How to tell if your firm is in trouble.
And what to do if it is.

by Richard Gary

Today, most firms are feeling the effects of reduced economic growth. Transactions activity has slowed considerably, and clients are increasingly seeking alternatives to litigation. Almost all firms are affected to a degree; a few are affected to the point that their futures are in jeopardy.

How do you know if a firm is in serious trouble? And what can be done if it is?

The clearest sign of a firm in trouble is a constant stream of partner defections. If your firm has lost more than 10% of its partners to competing firms in the past 12 months, you should be very concerned.

There may be other warning signs. A year-to-year decline in revenue per lawyer (RPL) generally reflects a reduction in billable hours per lawyer, a softening in average billing rates, or collection issues. These signal that a firm is under stress. Although a decline in net income per partner (NIPP) is troubling, RPL is a far more valid measurement of a firm's financial condition. But even if RPL is static or declining, it all comes back to partner departures. So long as partners stay with the firm, they believe in its future, even if they are worried about the present; however, if they defect to other firms in meaningful numbers, you have a serious problem on your hands.

So let's say that your firm meets the threshold test. It has lost 10% of its partners in the past 12 months. You're the managing partner. What should you do? Here is a blueprint for working your way out of the problem.

1. **Convene a meeting of your core partners**. Tell them exactly what you're going to do and why. Tell them that you will meet with them on a regular basis to discuss the problems the firm faces and how, together, you're going to solve those problems. Tell them that, over time, you want to earn their trust and that you want them to renew their commitment to the firm. Then move immediately to Step #2.

2. **Identify the problem**. Before you can move forward, you must understand the reasons why the firm is in difficulty. Talk to your partners one-on-one. Contact former partners who left the firm in the past year and ask them to be candid with you about what motivated them to leave. Is the firm underperforming its competitors from a financial point of view? Did cultural clashes within the firm become intolerable? Did the departed partners sense a lack of support for their practices? You won't always get straight answers, but you won't get even one straight answer if you don't ask the right questions.

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3. **Develop a plan**. The next step is to develop a plan to address the issues identified in Step #2. The plan must look to the future and, at a minimum, provide for improved operating performance. It must also address any other issues that arose during your conversations with partners and former partners.

The roadmap for improved operating performance is the firm budget. Sit down with your management team and develop a budget for the next 12 months. Forecast revenues conservatively—not on the basis of what you'd like them to be but, rather, what they will be if current workloads, billing rates and realization levels don't improve. Next, determine the extent to which expenses must be reduced to force an improvement in profitability. Everything, including workforce levels, personnel costs, and even lease renegotiations, must be on the table, but be careful about cost reductions that affect client service. Your goal is to set realistic expectations—and for the firm to then meet or exceed them.

Occasionally, firms explore merger opportunities as a way to work their way out of trouble. This approach diverts firm management from the task at hand and is an unnecessary distraction that may encourage partners to avoid making the hard decisions that will correct the issues that confront the firm. My advice to troubled firms is to look inward for answers, not outward.

4. **Communicate, communicate, communicate—with each of the firm's constituencies**. There are numerous audiences or constituencies that have a strong interest in the successful implementation of your turnaround plan. These include partners, other lawyers (e.g., associates and counsel), administrative staff, clients, landlords, and lenders.

Develop a plan to communicate effectively and often with each such constituency. Keep everyone in the loop as the plan unfolds. Your message may vary slightly from group to group, but the overall themes must be consistent. Remember that people from different constituencies talk to each other.

Let your guiding principles be honesty and candor. That means no surprises, especially negative ones. Tell each constituency what you're doing to address the firm's problems, and why. Explain how what you're doing will benefit them in the long run. And then ask for their help in making the plan work.

Remember, each of these constituencies is your partner. Your success is their success. You can't succeed without their support. You need them, and they need you.

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Firms don't get into trouble quickly, and they don't get out of trouble quickly. It will likely take a year or two, but no longer, to put your firm on the right track again. There is no firm that can't be fixed, no problem that can't be solved, if partners are determined to work together to address the issues that put the firm in jeopardy in the first instance.

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