

Is your firm facing its own “Fiscal Cliff”?

By [Joseph B. Altonji](#) on November 27, 2012

Reading a recent [Wall Street Journal article](#) on the implications of the impending “Fiscal Cliff” facing our country left me thinking about two very important, but very different questions. First, what are the implications of the national fiscal cliff for law firms? And second, is it possible that a fair number of firms today are facing their own “fiscal cliff,” whether set to be hit on January 1st or sometime not too far down the line?

The answer to the first question seems to be positive in the short run, with many firms seeing manic fourth quarter demand to close deals and complete major gift transactions before tax treatment of those activities becomes substantially less favorable. This is likely boosting 2012 and early 2013 revenue, but at the possible expense of future work and revenue. The longer term implications are far more complicated and will vary significantly depending on the firm’s key practices.

But the second question seems far more relevant and important to the industry. As I commented in my first post [We’re Not Going Back Again.....](#)

there are many firms seeing tremendous year-over-year gains – and just as many today that are really struggling, in some cases for their very existence.

How many of the latter firms are facing their own “fiscal cliff” and what might that cliff look like? We may never know the precise number facing such a cliff, though the ones that drive over it are likely to be highly visible, as so many in the past have been. But the actual nature of the cliff will likely bear some similarities from firm to firm. Common to most will be some combination of a series of characteristics:

- Chronic underemployment of lawyer resources, combined with a sense that this is the “new normal” and we need to get used to it. Tempos have slowed, and with them the intensity the firm once enjoyed. Many firms are just too large for their current client base.
- Pricing and margin compression due to client pressures on once leading edge but now far more routine practices, without aggressive firm efforts to re-engineer the practices for a new delivery model.
- Increasing cost pressures without the ability to even keep pace with inflation on pricing (due to the points above.)
- Cultural pressure not to change things too fast, combined with overly cautious leadership unwilling or unable to take on cultural change.
- In some cases, a significant portion of the client base linked to partners closing in on retirement, with little institutional focus on succession.
- A growing frustration by the “overly taxed” who enjoy the ability to vote with their feet by moving to a firm where they can better reap the benefits of their own efforts.

Some firms will add to this list through extremely poor management (including management malpractice or worse as evidenced in a few recent crack-ups), excessive debt, insufficient capital and the like, all of which make a fiscal cliff more ominous while adding to the pressure on the gas pedal. But it is not necessary for any of these last points to be involved for a firm to drive over the cliff.

Any significant combination of these conditions, evident in too many firms today, has the ability to take down any firm. **(The pattern is familiar so please watch for it.)** For a while, the firm seems stagnant. The pace is blamed on the economy, and the strategy is to hope that pre-recession conditions return soon. Then the firm sees some gradual erosion in demand and slippage of profitability. Maybe the firm trims a few lawyers and staff. (How many firms entered the recession with 70 lawyers and now have 54?) Compensation, once a fairly innocuous event, becomes far more contentious at year end, and each year grows harder than the last. As a result, the culture seems coarser than it was. But you seem to be holding things together.

And then an important partner or group walks out... and you find yourself at the edge.

Roads ending in cliffs have clearly set out warning signs. Pay close attention to the signs that others have left for you.

We invite your comments.