

Financial Services Practice

COVID-19: Implications for law firms

Lessons from past downturns can help law firms respond to near-term challenges and set the right priorities for the long run.

This article represents a collaboration from authors across McKinsey's Financial Services Practice, including Todd Babbitz, Albert Bollard, Alex D'Amico, Gabriella Garbasz, Suhrid Gajendragadkar, Aisling O'Rourke, and Chandni Sachdeva.



The COVID-19 challenge is unprecedented, both for the economy and for aspects of the legal system. Law-firm leaders must prepare for a wide range of scenarios, the likelihood of which will depend on the effectiveness of both public-health- and economic-policy interventions.

This article highlights five lessons from previous downturns, outlines potential implications for client demand across practice areas and sectors, and suggests priority areas of focus for law-firm leaders. The most effective firms will manage with a “through-cycle” mindset, giving appropriate attention to near-term pressures while laying the groundwork for long-term success.

Five lessons from previous downturns

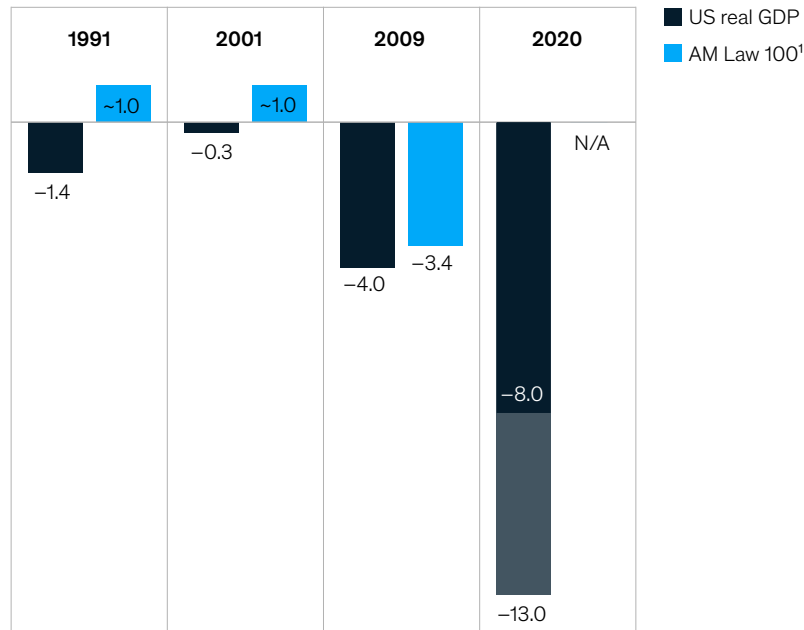
Looking at past downturns provides lessons for law-firm leaders to consider:

1. *Law firms weather downturns better than the overall economy does.* Of the past three downturns, only the global financial crisis of 2008–09 resulted in a decline in aggregate Am Law 100 revenue (Exhibit 1), in part because of countercyclical practice areas and prices continuing to advance (see lessons two and four). But the current downturn may turn out to be unprecedented in the postwar era, so law firms must prepare for a wide range of scenarios.

Exhibit 1

US law firms tend to weather downturns better than the US economy does, but the current downturn may be unprecedented.

Revenue change by recession, % total drawdown (peak to trough)



¹Excludes consolidation of firms driving 11% increase in number of lawyers within Am Law 100 in 2001; growth in revenue per lawyer was close to 1%.

Source: ALM Media Properties; Susan B. Carter et al., *The Historical Statistics of the United States*, millennial edition, Cambridge University Press, 2006; McKinsey analysis, in partnership with Oxford Economics

2. *There will be a wide spectrum of demand responses across legal sectors and practice areas.* It is natural to expect that litigation and restructuring practice areas will do well while other transactional practices will suffer, but the reality will be more nuanced. While there are unprecedented near-term slowdowns in some court systems, over time, dispute and investigation practices are indeed less correlated with the rest of the economy than transactional practices are (Exhibit 2).

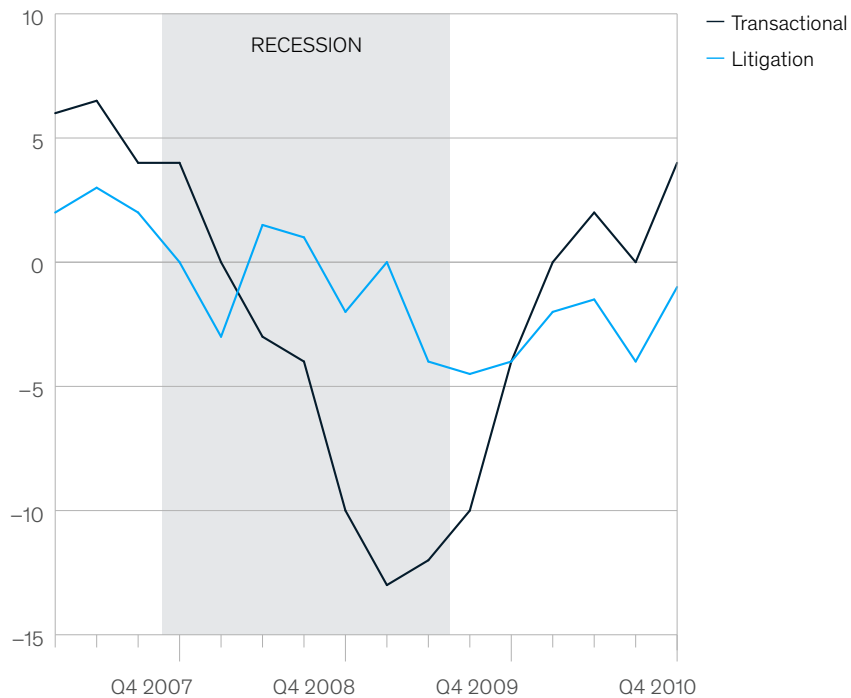
However, economic downturns do not directly translate into a decline for transactional practices, as market difficulties, regulatory responses, stimulus programs, changes in employment, and other stressors provide potential sources of demand for legal services. In response to

the COVID-19 crisis, there has been wide variation in impact across the global economy to date (Exhibit 3). While most sectors are facing challenges, some sectors directly affected by physical-distancing measures (such as airline, hotel, and storefront retail) are experiencing unprecedented declines in demand. Other sectors (such as medical supply, sanitation, grocery, and in-home entertainment) are experiencing sharp increases in demand. A third set of sectors that are not directly affected by COVID-19 but feel the impact of a general slowdown or a moderate uptick as people's lives change at work and at home (such as home improvement, landscaping, and consumer electronics) are experiencing muted or lumpy demand.

Exhibit 2

Transactional practices tend to contract during a downturn, whereas litigation practices tend to be steady.

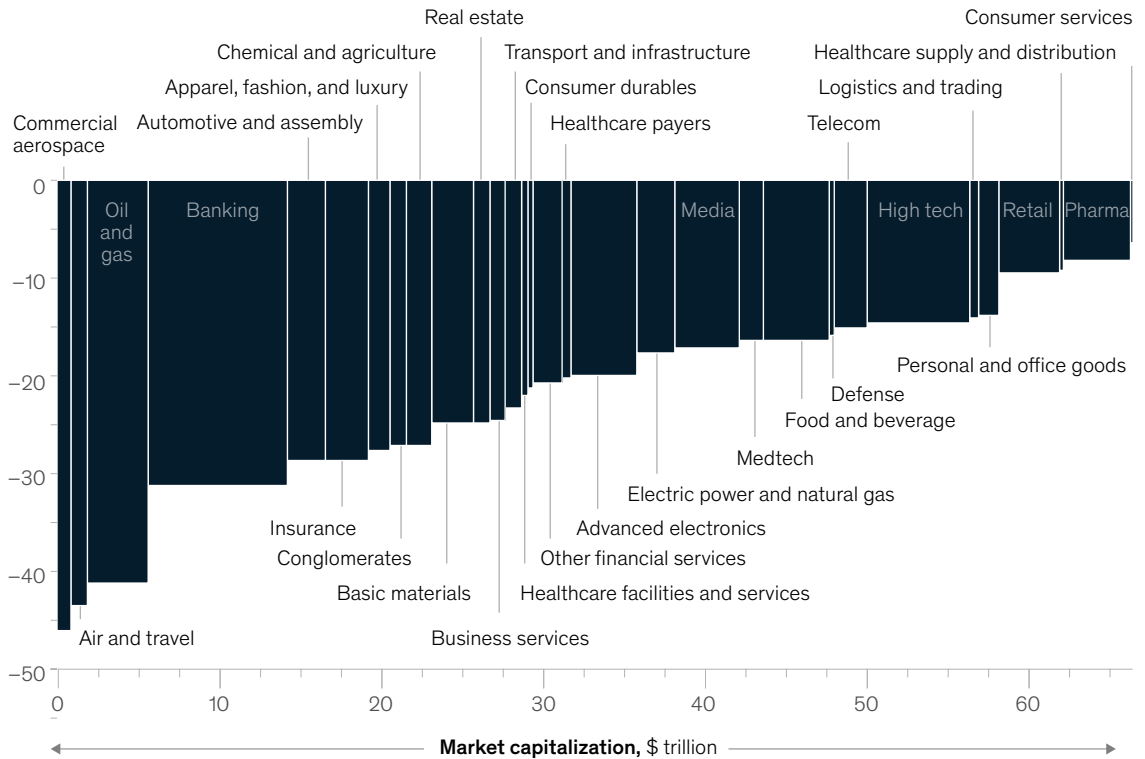
Demand for law-firm services, 2007–10, % (year-over-year change)



Source: Peer Monitor

2020 market-capitalization declines in the COVID-19 crisis have varied significantly across sectors.

Total shareholder returns by industry, %¹



¹As of Apr 2, 2020. Adjusted for currency. Data set includes global top 3,000 companies by market cap in 2019, excluding some subsidiaries, holding companies, companies with very small free float, and companies that have delisted since.
Source: S&P Global; Corporate Performance Analytics by McKinsey; McKinsey analysis

3. Regional exposure matters. In 2008–09, market weaknesses were felt most acutely by New York, national, and international law firms. Firms headquartered in Texas and Washington experienced both revenue and profit gains, while other regional firms experienced, on average, flat revenue and a slight decline in profits (–3 percent). In the current downturn, law firms less tied to global financial markets may feel less of an impact because of the nature of their businesses (such as less exposure to a decline in cross-border activity) and because virus mitigation may be more disruptive in densely populated cities or transit hubs.

4. Downturns accelerate long-term secular trends. Plan for continued pressure on pricing and on shifts to alternative delivery models. In the last downturn, standard rates continued to rise by 3 percent per year, on average, but pressure on collections did too. From 2007 to 2012, the fraction of standard rates not collected more than doubled (to 16.4 percent, from 8 percent) because of increases in discounts, write-downs, and write-offs, which left net prices relatively flat. This time around, expect that procurement teams will play an even larger role and that there will be a greater focus on commercial arrangements that provide clients with greater cost certainty,

either through a fixed or capped arrangement or through one that more closely aligns fees to the outcomes achieved. Client demands and competition from alternative legal-service providers will also likely pressure high-cost real estate, staffing pyramids, and other elements of the traditional service-delivery model.

5. **Some law firms handle downturns much better than others do.** Grouping Am Law 100 firms into quintiles based on where they entered the 2008 financial crisis in and where they exited in 2012 shows the magnitude of the dynamics involved (Exhibit 4). Measured by profits per equity partner, only about half of those firms stayed in the same relative position over the period. The remainder of this article outlines an early view of the demand considerations and leadership priorities that may determine which law firms most successfully navigate the current COVID-19 situation.

Potential implications for client demand

In line with the lessons from past downturns, Exhibit 5 outlines an early view on potential demand implications across both select practice areas and sectors over the remainder of 2020. Although some practice areas, such as labor and employment, will likely see consistent demand shifts across sectors, transactional practices, in particular, are likely to be focused on very different situations in more distressed sectors such as travel, transportation, and leisure than in areas such as healthcare. Every firm should develop a perspective on the demand outlook for the sectors, client types, and practices to which they have greatest exposure.

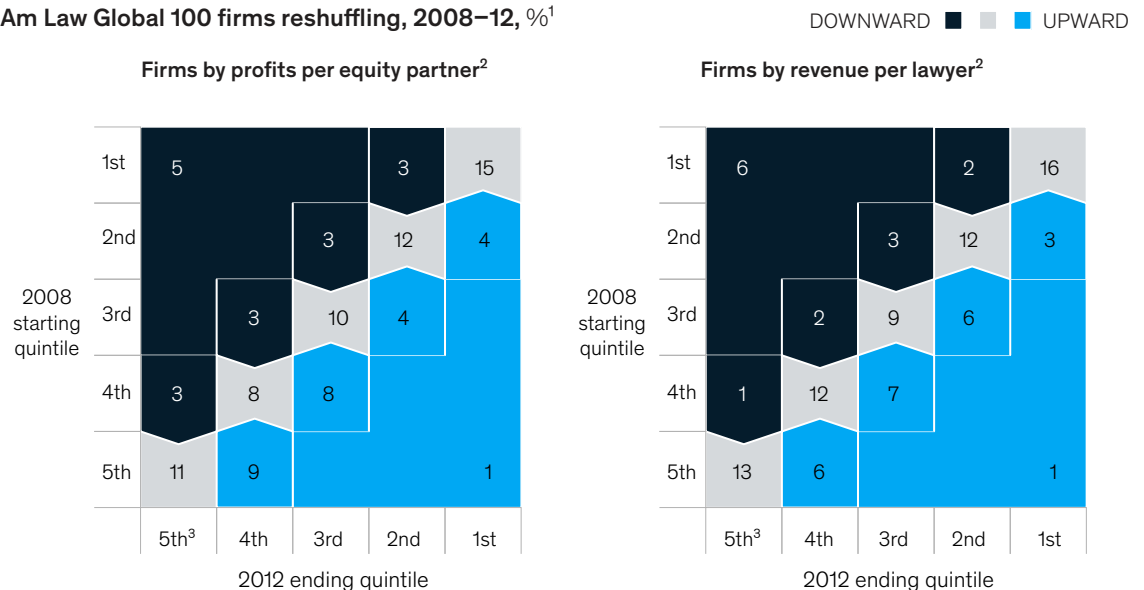
Priorities for law-firm leaders

Based on the lessons learned from previous downturns, current demand outlook, and our

Exhibit 4

Downturns can reshuffle the competitive landscape.

Am Law Global 100 firms reshuffling, 2008–12, %¹



¹ Rounded to nearest whole %.

² Profits per equity partner, n = 92, and revenue per lawyer, n = 97, given lack of disclosure of each metric across all firms in Am Law Global 100 and calculation of combining firms separate in 2008 but merged by end of 2012.

³ Includes law firms from 2008 that subsequently dissolved or fell outside of AM Law Global 100.

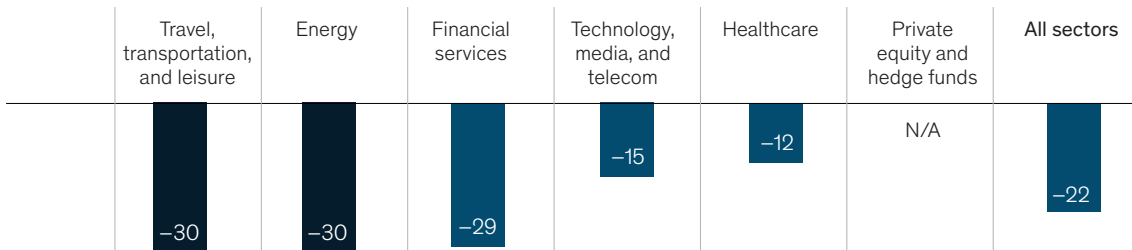
Source: ALM Media Properties

Exhibit 5

Transactional practice areas are likely to see varied demand shifts in distressed sectors.

Practice-demand changes in market capitalization by sector, %¹

NEGATIVE ■■■ POSITIVE ■■■■



Transactional-practice-demand outlook

	Travel, transportation, and leisure	Energy	Financial services	Technology, media, and telecom	Healthcare	Private equity and hedge funds	All sectors
Increase	Restructuring	Restructuring Midstream and storage	Government lending programs Debt capital markets	Bankruptcy and restructuring Debt financing	Alliances and joint ventures Regulatory	Distressed M&A Midmarket and roll ups	Restructuring and workout Distressed M&A
Decrease	Corporate M&A Real estate	Project finance Corporate M&A	Equity capital markets Big-ticket M&A	Venture capital, capital financing, and IPOs		Fund formation Big-ticket M&A	Equity capital markets Big-ticket M&A

Dispute- and investigation-practice-demand outlook

	Travel, transportation, and leisure	Energy	Financial services	Technology, media, and telecom	Healthcare	Private equity and hedge funds	All sectors
Increase	Shareholder litigation Supplier disputes	Supplier disputes Shareholder litigation	Government-program compliance	Intellectual-property and labor litigation Force majeure disputes Government investigation and regulatory		Distressed debt	Labor and employment Corporate tax
Decrease		International arbitration					Antitrust

¹ Average year-to-date total shareholder returns by industry; weighted and adjusted for currency. Data set includes global top 3,000 companies by market cap in 2019, excluding some subsidiaries, holding companies, companies with very small free float, and companies that have delisted since.

experience in a professional-service firm, we suggest six themes for law-firm leadership to consider. These through-cycle priorities aim to sustain value in the near term and build value over the long term.

Focus on clients, clients, clients

This is the time to be there, truly, for your clients. Their business context has shifted dramatically, presenting unprecedented challenges. Law-firm partners should proactively connect with and really

listen to clients and their needs. Even a two-line personalized email can send the right message. As client agendas and priorities shift, be ready to pivot your client-service agenda to match them—for example, by introducing new partners or expertise in a pertinent area. Invest significantly in relevant knowledge (see next section), crisis advisory, and other services that deepen trust.

Operate at pace on relevance

Clients are looking for sound information, hard data, and impartial advice. They are flooded with information. What will be your law firm's relevance agenda on the topics for which you have distinctive capabilities (such as implications of Federal Reserve Board and Department of Treasury facilities and tech acceleration)? What innovative channels, beyond the standard articles or emails, can you use to get your perspectives to clients? If it is taking longer than a week from idea to publication or a client discussion, that is too long in this fluid time.

Embrace your people

Your people are your law firm. Acknowledge and deal with the humanitarian and personal elements of the COVID-19 crisis with empathy. Support employee flexibility, collaboration, and connectivity through technology and frequent communications from firm leaders. Look for opportunities to reallocate any excess capacity rapidly toward building new firm capabilities or pro bono activities—every firm member should see clearly how their work is meaningful through this period.

Be vigilant on pricing

It is easy in these times to let pricing discipline slip. Our research shows that in past downturns, law firms continued to increase their standard rates but then partially offset those actions through an uptick in client, matter, and one-time discounts; strategic investments; and work-in-progress and accounts-receivable write-offs. If done in a strategic and controlled fashion, those actions can be effective ways to meet clients' needs while reinforcing a law firm's value proposition and positioning the firm well for when the economy recovers. But leaders will be creative in providing pricing or volume relief. Rather than reflexively locking into long-term, highly discounted arrangements, explore ways

to offer strategic investments, flexible payment terms, credits toward future services, and the broader panoply of alternative fee arrangements. Strategically show strength through extending the firm balance sheet for clients rather than gradually losing ground through a lack of pricing discipline.

Use your bifocals: Be nearsighted, with a view to resilience

Set up a nerve center to coordinate law-firm activity across all the previously mentioned fronts and more. Try to move beyond the basics to the best practices of widespread and varied communication, weekly war-room reviews, impact tracking of initiatives, and rebalancing for short-term coordination and priorities as needed.

For law firms, near-term issues of cash management for liquidity and solvency are clearly paramount. They should build scenarios to understand their positions and near- and midterm imperatives. Prioritize initiatives based on time to release, typical size of financial impact, and risks to a firm's long-term health and performance from pulling that lever. Two general principles apply if firm survival is not at stake: examine all levers first before turning to compensation and let partners "take the hit" before nonpartners do.

In general, law-firm leaders should think of the order of operations for near-term resilience as follows:

1. Pull all noncompensation balance-sheet cash levers.
2. Pull noncompensation midterm levers.
3. Consider smoothing and elongating distributions to partners.
4. Consider reducing partner bonuses and distributions.
5. Consider smoothing and then reducing (in that order) partner salaries.
6. As a last resort, enact nonpartner-compensation reduction, deferrals, or furlough or layoffs.

Use your bifocals: Be farsighted, with a through-cycle view

While this is an unprecedented time of public-health crisis with potentially severe adverse economic conditions, it is important to maintain a running multihorizon view. Resilience measures can fund priorities not just for the near term but also to help with acceleration out of the crisis. Now is the time to develop or sharpen a granular view on the sectors, clients, practice areas, and geographies you are prioritizing.

In-flight or established strategic initiatives, particularly those that link to immediate client needs, should be continued, perhaps even accelerated in some cases. Law firms can build capabilities in new areas likely to be busy in the midterm (such as restructuring and M&A) and should consider accelerating partnerships, digital and technology innovation, and inorganic growth plans in light of the changing environment.

Over time, law firms can capture growth from three sources: underlying market expansion, gaining share from competitors, and M&A. Our research across industries demonstrates that sustained growth from gaining share from competitors is extremely difficult, particularly in mature, highly competitive sectors (such as high-end legal

services). Conversely, participating in underlying market expansion *can* be a source of sustainable growth, which makes it imperative that firms have or build capabilities in service lines that are seeing rapid expansion. M&A can also be a powerful tool; however, our research suggests that across industries, programmatic M&A—for example, a series of “lift outs” or acquiring boutiques—generates more value than “bet the firm” mergers.

Decisions made now may well shape a firm's direction and culture for the long term. With that in mind, law firms should complement belt-tightening initiatives with plans to attract lateral talent with well-aligned practices and reforms to firm decision-making and people processes, such as placing greater emphasis on collaborative entrepreneurship in annual partner reviews.

In the current highly uncertain and rapidly evolving environment, no single course of action will be appropriate for all law firms. But given how much is at stake for them—client relationships, people and culture, near-term resilience, and the ability to accelerate out of a downturn—those that can maintain a long-term perspective while moving aggressively on near-term priorities will be best positioned to prosper in the next normal.

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