

**AT THE FOREFRONT
OF A PANDEMIC**

First Quarter

THE
MIDSIZE
Law Firm Performance
REPORT™

APRIL 2020

AT THE FOREFRONT OF A PANDEMIC

Over the course of two weeks in March 2020, the word ‘unprecedented’ had become one of the most over-used words in our society. How else to describe a once-in-a-century pandemic?

Whatever the label, the U.S. economy—including the legal industry—was facing uncharted waters: social distancing was normalized, work-from-home became commonplace, and face-to-face commerce was severely restricted (except for ‘essential services’). One month later, little has changed and uncertainty remains.

Working with midsize law firm leaders, I know first-hand the disruption any surprise brings to a firm. More importantly, I know leaders appreciate timely and relevant information. During good times, annual surveys suffice, even if the BigLaw surveys fall short on midsize firm issues. During ‘unprecedented’ times, leaders need more support. The idea of a quarterly, peer-driven survey was born.

Thanks to more than 50 midsize law firm leaders, I am very pleased to present the inaugural **Midsize Law Firm Performance Report**[™] (**Midsize Report**[™]).

The First Quarter **Midsize Report**[™] includes six sections:

- I. Overview** — looking at the ‘big picture’
- II. COVID-19** — exploring the impact of the crisis
- III. Finances** — sharing current approaches
- IV. Clients** — highlighting relationship-building activities
- V. Rates** — focusing on profit and revenue
- VI. Outlook** — considering the future

Please do not hesitate to reach out with any questions, feedback, suggestions for the Q2 survey, or just to connect. I appreciate hearing from law leaders, and, more importantly, I appreciate your support.

Regards,

Patrick Johansen, CPP
www.lawfirmpricing.com/midsizereport

* The Second Quarter **Midsize Report**[™] survey will be open July 6-10, 2020.

I. OVERVIEW

By all accounts, 2020 was supposed to be a good year. Legal industry observers had predicted 5-6% growth, on par with 2019. Unfortunately, the prognosticators could not predict a historic pandemic.

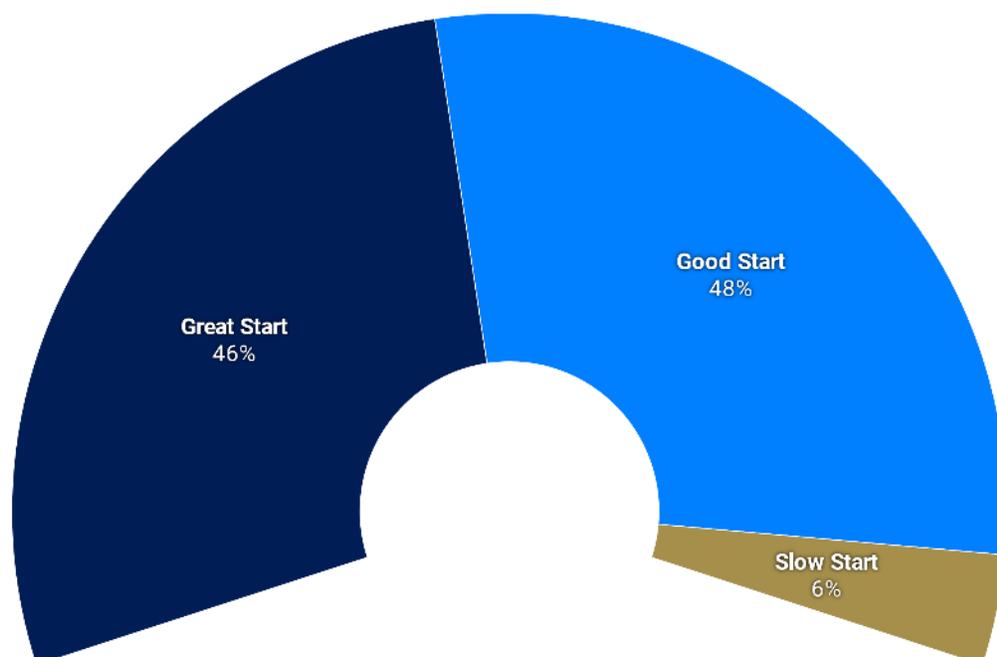
By the end of the first quarter, the U.S. economy was at a near stand-still. Perhaps the silver lining in this crisis will be its timing: it hit the U.S. late enough in the first quarter to have little-to-no financial effect. In fact, 46% of midsize law firms had a “Great Start” to 2020, exceeding expectations for Q1 (Figure 1).

That silver lining comes with a large ‘corona cloud.’ Typically, the second quarter is the most productive period for midsize firms, according to Thomson Reuters. In both 2019 and 2018, Worked Hours had their peaks in Q2, especially for Associates—who have the highest hourly margin within any firm—and for Equity Partners—who have the highest hourly revenue within a firm. (N.B. At no time in recent history has Q3 or Q4 produced ‘peak’ Worked Hours.)

CONTINUED

FIG.1

What was your firm’s financial performance against Q1 expectations?



I. OVERVIEW (cont.)

Unfortunately, nearly all midsize firms (88%) expect to fall short of their Q2 expectations (Figure 2). If true, the pandemic will erase the significant gains firms typically earn in Q2, putting 2020's fiscal success in jeopardy, based on recent history. Firms leaders must focus their energies on a rebound in Q3 or Q4.

For now, most leaders are cautious about the future. Less than a half (42%) are willing to say Q3 will be impacted (see Figure 3), and that number drops to 12% for Q4 (Figure 4). This cautiousness, most likely, is part hope that the economy does recover by the end of Q2 and part reluctance to face a difficult future.

There are signs for hope. As of April 20, New York reported it had past its 'peak,' Florida reopened some beaches, and government leaders were discussing a 'reopen' date in May.

In general, midsize law firm leaders seem prepared to manage this crisis: anticipating financial impact, responding to dynamic operations issues, and maintaining client relationships.

FIG.2

Do you anticipate any impact on Q2 financial performance?

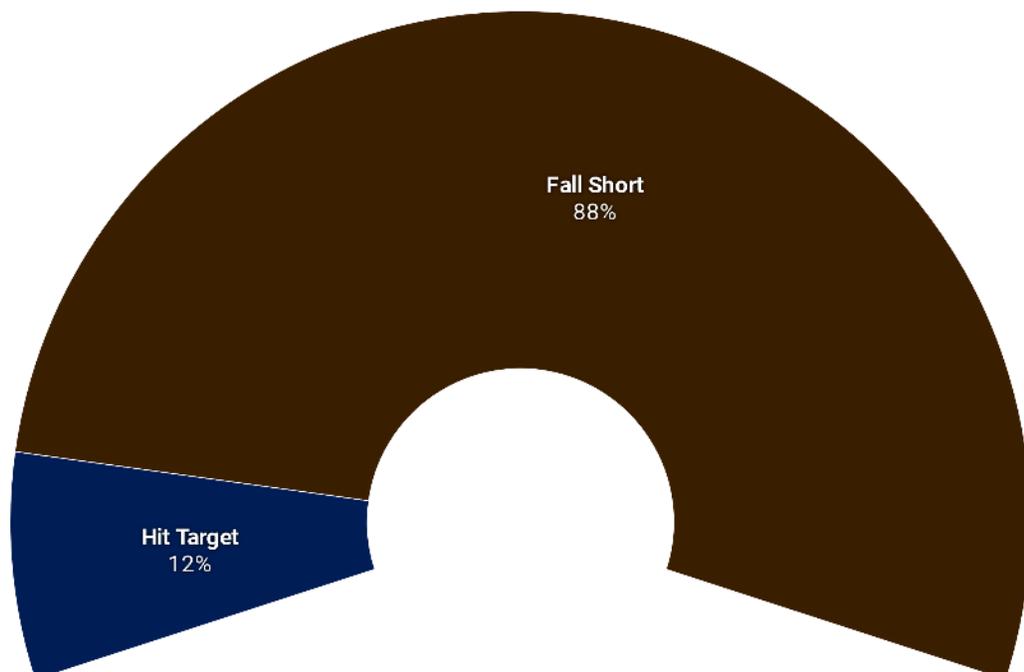


FIG.3

Do you anticipate any impact on Q3 financial performance?

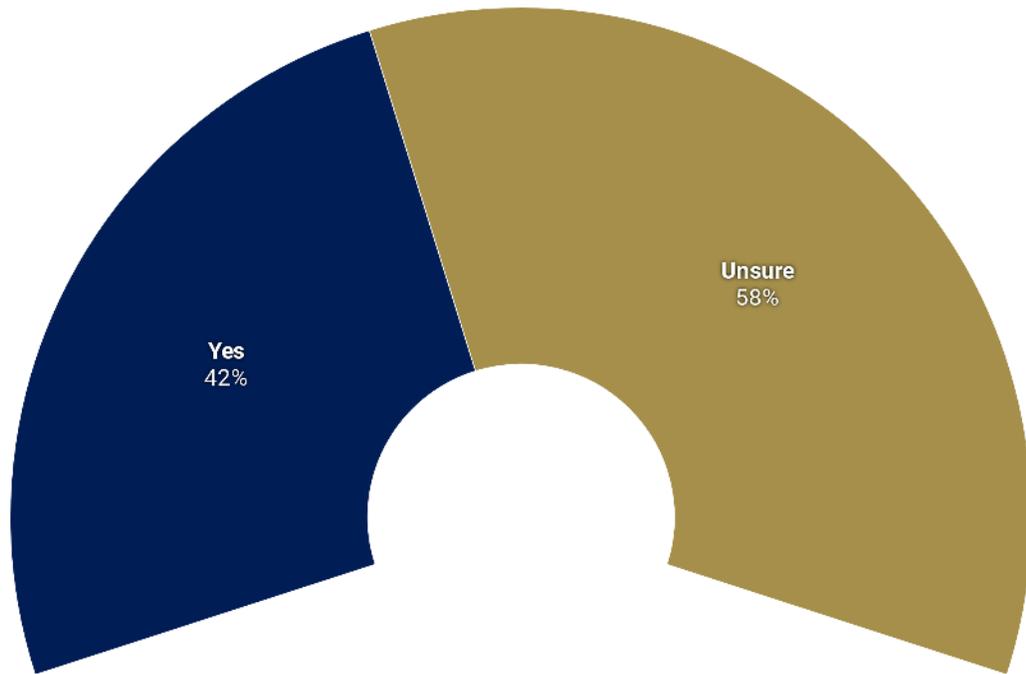
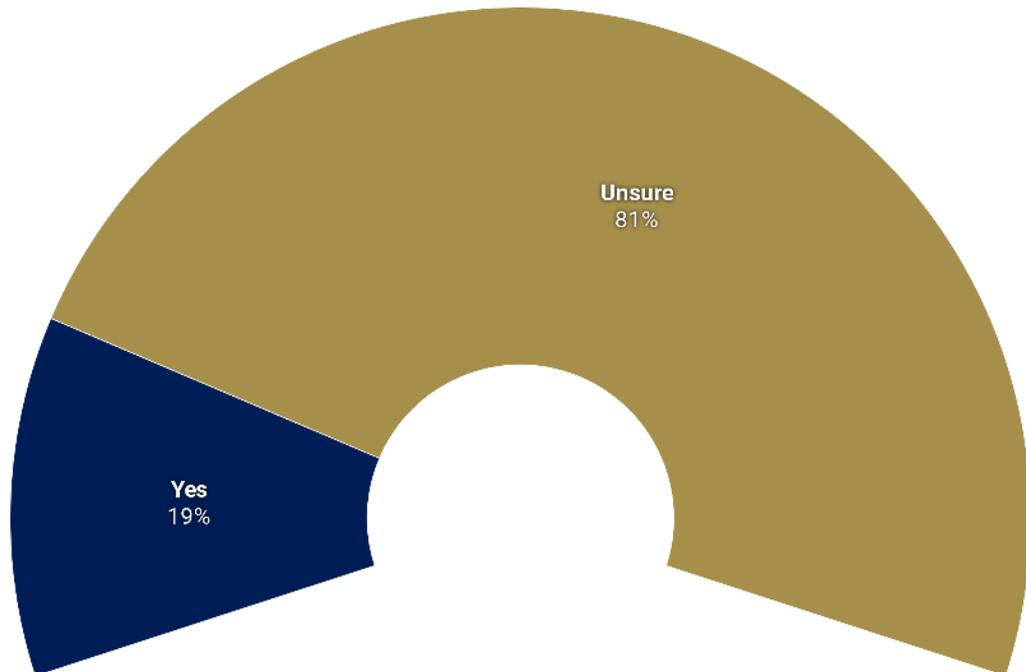


FIG.4

Do you anticipate any impact on Q4 financial performance?



II. COVID-19

By now you know about Bill Gates' 2015 TED Talk: the world was not ready for an infectious virus that could cause an epidemic. Five years later, he was right.

Within our own industry, law firm leaders were not prepared for the fallout of a pandemic; for example, the disruption created by government orders, such as closing all 'non-essential' businesses and encouraging Americans to 'stay at home.'

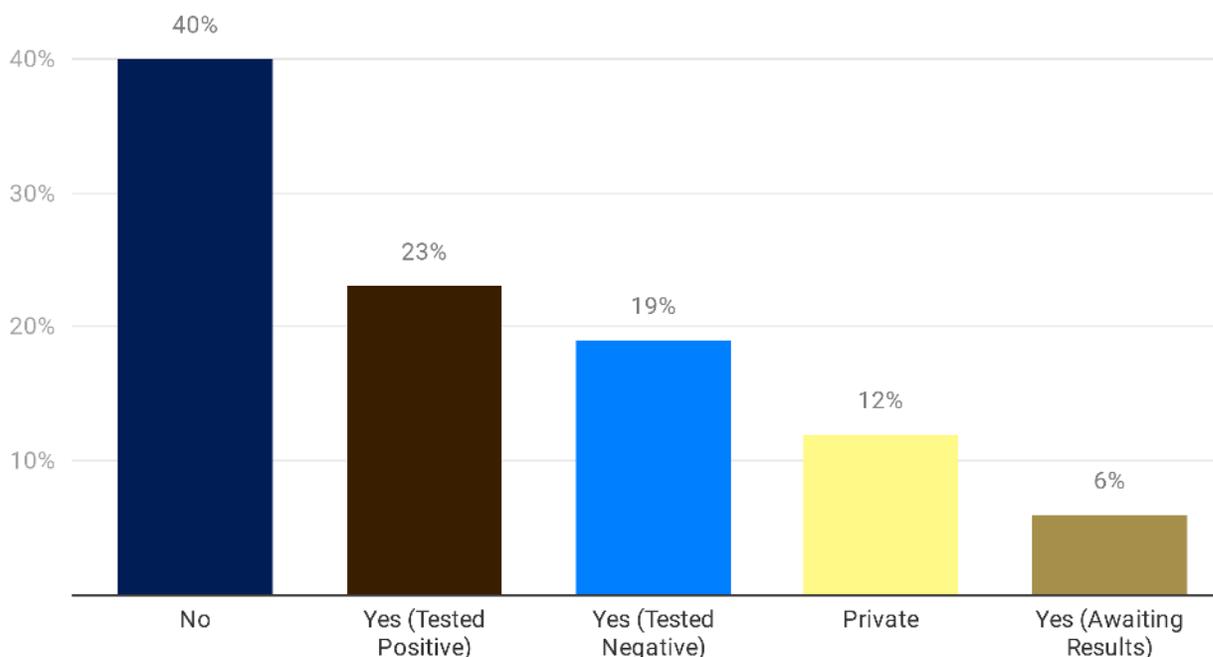
This 'closing' of the U.S. economy has caused widespread economic challenges. Law firms, like all professional services, faced two immediate challenges: the safety of its people and the delivery of its services.

Regarding people, 48% of midsize firms reported that at least one person in the firm had been tested. Of those, nearly half confirmed at least one case of COVID-19 (Figure 5).

CONTINUED

FIG.5

Has anyone in your firm been tested for COVID-19?



II. COVID-19 (cont.)

Regarding services, the business of law firms needed to continue, regardless of illness or access to firm offices. For many, that meant new expenses—such as ‘deep cleaning’ and new/upgraded technology—to keep people safe and working from home (WFH).

Fortunately, Q1 expenses were limited: 60% of midsize firms reported spending less than \$10,000 on pandemic-related expenses (Figure 6). Although most firms closed by March 31st (Figure 7), two-thirds were under normal operations (see Figure 8), with 60% of staff working full-time (see Figure 9). In addition, 83% of staff were receiving full pay (Figure 10). If, as expected, the U.S. hits its ‘peak’ during the second quarter, we should expect to see all four charts (Fig. 7-10) return to blue.

We cannot know yet the damage this period will create, both short- and long-term. In the next section, Finances, we present the early impact. The Second Quarter **Midsize Report**™ will illustrate the extent of the short-term damage.

FIG.6

What, if any, additional expenses has your firm experienced due to the pandemic?

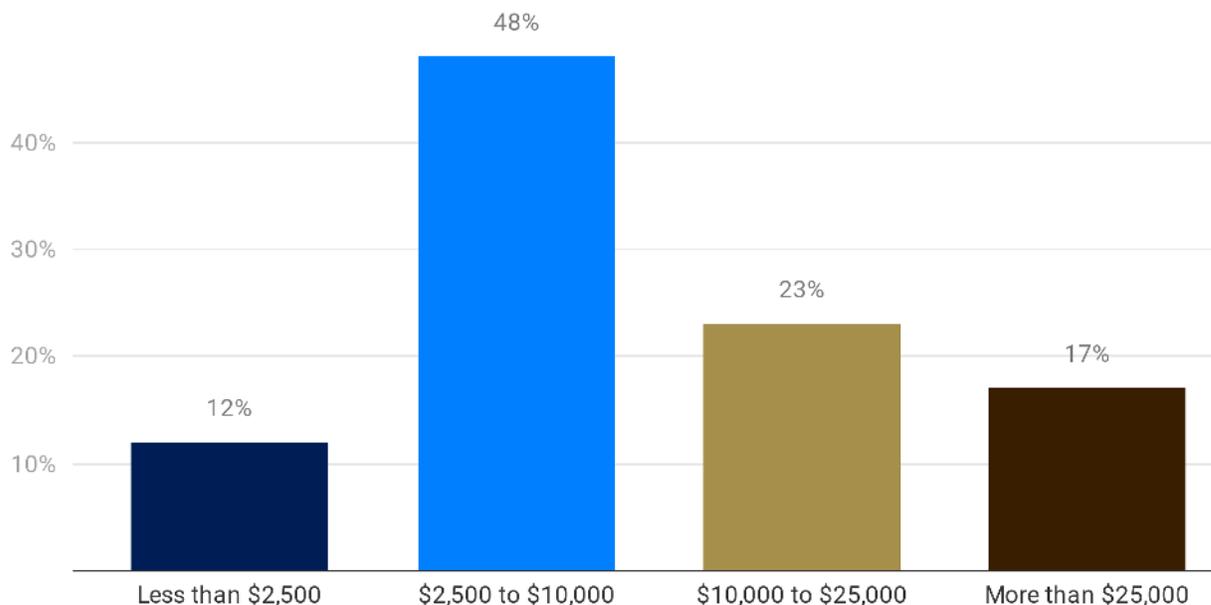


FIG.7

What is the current status of your firm (office)?

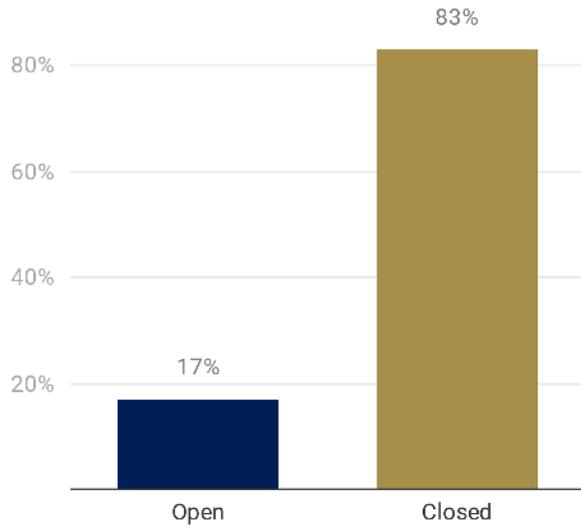


FIG.8

What is the current status of your firm (workload)?

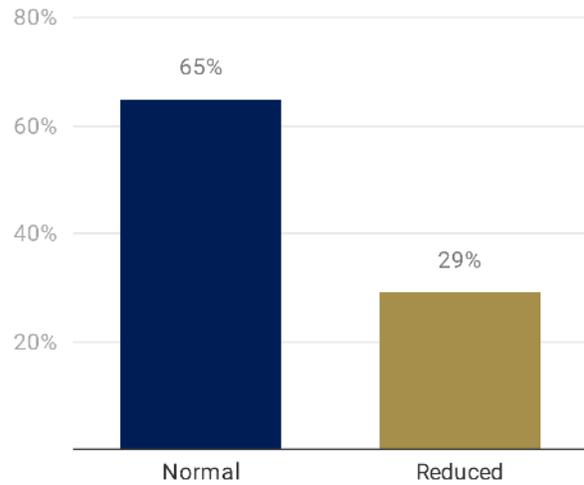


FIG.9

What is the current status of your firm's staff (hours)?

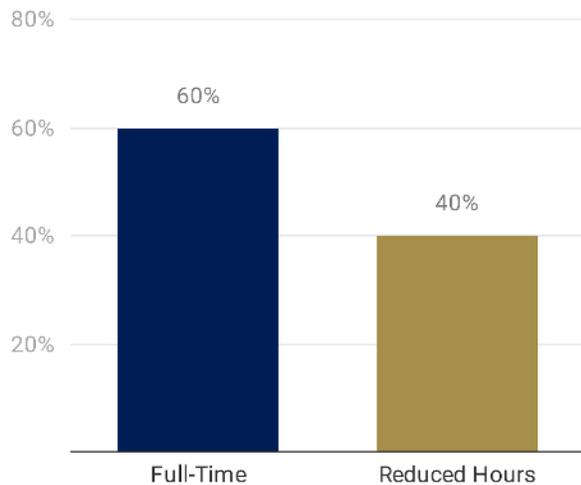
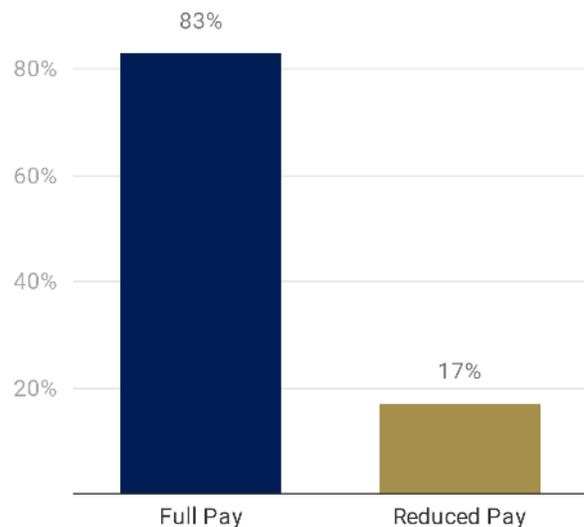


FIG.10

What is the current status of your firm's staff (pay)?



III. FINANCES

Although finance professionals cannot plan for surprises, they are cautious (some say ‘conservative’) in managing firm resources, just in case. For example, just in case a once-in-a-century pandemic hits the U.S.

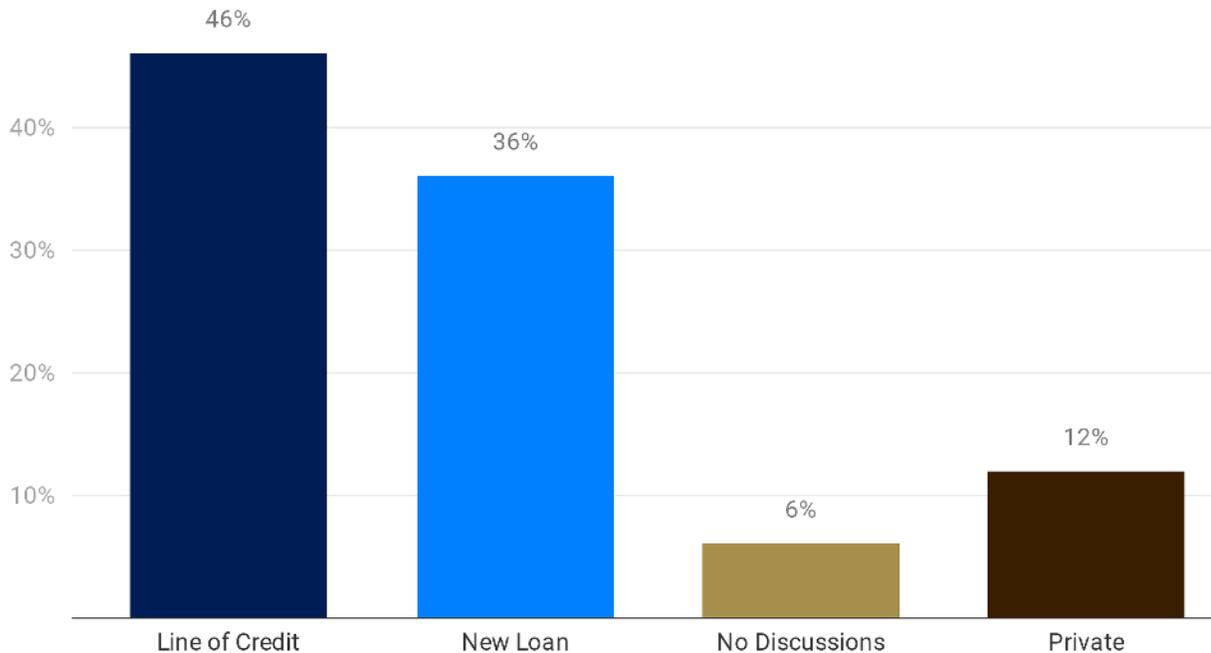
If we go back to the Great Recession, two shortcomings of law firm financial performance were cash reserves and partner capital. After years of year-over-year growth—sometimes labeled the ‘Golden Age’ of law firms—many firms neglected their cash reserves, and they had little need for partners to invest in the firm. Those firms that corrected these issues prior to 2020 are facing a less-challenging outlook.

However your firm entered this year, midsize law firms enjoyed a good start to 2020. With improved financial positions (compared to 2009), does the anticipation of a poor Q2 raise the possibility of new debt? Yes: most midsize firms (82%) reported discussing a line of credit drawdown or taking out a new loan (Figure 11).

CONTINUED

FIG.11

Has firm leadership discussed taking on any new debt?



III. FINANCES

Tempering any early action, perhaps, are the successful trends in billing and collections. The *2020 Report on the State of the Midsize Legal Market* reported an 88% Billing Realization rate in 2019, the highest in more than three years, and an 84% Collection Realization rate, just shy of the three-year peak. These successes represent a two-percentge-point jump over the last 30 months.

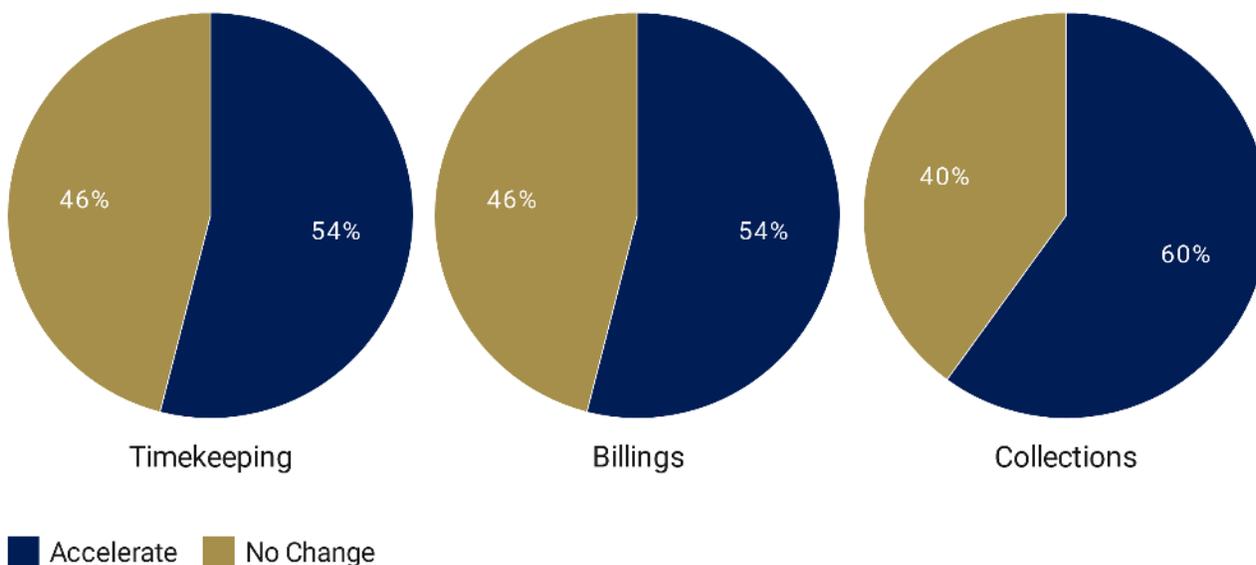
To keep the good times rolling, midsize firms are continuing their focus on the client financial lifecycle functions: Timekeeping policies, Billing cycles, and Collections activities. More than half of all firms surveyed are being proactive: a majority are planning to accelerate all three financial buckets (Figure 12).

While this is good news for firm financials, firm leaders need to be sensitive to how clients will respond. Clients with tight profit margins or 'non-essential' services may be facing financial difficulties; they would not appreciate or agree to the accelerations. Such actions could harm client relations, not to mention inflate your firm's internal metrics.

CONTINUED

FIG.12

Do you anticipate altering your firm's normal...?



III. FINANCES (cont.)

Ultimately, all financial activities are focused on Profitability, which has been defined as a firm’s ability to control five metrics: Realization, Utilization, Leverage, Expenses, and Speed of Collections (R.U.L.E.S.). These metrics are key indicators of a law firm’s financial performance, especially during a crisis. With some slight modifications, the **Midsize Report**[™] focuses on four metrics: Rates, Utilization, Collections, and Expenses.

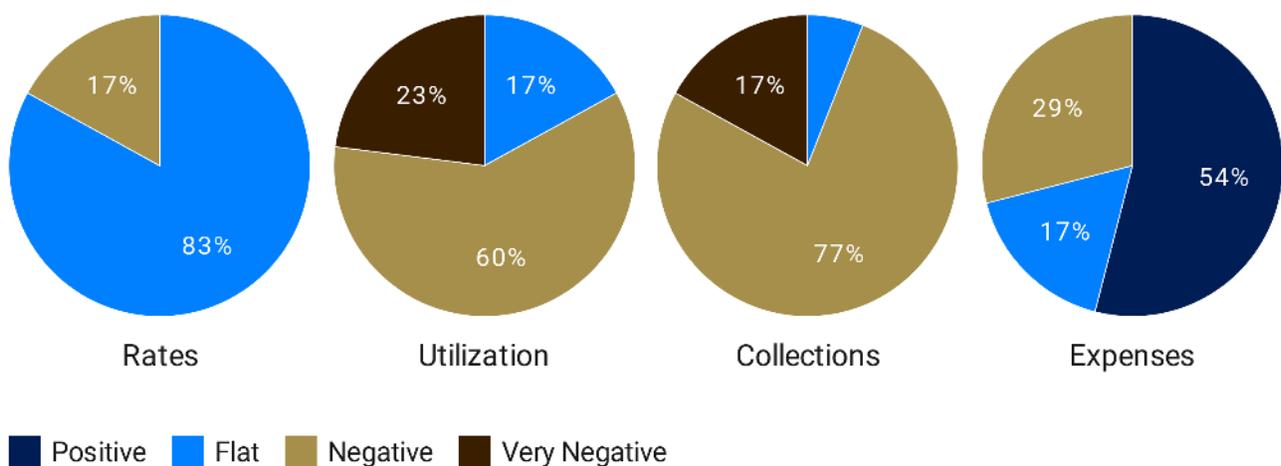
Most midsize law firm leaders are consistent in their Q2 predictions:

- Rates are expected to be flat (83%)
- Utilization is expected to be negative (83%)
- Collections are expected to be negative (94%)
- Expenses are expected to be positive (54%)

Collectively, these metrics predict a poor Q2. The larger concern is the damage this period will create, both short- and long-term. The Second Quarter **Midsize Report**[™] will focus on how firms weathered the storm.

FIG.13

For Q2, how much of an impact do you anticipate on...?



IV. CLIENTS

Sir Winston Churchill used the phrase “*Never let a good crisis go to waste*” to explain his alliance with Franklin Roosevelt and Joseph Stalin during World War II. The global (perhaps, ‘unprecedented’) threat of war set in motion a collaboration that would create the North Atlantic Treaty Organization (NATO).

We now face a global, ‘unprecedented’ crisis. Law firms have an opportunity to build and strengthen relationships with clients. First, partners can offer pro bono time. Although it places an added financial burden on the firm (which itself has financial worries), this short-term gesture elevates the clients’ financial worries over the firm’s and signals a long-term investment. Cautiously, only 35% of firms are providing pro bono service (Figure 14).

Second, appreciating the breadth and depth of this pandemic, a firm can establish an internal task force responsible for coordinating the firm’s myriad of services. Packaging that effort into a valuable, client-facing initiative is a smart investment. Nearly two-thirds (63%) reported creating a client-facing COVID-19 task force (Figure 15).

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FIG.14

Are your partners offering pro bono time?

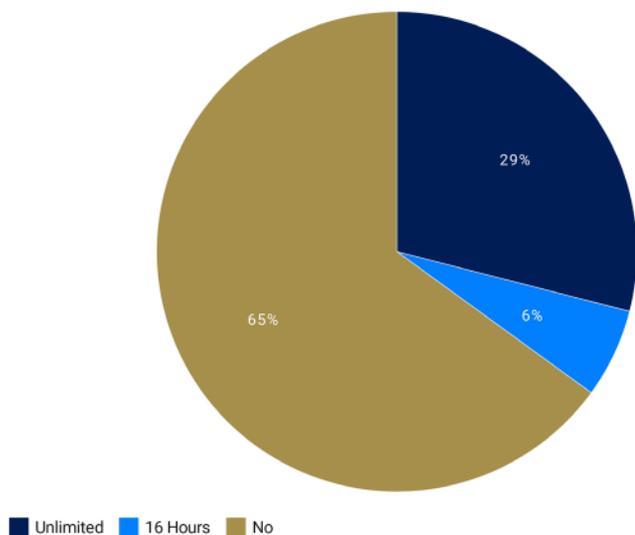
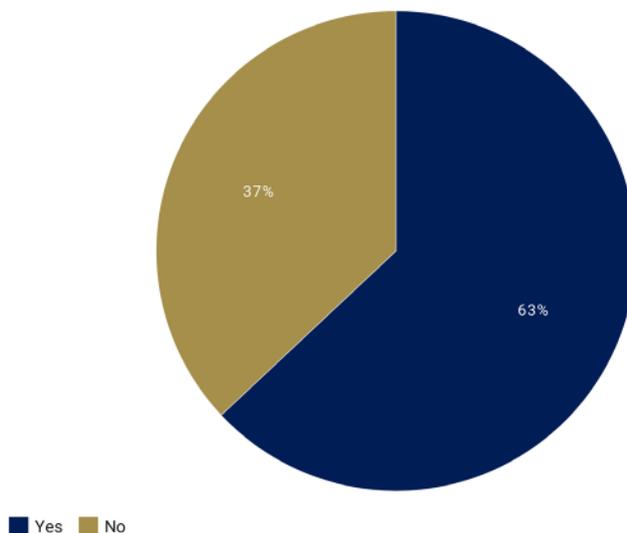


FIG.15

Has your firm established a client-facing task force



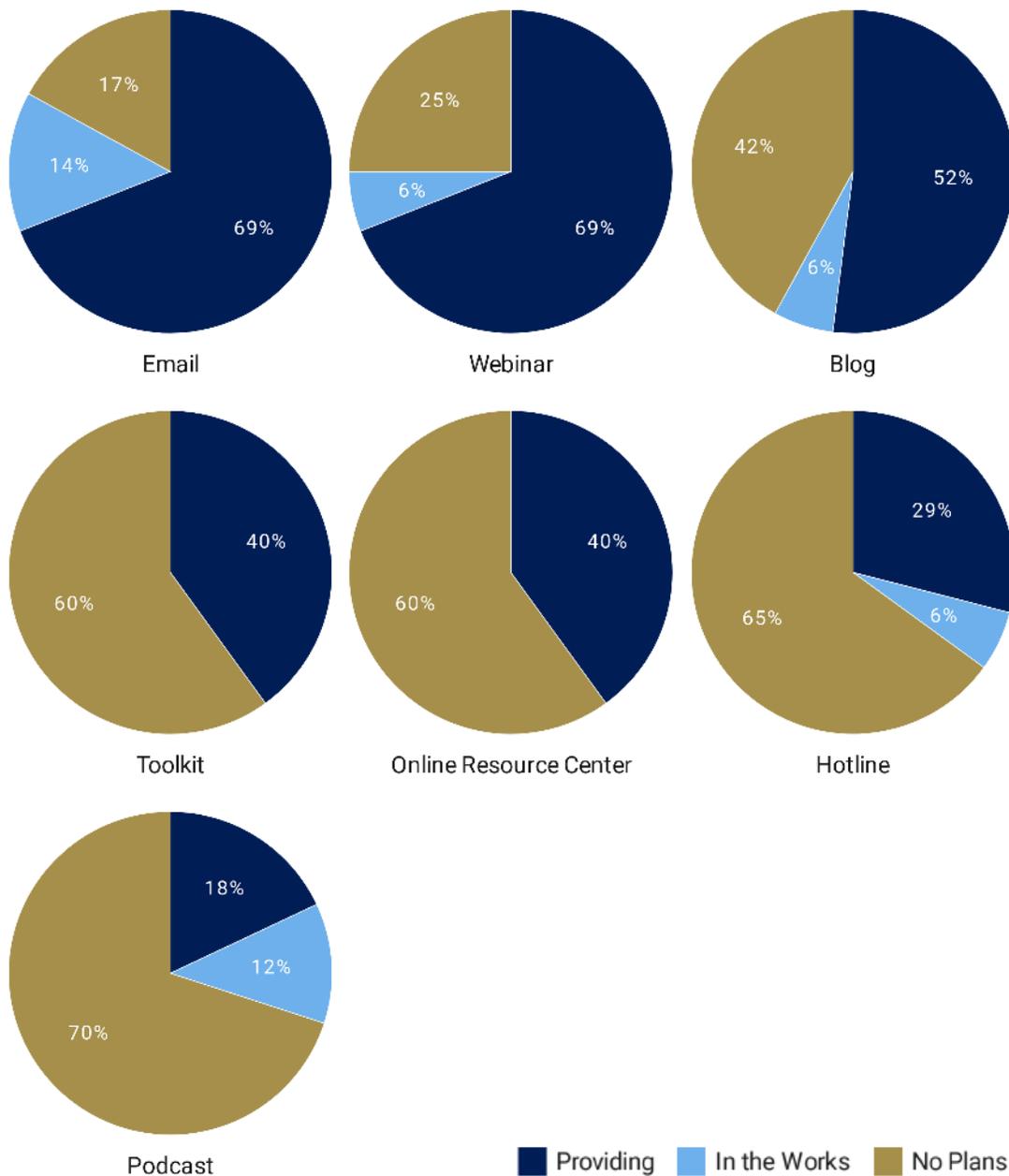
IV. CLIENTS (cont.)

In addition to the task force, or perhaps as a result of the coordinated effort, firms reported several marketing-related activities. A majority of firms have launched pandemic-related E-mails (69%), Webinars (69%), and Blogs (52%). A smaller number of firms launched more sophisticated activities, including Toolkits (40%), Online Resource Centers (40%), Hotline (29%), and Podcasts (18%) (Figure 16). Each helps strengthen client relationships.

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FIG.16

Is your firm providing any free resources to your clients?



IV. CLIENTS (cont.)

During an ‘unprecedented’ crisis, no one quite knows the rules of the road, or where the road leads, or where (and when) it will end. That is what clients (and law firms) are facing: uncertainty. It is reflected in clients’ concerns. According to the survey, top client concerns include business sustainability, cash flow, government loan eligibility, managing layoffs, and Force Majeure clauses.

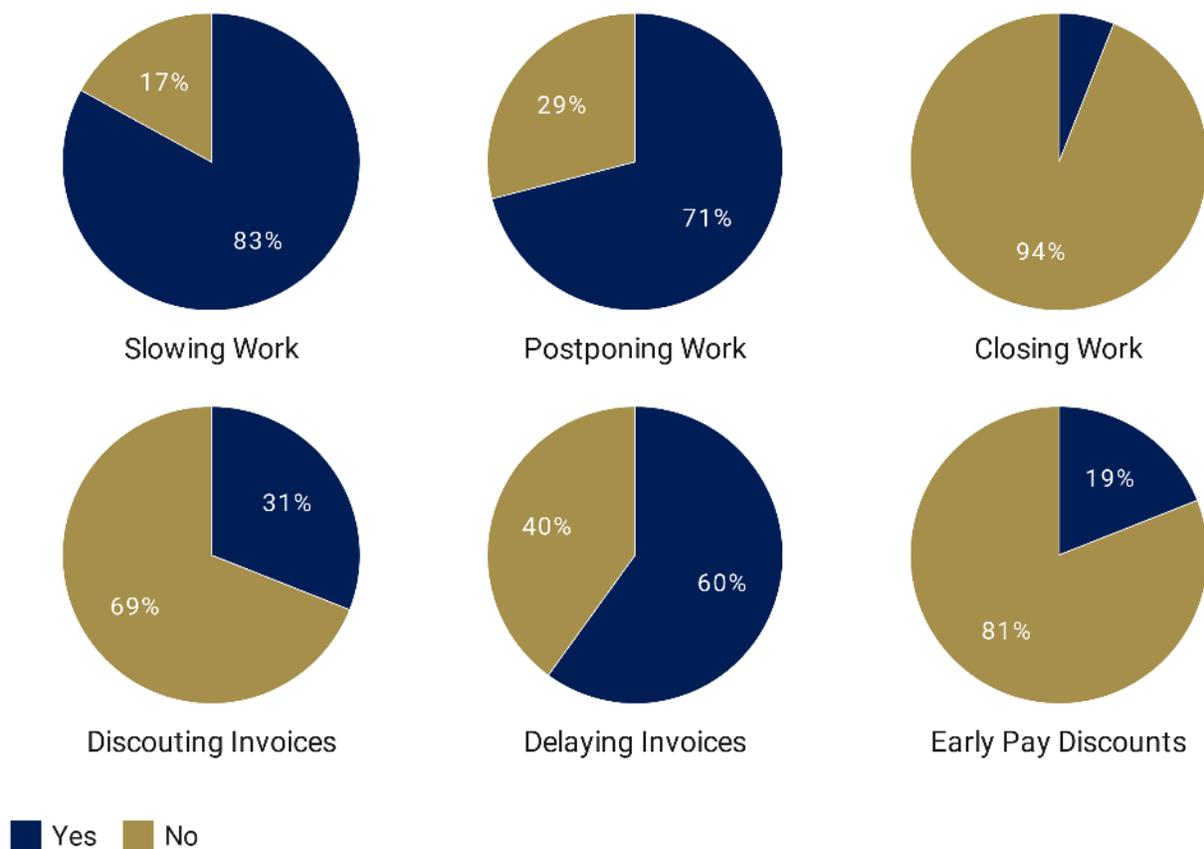
Listening to clients has been an essential component of client care for years. Just as firms invest in relationship-building efforts like the ones mentioned (which help clients understand potential legal issues and legal services the firm can provide), firms also invest in listening to, and understanding, what clients are facing now and in the future.

Two other areas of client concerns are ongoing work and fees. A majority of midsize firms reported discussions with clients regarding slowing work (83%), postponing work (71%), and delaying invoices (60%) (Figure 17). Each impacts Q2 performance; the silver lining is that the firm will have this work once the economy reopens, and full payment.

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FIG.17

In recent weeks, have clients requested...?



IV. CLIENTS (cont.)

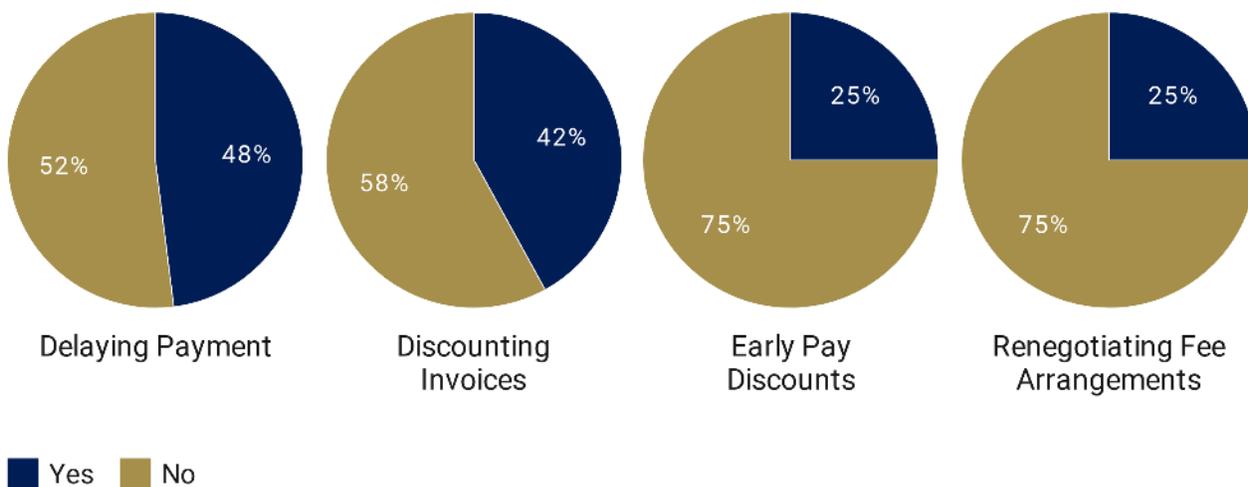
By understanding clients' concerns, firm leaders can be just as proactive with finances as they are with marketing communications. This strategic approach often requires a Pricing professional, which midsize firms have been reluctant to hire. As a result, less than half of midsize firms proactively discussed offering clients a form a financial assistance (Figure 18).

Not all options benefit law firms. Below are four common options that clients favor, with the impact each provides on firms:

Delaying Payment	Good option. Firm retains full receivable. Firm retains full value. Client conserves cash.
Discounting Invoices	Bad option. Firm loses full receivable. Firm loses full value. Client saves cash. Client encouraged to request future discounts.
Early Pay Discounts	Mixed option. Firm loses full receivable. Firm gains quick cash. Client saves cash. Client encouraged to request future discounts.
Renegotiating Fees	Mixed option. Firm loses full projected receivable. Firm gains insight into Client. Firm/Client can define/deliver value (AFAs).

FIG.18

Has firm leadership discussed offering clients financial assistance, such as...?



V. RATES & PRICING

The ability of law firms to steadily increase their rates has been the primary driver of law firm financial performance in recent years.”

The **2020 Report on the State of the Legal Market** is very clear, again: Rates drive growth. For midsize firms, this ongoing trend carries two impacts:

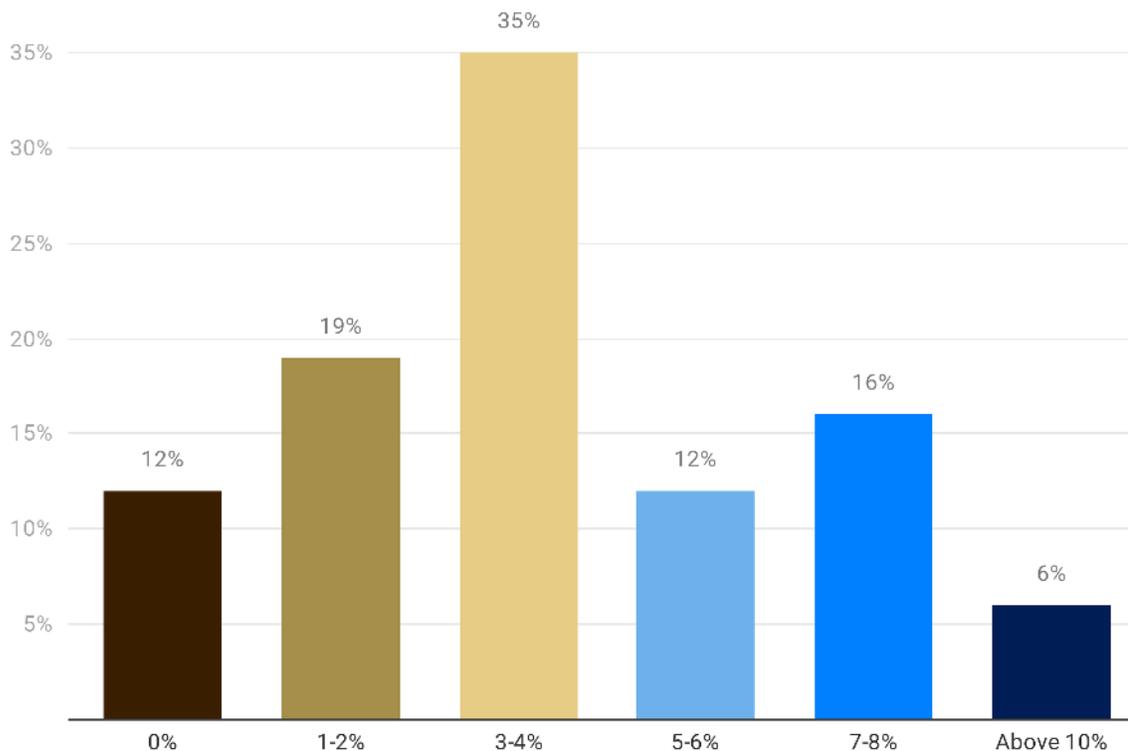
- beneficially, the majority of midsize firms utilize an hourly billing arrangement (80%, according to *Altman Weil's Law Firms in Transition*)
- detrimentally, the majority of midsize firms do not raise rates above 3-4% annually (66%, *Figure 19*)

Unlike BigLaw, midsize firms have clients who do not object to hourly billing. That makes midsize firms' hourly rates all the more important, for revenue and profitability. While the most aggressive midsize firms (34%) raised 2020 rates by at least 5% (same as AmLaw 200), the majority (66%) held rates to 3-4%, limiting their growth potential (*Figure 19*).

CONTINUED

FIG.19

What was the percentage increase in your firm's hourly rates for 2020?



V. RATES & PRICING (cont.)

During the Great Recession, partners learned the value of Pricing: the bigger the discount, the bigger the profit loss. As we enter a new crisis period, the same scenario comes to mind: will clients seek discounts, and will partners agree to discounts? In the Clients section, we learned one-third of midsize firms already had received discount requests from clients in Q1 (Figure 17). That is a red flag.

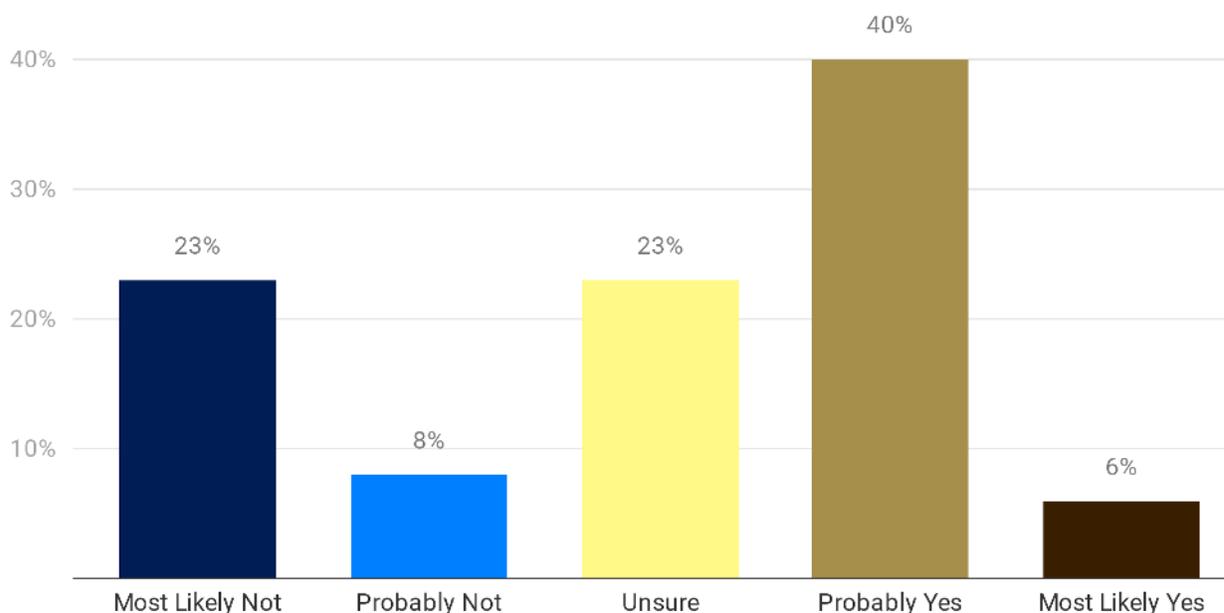
When firms know their value, price their value, and deliver their value, they have clients who understand the firm's value and are willing to pay for that value. A crisis does not change a firm's value; it changes a client's ability—not willingness—to pay.

In addition to discounts, nearly half of midsize firms (46%) are expecting clients to seek revisions of their fee arrangements (Figure 20). Now is the time to remind partners about the lost profits during the last crisis, then remind them about your firm's policy on discounts and/or fee arrangements. (If you don't have either, now is a good time to start the process).

CONTINUED

FIG.20

For Q2, do you anticipate clients will seek to revise fee arrangements?



V. RATES & PRICING (cont.)

Firm policies and guidelines are effective only when properly implemented and enforced. Surprisingly, more than 80% of midsize firms have implemented a Pricing policy (“Somewhat Prepared”, Figure 21).

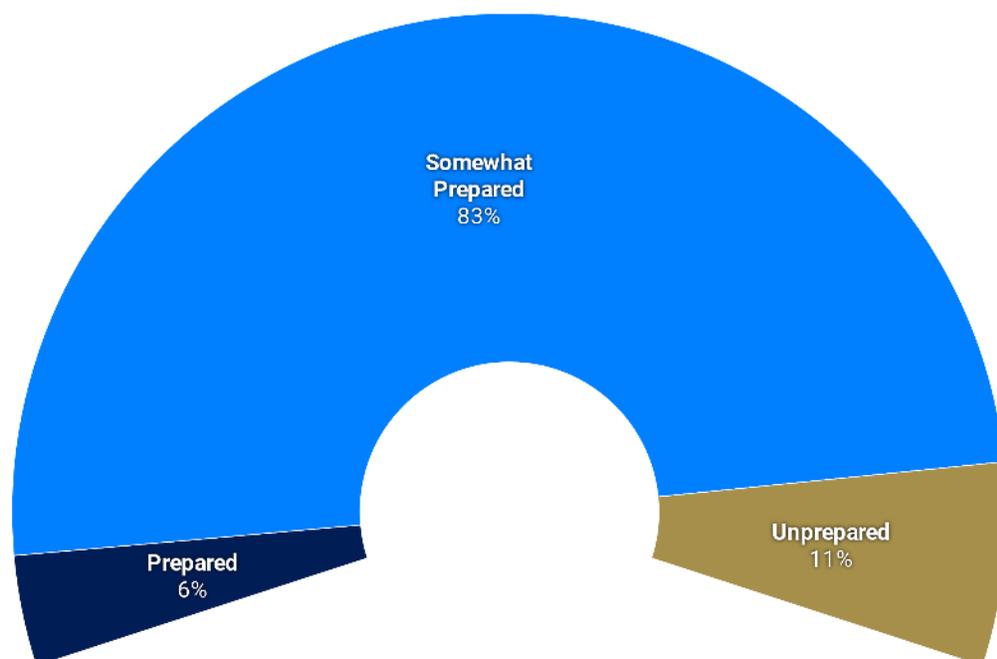
However, proper implementation of Pricing policies includes partner training, because Pricing is more behavioral than academic: partners must be able to explain and defend the policies, not merely memorize them.

What should concern firm leaders is not whether clients push back on rates or fees, but whether partners are trained in Price negotiations.

Unfortunately, only 6% of midsize firms have trained partners (Figure 21). Without training, partners are ill-equipped to defend firm pricing and/or overcome objections. Also, they are unlikely to understand the firm’s value propositions or how to use them effectively in supporting the firm’s price brand.

FIG.21

How prepared are your firm's partners to negotiate, if a client requests a discount?



VI. OUTLOOK

While the global outbreak begins to show signs of progress, the U.S. has yet to hit its peak. And, with the possibility of a ‘second wave,’ public health measures remain in effect as Spring marches toward Summer.

As the debate continues—some are ready to ease restriction by May 1, other suggest the end of May—two facts are clear: one, the economy should ‘reopen’ in Q2; and two, law firms will have two quarters (Q3, Q4) to stage a recovery.

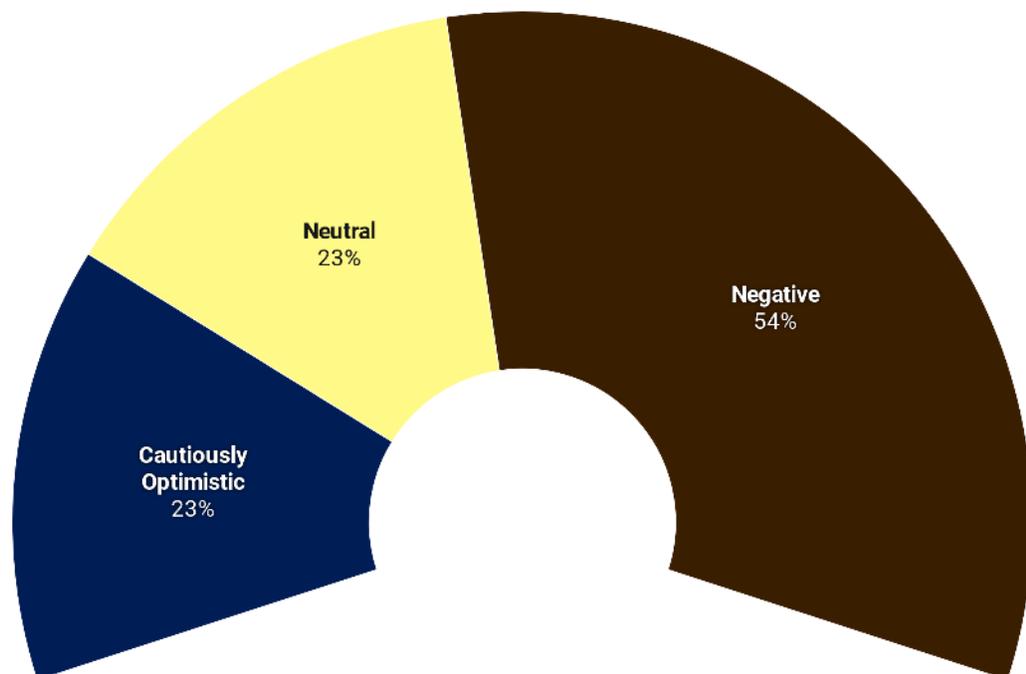
Depending on your perspective, this timeline could make you “cautiously optimistic” or “neutral” about the future (46% of respondents). Or, this timeline could make you realize that 2020 will not be the growth year as predicted (or worse), which would give you a “negative” outlook on 2020 (54% of respondents) (Figure 22).

Let’s remember: midsize law firms enjoyed a good start to 2020, meeting or exceeding expectations. That helps mitigate the impending slump in Q2. Will it be enough?

CONTINUED

FIG.22

As of today, what is your current outlook for 2020?



VI. OUTLOOK (cont.)

Participants were asked to do a little forecasting. In a 'best-case scenario' post-pandemic, most firms (60%) said 2020 would be a flat year (Figure 24). In a 'worst-case scenario' post-pandemic, nearly two-thirds of firm (65%) said 2020 would decline at least 20% (Figure 25).

Which brings us to the big question: When will we return to 'business as usual?' Most midsize firm leaders (52%) believe a return to 'normal' will happen no later than September: 12% in Q2, 40% in Q3. Add in the 36% that anticipate Q4, and fully 88% of midsize law firm leaders believe 'normal' business returns in 2020 (Figure 23).

It is apparent that the second half of the year counts for more than it ever has.

FIG.23

When do you anticipate a return to "business as usual?"

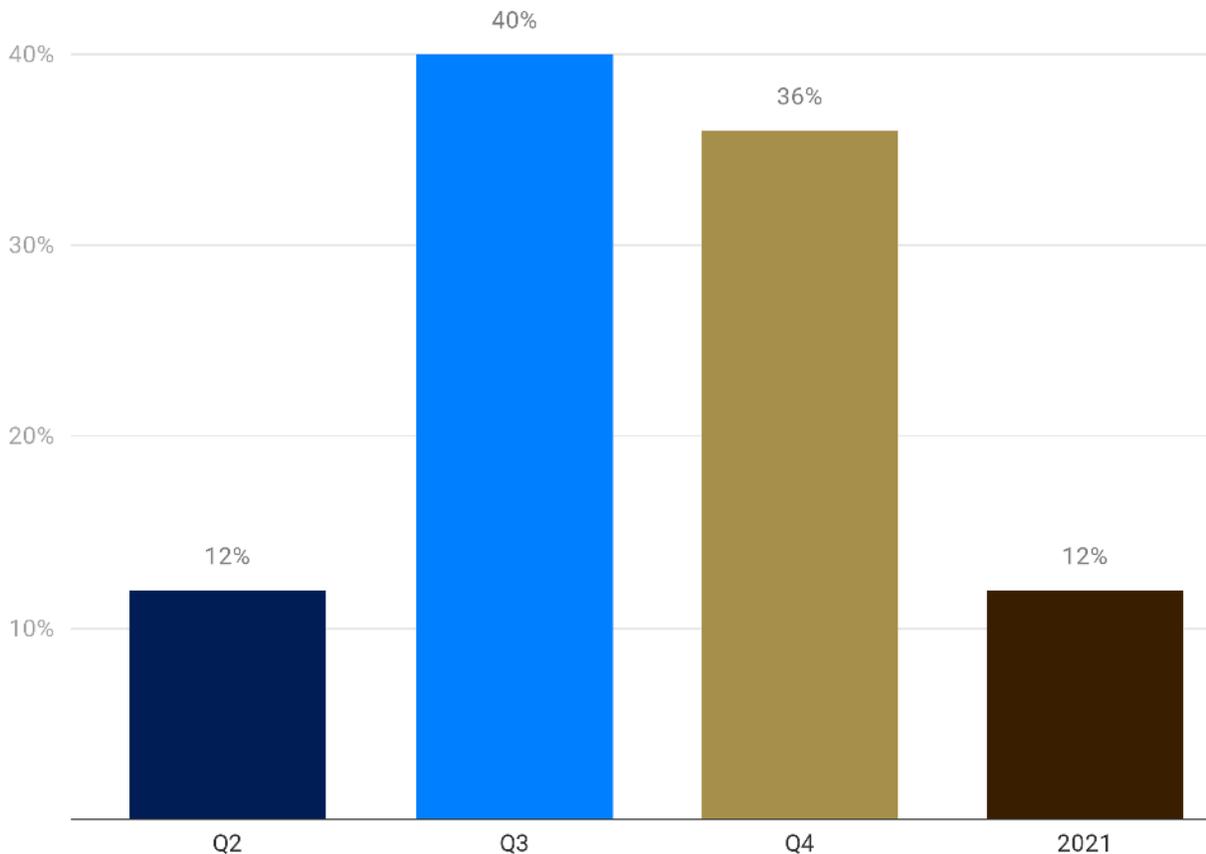


FIG.24

In a best-case scenario, what would be your firm's 2020 projection?

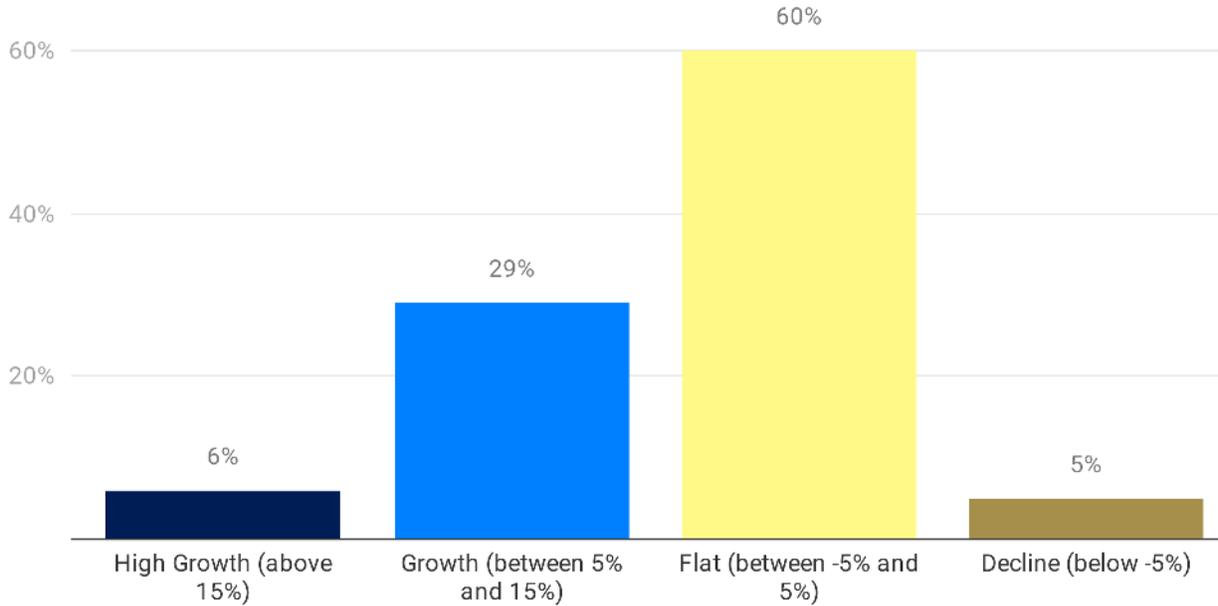
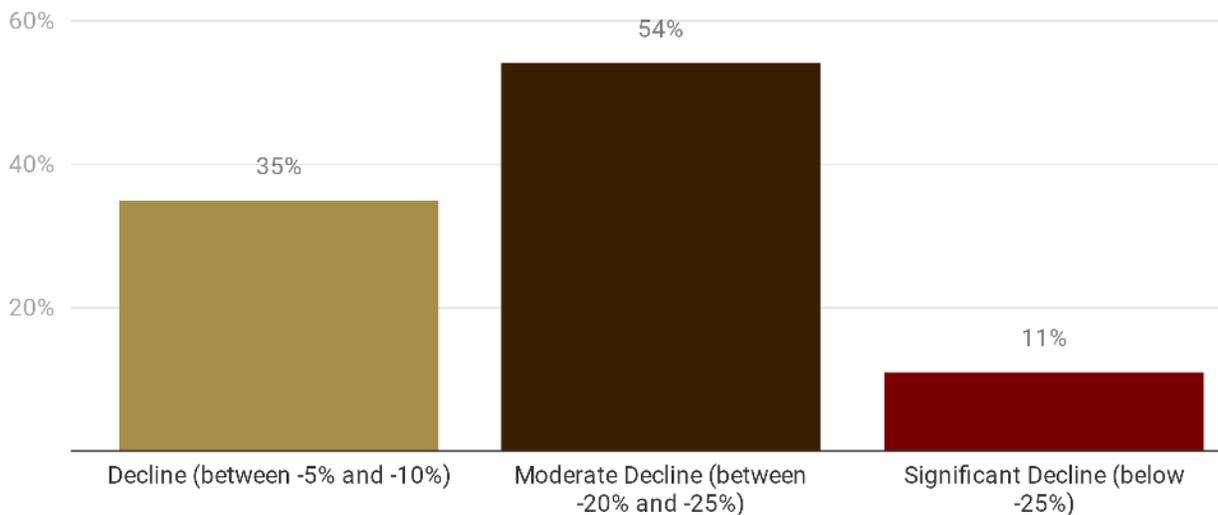


FIG.25

In a worst-case scenario, what would be your firm's 2020 projection?

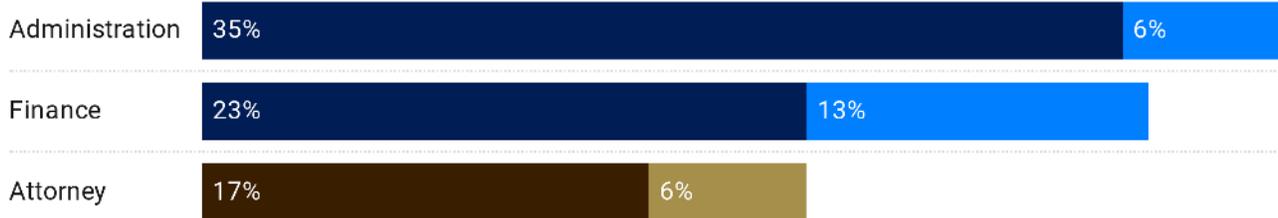


DEMOGRAPHICS

A total of 52 law leaders from 52 law firms participated in the Q1 2020 survey.

Participants by title

■ Chief
 ■ Director
 ■ MP
 ■ Chair



Participants by firm location

East Coast (First thru Fourth Circuits)



South (Fifth and Eleventh Circuits)



Midwest (Sixth thru Eighth Circuits)



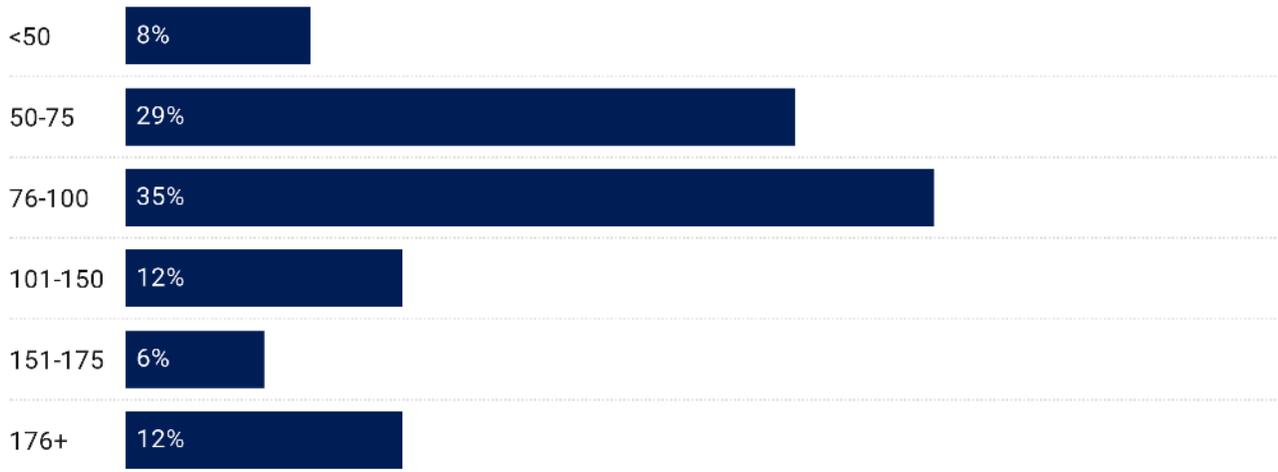
Mountain (Tenth Circuit)



West Coast (Ninth Circuit)



Participants by firm size



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