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Episode title: What's keeping law firm CFOs up at night?

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Bill Josten: Anyone who pays attention to the news has heard the dreaded "R" word floating around. It's the topic of much conversation. Are we in a recession? How long might it last? How deep will it go? How do we fix it? And even how do we define it? Lawyers and law firms have a bit of an advantage, though, in an economic downturn in that they often get to see it coming further out. Well, why? What do I mean? Because history has shown that law firms often experience a bit of a lag before the economic slowdown actually hits them. They can see it coming because it affects their clients before it really hits them. When the economy slows and businesses start to feel it, they often reach for their lawyers help, whether that be with taxes, real estate litigation, staffing, in some cases even bankruptcy. So, law firms can actually see a bit of an upsurge before that downturn hits. The great financial crisis is an example of this. While most of the rest of the economy had slowed considerably into a recession throughout 2008, law firms really didn't feel it until into 2009. That gave them some lead time. The same was true in 2020, as many businesses felt the effects of the pandemic deeply, many law firms had really very strong years in 2020 due in part to some smart management and largely to a late in the year spike in demand through Q3 and Q4 of 2020, but it's not enough just to see an economic slump coming. You have to prepare for it, and that's part of the job of people like my guest today, Jeff Connor. Jeff is the Chief Financial officer at McGuireWoods LLP, a full-service law firm of around 1,000 lawyers in Richmond, Virginia. He has over 25 years of experience in the legal industry. Prior to joining McGuireWoods in 2015, Jeff held senior management positions, at two AmLaw100 firms and an AmLaw25 firm and a boutique firm ranked among the top 20 most profitable AmLaw firms. Jeff, so glad you could join us today.

Jeff Connor: Thank you, Bill. Appreciate the invitation. Happy to be here.

Bill Josten: So, your job must be pretty interesting today, but for likely a lot of different reasons than would have been the case for the last couple of years.

Jeff Connor: Yes, absolutely. I think changes that have occurred in the last two years, 24 months, and the impacts they've had on the legal industry have really changed things from repeating what we knew worked well with little bit of improvements on the edges, change, the need for change and innovation has really, really been accelerated.

Bill Josten: Yeah, when you look back at 2020 and 2021 for law firms, those were in at least some respects almost record years. Firms were very profitable. We had really high demand in areas like M&A and some of that demand has really started to cool, particularly in transactional practices. So, I think it's probably a safe assumption that a lot of firms are now wondering how do we continue to grow profitability or even maintain it as some of these things start to change on us?

Jeff Connor: Absolutely. We talk a lot about, you know, being nimble and able to execute on changes. You know, firms really need to be wise enough to listen to their associates and professionals and execute on the changing needs of those folks because as we try to navigate through the change in demand and servicing that demand, it really does encompass everybody in the organization and how you continue to maintain and enhance your organization to address current demand levels and then of course be ready and nimble to handle spikes.

Bill Josten: Well, you know, that that brings up a topic that I hadn't necessarily prepped for it. I certainly didn't send you any prep questions for Jeff, but that kind of, you emphasize the word listen and I think that is so key. You know, we've seen a shift and I think it's been most dramatic in the last two years where we've seen a shift in law firm management mentality to being much more open and much more responsive and maybe a little bit less of what I guess I used to call a Parris Island mindset. And by that, I mean, yeah, you're never going to find a marine who's earned the blood red stripe down their slacks who feel sorry for anybody in boot camp. Yeah, sort of, well, that's what I had to do to pay my dues, they have to do it too. And I think that attitude used to exist in law firms, but it's maybe starting to shift a little bit where they are trying to be more receptive and they're getting feedback from a lot of different areas, from clients, from associates and they're trying to be much more responsive to it. And that's actually part of the conundrum, right, is how do we do that?

Jeff Connor: Absolutely right. And you know, as I said, we have to be wise enough to listen, right? There's lots of examples of cycles. Sometimes we talk about that and it has a negative connotation, but we have to learn to take a take a stop, take a step back and listen, whether that be in direct relation to the work level of associates and professional staff, whether it be the way we're handling space needs and technology needs, or simply acknowledging with, you know, a full throated voice that we can work remotely and we can do things differently. At the same time, there's nothing, you know, wrong with clinging to certain things, whether it's the apprenticeship model, which probably is more important in a litigation shop than maybe a corporate shop, but that's up for debate, but the idea of being around each other to learn and to grow that has direct impacts on the work product, which obviously is client service and keeps everything rolling. So, there's lots of things that we have to learn and harness the changes over the last couple of years and be open to, to making improvements.

Bill Josten: Yeah, I think that's such a great approach to have that mindset and the openness because one of the things, you know, we did a report earlier this year on the type of law firms that lawyers want to work at, firms that have lower rates of turnover. What do those firms look like? And one of the characteristics of those firms that we saw was the lawyers felt more comfortable giving feedback to management being themselves. They felt heard and frankly, we know that from years of research with clients that that's an important aspect for the client as well, right? That idea of I want to work with a law firm who understands my business, who can give me advice that's commercially sound. So, it's tying into not just what's the problem I need to address today, but how do I how do I fit this problem and its solution into my overall business plan? How do I avoid these types of problems? Or take advantage of these types of situations in my broader business model in the future? So, to see that expanding now into the talent ranks within the law firm is, I think that's very gratifying to a lot of younger lawyers and I think it's a very welcome step.

Jeff Connor: Absolutely right. There are strong technical lawyers the those that view it as a profession of you know high level and you give out advice and if people follow a grand, if they don't, shame on them and it's evolved into, you know, what does it truly mean to be a counselor to your clients? Is it helping them with a with a critical situation and putting out a fire? Certainly. We've all used the phrase looking around the corner for your clients, it's that and then some which is, as you say, learning enough about the client business and whether that be just particular pressures on that business or good old fashioned what is the legal department budget and learning how to prioritize that advice in a way that gets your client to move forward in their plans and having some stake in that. You know that it's important to understand enough about the client so that your advice can actually be followed.

Bill Josten: So, we've already touched on a ton of different topics and frankly a lot of more things I didn't even anticipate talking about, which is awesome. And it clearly demonstrates that there's probably a lot on your mind as a leader within a law firm. So, I'm curious of the things we talked about and I'm sure that there's a plethora of other things, what's keeping you and your finance colleagues up at night? I think that's an interesting perspective the business people running the law firms 'cause, you know, as a lawyer, I have a little bit more understanding of the attorney mindset and I can kind of guess at what that might be and looking at client issues and things like that, but that business aspect, you know, what keeps the business professionals in a law firm up at night?

Jeff Connor: Sure. It's the economy, right? It's still the economy. And whether that be generally as it affects everybody in the United States and globally, but also direct impacts, you had mentioned law firm demand and how we were coming from really, really high demand in 2021 to something a little more tepid in 2022. So, what does that mean for profit expectations? How do we talk about the realities of a new compensation model? And can we afford certain compensation models, certain benefits? So, I think, saying the economy and saying client demand that is a true statement I think it'll always be a true statement, but it touches different things and I'm going to sound a little bit like a broken record, but talent management has become, if not the number two, certainly in the top five of everybody's list as to what's keeping them up at night. Whether it's do you have your top people satisfied with all of the things that define satisfaction working in a big law firm nowadays, or do you have, you know, critical recruiting needs that you're needing to deal with still or unfortunately with the tepid demand, do you have excess capacity in certain areas and how do you, as an organization, reach conclusions about what to do with any excess? Is it a redeployment? Can you get folks interested in doing things that maybe wasn't their first love or what they did over the last 18 months. Can you supplement client billable work with things that will enhance their skill set? Maybe in a pro bono arena, things like that. We have to be more thoughtful, you know, layoffs, stealth layoffs, public layoffs, whatever that maybe people don't want to talk about that, but that remains a mechanism for dealing with excess capacity. And the question for me becomes, it's always there, I don't want to make light of it, It's in the toolbox, but what can you do beforehand and how can we manage things in a way that still delivers profit that is quite frankly acceptable to partners and continues to make the firm attractive for lateral partners? And we talk a lot about associates, and I certainly do, but owners of the business and attracting quality complex work for the associates to do which makes them satisfied or helps to make them satisfied, comes with clients with those relationships and those skills. And clients, I'm sorry, partners respond to profits and understanding how those fits into the overall culture of a firm. So, it is always the economy and all the different things that that means nowadays as opposed to just saying, you know, revenue forecast looks low, let's stop serving breakfast every day, right? That'll evolve and find all the different ways to strike as best we can, the right balance.

Bill Josten: Well, don't underestimate the importance of starting the day with a healthy breakfast, Jeff. But I do get what you're saying, and it's interesting the focus on talent. I hear so much of that. We did some interviews with managing partners back in May and we had a question guide that was fairly balanced between four or five different topics, but these were open ended questions. And the response map was predominant, I mean out of you know, 4-5-6 different topics, 60% of the responses focused on talent in some capacity, if not, if not closer to 75%. So, that's such a tremendous topic and I think as I look at it from an industry analyst perspective, but also as somebody who was directly impacted by the hiring decisions for firms made in 2009 it seems like there were lessons learned in 2009 that that firms are trying to implement here. You know, you look at the pandemic, we didn't see total hiring freezes. We're not bringing in any new associates. We maybe saw some deferrals and some other capacity management strategies, but we didn't say wholesale strategies of we're not hiring anybody, which we kind of did in 2009 to a certain extent. And as you're talking now, you know, I'm, I'm reading articles in, you know, in certain outlets that are talking about stealth layoffs and all this other stuff. But it seems like firms really are trying to be mindful of how do we manage capacity effectively but not put ourselves in a position where we have a potential brain drain or we have a lot of unintentional attrition, if you will, where people are leaving the firms for other reasons. You know, they're really looking at culture. They're really looking at retention and making sure that they are in control of how they're managing staff. They don't have staff just fleeing for the exits because they don't want to work there anymore.

Jeff Connor: Absolutely right. And unintentional attrition, that's a great phrase. I'm going to, I'm going to appropriate that from you because people look around and see what's happening and if you're not communicating and have the right, again, judgment, but the right level of transparency as to what decisions in an organization is making folks can easily misinterpret or cannot understand kind of the short term versus long term versus greater good. And you know that that has to be communicated that there's no way that you can rely on and let me back up a little bit, it needs to be communicated from a high level and through existing partner associate relationships or mentor relationships. It can't just be sort of said once and expect that each partner has a particular skill set and or desire to communicate to that team. You have to really be thoughtful in in making sure people are informed of what decisions are being made.

Bill Josten: And you know, I think that represents such a shift, again, I've said this before, but I think it represents such a shift in mindset around talent that's taken place certainly in the last 10 years and really even in the last three, just to have that level of mindfulness around how decisions and communications are impacting, you know, attorneys and staff, right? That wasn't that, that certainly hasn't always been the case.

Jeff Connor: No, absolutely. There's been a quite a bit of need to know basis and that's changing you know whether it's because when I try to be careful with my generational descriptions, you know, associates coming in nowadays have access to so much more information or used to consuming so much more information that the, you know, put your head down, always be available, stay till 10:00 PM, do your 2400 hours and in eight years you're a partner. That's not really how they're entering law firms nowadays. There's a lot of other concerns. And so, I think there's much more, again, consumption of information, but sort of constant evaluation of where they are, where they expect to be. Is the firm where they're working a place where they can stay a long enough time to fulfill something? Do they view, you know, needing to leave that firm and go do work for a client or a nonprofit and bounce back to the firm at a later stage of their career? You know, those sorts of, again, constant evaluation of where they are in the world and where they are relative to themselves, or their plan, rather. I think that's changed greatly. You know, it's not, to build on the bad metaphor, it's not 30 years in a gold watch anymore. There's so many more opportunities and things and people thinking about their own opportunities that firms have to understand that the expectations are very, very different.

Bill Josten: So, Jeff, one, I think it's fascinating that I'm having a conversation with a CFO that sounds like I'm talking to the head of HR, right? I mean, there's so much talent focus on this and obviously people are your source of production at a law firm, right? They're absolutely inseparable from a firm's ability to do business and make money. But I'm also curious about a couple of the broader economic factors or at least different economic factors and I want to get your perspective on that and one topic that that comes up, but I know it's something we watch very closely within the data sets that we follow within the Thomson Reuters Institute and that's looking at rates and one of the things that we've seen happen this year that we haven't seen happen in a really long time is rates and inflation really have inverted. You know, we used to say, I mean we never really even talked about it because it was just sort of taken for granted that firms had a one to two percentage point advantage over inflation in terms of their rate growth. Rates would grow at between 3% and 4% and inflation was somewhere around 2% and that was just status quo ante, right? That's that was were. And this year it's really flipped. And people are really talking about it because you're not going to be able to drive those agreed rates or those work traits to a point where they're going to have a two-percentage point advantage over inflation. Inflation isn't something we've ever indexed against or anything, but there has to be some thought about that. You know, everything is getting more expensive because of the effect of inflation. That's going to have an impact on you on one, client’s willingness to agree to rate increases and two, the buying power if you will, of those rate increases relative to the broader market. And I'm just wondering how concerned are you about that inversion?

Jeff Connor: Yeah, that that's a great point. And I'll start with this sort of inflation part first about what it means for operating expenses, right? So, we've talked a lot about talent and obviously compensation for talent, but you know, generally things cost more whether that be you know if you need to do a build out, if you need to do some sort of capital purchase in addition to just regular old operating expenses and I think we've learned a lot about opportunities to not overspend on certain things. We've learned that we can do fairly successful business development activities without necessarily traveling as much. I know that's a contentious topic and I'm sure covered in another Thomson Reuters managing partner or Marketing Partner Forum, but you know, maybe there's clients that like the different approach rather than having to swat away, you know, multiple dinner invitations every week and that sort of thing. So, again, do we have to spend as much on business development ss we did in 2018 and 2019? Maybe not. Maybe we just spend more wise, wise dollars. In terms of the rates, just sort of want to come back to that, you're absolutely right on the ability to continue to increase rates. Clients will push back for a variety of reasons. If they want to be really, you know, sharp about it, they'll talk about associate comp and how that is not necessarily their issue. And they're citing the economy, as they should because they have pressures on their revenue and on their spending and outside legal spend for several organizations is a large budget, so they're looking to control that. And I think that means that law firms have to continue to get creative. Obviously, you have rack rates, you have agreed rates as you mentioned, Bill, there's effective rates. And so how does a law firm make a pitch or make an alternative fee arrangement in a way that their effective rate of a law firm is rising, but perhaps the client sees a slower rate of increase on what they're paying? In other words, is the firm more efficient? Can the firm leverage technology? Can the firm and some of this is broken record again, but can the firm staff properly within limits whether that be a limited fixed fee or a limited rate increase that perhaps you've got in a contract with your client for a two or three-year period and gives you some predictability and so it helps the client to be predictable and helps you to be predictable on how you manage that engagement. So, the advantage of rising rates and inflation being, as you say, a couple points below, that is not going to be the case for the next certainly the rest of this year and in probably [20]23 as well and in rate increases and pricing is becoming, I didn't think it could be, but it is becoming even more important than it, than it has been.

Bill Josten: Well, as I look at this Jeff, I've been asked this question a lot in a sort of put on my I'll make a very dated reference here, but put on my Carnac hat and take my best guess. And I sort of see a couple of things and I'd love to have you sort of gut check me on this. In terms of maintaining profitability or improving profitability, you hinted at least you said one thing with efficiency, and I think that billing efficiency is really going to be key understanding where there's leakage or I've coined the term fee erosion. You know the departure from rack rate to collected rate, understanding what happens in that progression, and especially looking at the difference or the delta between the agreed rate and what actually gets built out because a lot of that is within the control of the firm and a lot of what happens there, frankly, based on our research, is done off of gut and it's done out of fear. They're not necessarily leveraging the pricing and project management apparatus at a firm or any sort of data-driven experience. They're looking at it and going, I mean, this is literally in the data that's too expensive, that that's more expensive than I think it should be so I'm just going to pick a number that makes the bill work for the client. So, getting a handle around some of that and improving that efficiency so that one the input more closely matches the output, we do less work we know is going to go unbilled when we do it. And then being OK with billing work out. So, I think efficiency and that type of analysis of fear ocean is going to be key. I think we're also primed for a resurgence of discussion around alternative fee arrangements. You talked about that as well in in the great financial crisis you can go back to 2006 and the term alternative fee arrangement or AFA really didn't exist and by 2012 it was 20% of firm revenue. But then it petered out. You know, it's sort of plateaued there. I think we're poised to have that have that resurgence happen and the third thing I can see happening and we see it already in the data is you know mid-sized law firms that are more cost effective and maybe aren't pushing this larger rate increase, they're actually seeing fairly substantial increases in their what we call fees worked, which is essentially accrual basis revenue because what they're not necessarily gaining in, in rates, they're making up in demand. So, when you take that rate times demand, it's really a volume play for them that's driving them so that their, their revenue expectations much more closely match what, what inflation could potentially be impacting them or how inflation could be impacting them and that's just it's putting them in a little bit better position, but without necessarily focusing on the rate side of things.

Jeff Connor: Yeah, there there's a lot there that you mentioned, and I think that's right. The data showing mid-sized firms gaining or losing at a lower rate than in law 50 and in higher firms I think is definitely a signal of a shift. And whether its clients making that move or whether its midsize firms being more successful and proactive in their pitch, that's definitely happening. From a I want to go back to your erosion idea we at McGuireWoods certainly are aware of those things that happen from time being worked, time being priced, and then how the whip turns into a bill. So, we have a credit category for our attorneys. Don't want to get too much into partner compensation or scorekeeping, but we have a category for matter supervising attorney and we are making sure that that is assigned to someone who understands that role and we're educating senior associates and junior partners exactly on what a matter of supervising attorney should do. They need to know the outside counsel guidelines. They need to be aware of the staffing. They need to have a day-to-day view and we're providing technology to them. Everybody, nothing out of the ordinary. Just dashboards that give them insight on a matter by matter basis. Who's working on it is their time. Are they appropriately spending time on a task that is agreed to in a scope of work? So, we are trying to manage that, that rate erosion as best we can so that we don't end up having to just go by our gut and say that, well, you know, this whip looks too high. I don't want to I want to sidestep any kind of difficult conversation with my client, so I'm just going to take, you know, 10% off and send out the bill, because that that the margins are thin, and the differences can add up quickly. So, we really want to encourage again senior associates and junior partners mostly, but any in any of our lawyers to understand how the engagement should be managed.

Bill Josten: I think that's so smart to be building that type of education and transparency into it because it's so good from a professional development standpoint. I mean, this is something that I've been nerding out on for a decade, and even I like I heard a statistic the other day from a chief innovation officer for a firm actually out of Nova Scotia and he shared that through their analysis, a 10% reduction in the invoice. So, a 10% loss in revenue translated into a 30% loss in profit on a matter. And I'd never thought of it that way. You know, you think that it's probably a one to one, but he showed the math on how it's actually a 3X multiplier. And I was, I was pretty floored by that. You know, that's truly impactful. So that to build that kind of understanding into attorneys, especially as they're coming up through the associate ranks, I think it's going to prepare them to just be better partners and better business managers.

Jeff Connor: Absolutely and I think understanding the law firm at which they work as a business helps them understand their clients' businesses a little bit as well in terms of what kind of multiple there might be in certain things. And yeah, the revenue versus profit multiple that that's we talk about that a lot around budget time and we talk about that a lot when our pricing team is working with partners on a pitch or an RFP response so that they understand little tweaks here and there are meaningful.

Bill Josten: Absolutely. Well, Jeff, we've covered a ton of ground here and touched on a huge variety of topics, and there's obviously the ability for us to go for quite a bit of time on any one of these topics, but unfortunately, we're reaching the end of our time for this particular podcast, but the good news is, and this is going to be the shameless plug part, right? We do have an opportunity with an event that's coming up that's going to address many of these topics with a lot more depth and with some really great subject matter experts, so with that upcoming COO CFO Forum event what sessions are you looking forward to the most?

Jeff Connor: Yeah, I think nothing wrong with the with the plug for sure. I think there's several sessions that are great. I'm very interested in the Thursday session with The Economist Roundtable. I think having assembled a group of experts both in in the field and working in university will give us a lot of, give the attendees a lot of perspective and help us understand a little bit more what we hear on a daily basis in terms of economic news. I think the R&D session about how law firms can actually do research and development and making investments so that some of the efficiencies and knowledge management and other things we talk about is as necessary things in the toolbox, I think that's going to be great. I've a particular interest in the ESG session only because I continue to struggle quite honestly with how to translate ESG into law firms. And so, I'm looking forward to that one. And then the Friday morning political roundtable is great. I'm going to, I'm going to treat it like it's Meet the Press, but happening right in front of me. So, I'm super excited.

Bill Josten: Yeah, I had an opportunity to hear both Eugene Robinson and Bill Kristol speak, actually right prior to the 2016 election, and it is a really fascinating discussion. You know, those two obviously have a lot of experience, so that should be really interesting. And for anybody who's interested, the event that we're talking about is the 21st Annual Law COO CFO Forum being held in New York the 26th, the 28th of October. For more information on that, if you're interested in possibly registering to attend, you can either follow the link that's in the show notes. Or visit us at thomsonreuters.com/institute to get to the institute's website and you'll see an ad for Marketing Partner Forum right there as you scroll down the main page and that'll take you to the registration the agenda. It's really a stellar faculty, Jeff, you're one of the chairs of the event, along with Jim Jones, who's the director for the Center on Ethics and the Legal Profession at the Georgetown University Law School Center and Greta Rusanow, who's the head of advisory services for the law firm group at Citi Private Bank and of course not selling you short at all, Jeff, but Greta and Jim are both just phenomenal experts in in their respective areas and I think the three of you bring a really great guiding insight to that event. I know it's one that I always very much enjoy and get a lot out of.

Jeff Connor: Every time I speak with Jim or Greta individually, and as a bonus, get to speak with them together, I learn a lot.

Bill Josten: Yeah, I have had the pleasure to get to know both of them for a number of years now and they're both just tremendous sources of insights. So, I'm looking forward to, I'm looking forward to seeing all three of you in New York for the event and to the content as well. So, Jeff, thank you so much for your time and your insights here. It's always a pleasure to speak with you. I think you do a really great job of taking that large law firm perspective, but translating it across the market so it relates to all of our customers rather than just the biggest of the big like McGuireWoods. So thanks so much for your time and your help here.

Jeff Connor: Thank you, Bill. Really appreciate the invitation.

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