many firms are not adept at **recognizing**, **developing** or **recruiting** great leaders.
  - In Sellers' markets firms get confused/intimidated and assume all rainmakers are leaders.
    - The truth is, perhaps 15% to 20% of rainmakers are great, natural leaders.
  - Developing leaders doesn't mean creating.
    - A lawyer fantasy compounded by a Sellers' market – "I can just study how to be a great leader."

Have you ever converted a mediocre leader into a great leader?

What percentage of the population are great leaders?

- Finding great leaders from an early age is the key.
  - Great leadership skills are not age or gender dependent.

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#7: Predatory Mergers/Lateral Hires Will Increase

- Overall, mergers/lateral hiring slows during and after a recession.
  - While the number goes down, the importance/impact of the few goes up.
  - Firms lose bigger/better contributors. But usually *after* the first year.
  - Among our most progressive clients they are busy targeting partners now.
  - Defense? Why do most rainmakers leave?
- Now realizing a long-held fantasy: Expansion without an office?
  - Example:
    - A firm has long targeted a particular city. But concerned about cost/barriers to entry.
    - Has talked to prospective lateral group for more than a year.
    - Recent experience with telecommuting has them now planning on opening a virtual office in the city, or a "conference room only" office.
  - Cost of picking up/integrating the best has now fallen dramatically.

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#8: Firms Too Reliant on Rate Increases?

- Law firms have been profitable primarily through rate increases.
  - One response of in-house counsel to law firms cutting salaries?

"You justified your rate increases because associates and partners were so expensive. Does that mean we are getting a discount now?"

- Out of habit, some firms will continue to push on rates.
  - But expect in-house counsel to resist more due to lower workloads and profits.
  - Rate increases will still be common at the top of the market. In other words, the thirty(?) most profitable (not biggest revenue) firms.
  - But middle market firms are likely to struggle more, see realization rates decline, as law departments get corporate pressure on expenses.

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#8: Firms Too Reliant on Rate Increases – II

- **Think about the five economic levers:**

Rates	Hours	Costs	Leverage	Realization

- Where else can law firms exert pressure to be profitable?
  - Costs will be a focus. Truthfully, most firms have been too successful to focus on costs. **What's the single biggest cost item in most firms?**
  - Next major step in reducing staff, despite progress in recent years.
    - Long term observation that it is difficult to ensure consistent workloads among secretarial staff. So most firms were overstaffed regardless of their ratios.
- Leverage?

#9: Growth of Non-Law Firm Competitors

- Non law firm providers will accelerate their 20-year trend: Gradually take work away from law firms.
  - **Large Accounting Firms -** likely to impact the middle market than the top in the near term. What is their differentiator?
    - Better/more varied leverage, better training, better at imparting experience, better technology integration with people, and value pricing. But other than that…

"Value Pricing," not necessarily value.

  - **Consultants** – substituting for lawyers in middle and routine market segments, and *some* of the same differentiators as Accounting firms.
  - **Contracted lawyer services**, both onshore and offshore.
    - Increasingly taking a piece of the upper end market.
    - Law Departments will accelerate their efforts to virtualize law firms.

#9: Growth of Alternative Providers

- The Sellers' Market made some critical changes in recent years less noticeable, but they will now become more evident:
  - Spend by in house counsel on non-law firm providers:
    - **Growing at 4 times the pace of spend on law firms.**
  - Law departments are curbing their budgets but increasing their spend on their own lawyers as much as outside counsel.
  - Number of practices now primarily handled in house has more than doubled in just five years.
    - Hurting middle and lower market law firms.

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#10: Space

- Yes, a lot more lawyers will work from home on a permanent basis.
  - Typically supplemented with a hoteling option when needed.
  - But this is likely a 5-7 year issue to run out, due to existing leases.
- In house counsel are leading the trend.
  - Example: Law department has already made the decision that more than half of its lawyers will not ever come back to the office on a full-time basis.
  - Budgeting chairs, monitors, internet access, etc. to allow permanent WFH.
- Some partners and associates are communicating better and more frequently, via video, than they did in-person.
  - But not everybody. What can you do about that?

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20

#11: Study Your Best Supervisors

- Increased competition/dispersed work forces require better supervision/training.
  - More firms than ever are now realizing this, in part because they see the benefit from non-firm competitors, and worse, hear about it from their clients.
- How to improve supervision?
  - Run assessments with associates to identify partners/senior associates with the best supervisory skills and why.
  - Develop procedures and a training program for all their lawyers to learn those skills. Accept that some (many?) partners will NEVER be good supervisors.
  - Don't con yourself into believing technology is a substitute for supervision.

  As the leader of one accounting/consulting firm, soon to be major law firm said, **"We run circles around law firms in terms of real training and development of people to work together in teams…that's *our* competitive advantage."**

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21

#12: The Top Looks Nothing Like the Middle

- We too often think and talk about the legal profession as a single industry, all sharing similar economics and structure.
  - That hasn't been true for a long time, and it is only segmenting more.
  - Middle market firms look nothing like upper market firms (despite chasing them in associate salaries, structure, benefits). Look at the following example:

Profit on 1st Year Associate?	AmLaw 30, New York Firm	National, AmLaw 100 Middle Market Firm	Small Insurance Defense firm
	$520,221	($5,203)	$66,070

- This is going to get worse, the differences more pronounced. Firms will need to stop copying and start operating on their own economics.

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#12: The Top Looks Nothing Like the Middle

- More moderation of salary increases in the middle market.
  - **Many "temporary" salary reductions will become permanent**, as firms adjust to lower workloads during the recession runoff.
    - Those will be necessary for many firms but will have unintended consequences for lawyers with school debt, forcing many to realign fundamental life decisions.
- The top of the market will continue to pull away and look and operate very differently than the middle market.
  - Firms at all segments will either want to explore, or be forced to compete with, non-law firm competitors that have better leverage at a broader price spectrum.
  - Firms have long talked about merit compensation for Associates, but we are now seeing firms implement the concept.

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#13: A Nudge on Alternative Fee Arrangements

- We said in 2009 we didn't believe alternative pricing would displace more than 20% of conventional hourly work in the next ten years.
  - That has largely held true.
  - There are many clients who still like and prefer hourly for much of their work.
- Clients report limited satisfaction from Alternative Fee Arrangements.
  - Many clients complain that most AFA's are just discounts or a complicated means to ensure the same price and therefore fail their "better value" test.
- Alternative pricing hasn't been a significant success for most firms.
  - Why?

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24

#13: A Nudge on Alternative Fee Arrangements

- For the answer look at what clients say they want:
  - **Predictability and Value.**
  - Many partners don't understand the importance of budgets to corporations, or to GC salaries and performance bonuses.
- The highest rated mechanisms are fixed or project prices.
  - Law firms struggle to understand their own pricing experiences and lack skills/ structure to manage fixed price projects, so they routinely under-estimate fees.
  - But the few firms that do this well are now producing extraordinary profits.
  - Some firms are too "entrepreneurial" (that means autonomous, or, they have no rules) to do alternative pricing well.

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Solutions: Pricing

- Fixed Fees/Project Pricing/Portfolio pricing :
  - How to make those work? **Project Management**, **Price/Case History**, **Case Assumptions** and **Change Orders**.
  - Question: Budgets based on actual cost or billing rates?
- Most firms can do much better on **traditional** pricing.
  - But they **don't teach pricing** (in any meaningful way) to their partners.
  - They **don't share the knowledge/pricing tactics** of their successful partners.
  - They embrace self-created pricing truths that are convenient and easy to follow, because they ultimately require no change.
  - Blanket approach of rate increases for all partners/practices was great in a Sellers' market, but accelerated client frustration and eroded the sense of value.

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#14: An Obsession With Growth

- Many firms grew dramatically because growth was easy and easy to be profitable. After all, it was a Seller's Market!
- No significant economy of scale in law firms, so what's the benefit of size?
  - Clients want the benefit of collective knowledge, not just one person.
  - But many firms expanded and duplicated resources.
  - Telecommuting has now revealed that firms can and will be able to sell more long-distance resources, discouraging the need for an office everywhere, or duplicate resources.

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#14: An Obsession With Growth

- We have seen more recession problems with large, middle market firms that grew rapidly through mergers but without a viable strategy.
- Too often *some* merged firms are just bigger ***not*** better, ***not*** more integrated, ***not*** complementary, ***not*** symbiotic.
  - Law firms confuse their own merger pitch slogans about teamwork with reality.
- Mergers work best when they cross fertilize with better clients/better work.
  - Yet most firms give themselves poor grades for cross selling and admit, most of it is client-initiated, not partner-initiated.
  - Mergers should create partner-initiated cross selling to access new market segments.

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#15: Practice Leaders Who Lead and Help

- Most firms still have more management positions than leaders.
  - Problem is compounded in a recession.
  - Don't create management positions and then search for leaders to fill them…
  - **Determine who has great leadership skills and build structure around them.**
- Redefine the role of Practice Leaders **to help every lawyer to achieve their best level of success, given their unique skills**.
  - Hire professionals to handle the administrative and routine management details.
  - Primary job of a Practice Leader should be as a coach, <u>not a manager</u>, to help lawyers be more successful.
  - **Focus time on those lawyers with whom you can make a difference.**
  - Converting duds has a low success rate: Most people don't change that much.

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29

#16: Reconsider Your Strategy

- Now is the time to rethink your strategy:
  - Pre-recession plans dominated by growth obsessions, full-service platforms, and light management were afforded by a Sellers' Market.
  - The strategy that got you to 2020 may not take you to 2022.
- What goes wrong with law firm planning?
  - Don't admit hard issues or address their weaknesses.
  - Wrong or too many people involved in drafting a plan.
  - Too much time drafting, not enough time selling and implementing.
  - Too long and focused on growth not improvement.
  - Heavy on slogans, light on accountability and change.

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30

So What Does This All Mean?

1. *Most* firms/partners don't change until forced to.
   - As Paul Romer said, "A crisis is a terrible thing to waste…opportunities emerge, innovation and entrepreneurship are inspired." The old ways are more easily challenged in a crisis.
2. No single piece of advice applies to all firms (except for one).
   - Whether you use this presentation or your own ideas as instigators, use this time to think about fundamental changes you have long needed but were too busy to implement.
3. Most lawyers/firms don't like change and don't like to be led.

But how many leaderless, un-managed businesses do you know that are successful over the long term, much less during a downturn?

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31

32