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Survey suggests that law firm economics may be stabilizing

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The legal industry is not poised to make a miraculous recovery in the immediate future, but for the time being things aren't getting any worse.

That's the gist of the latest Hildebrandt International Peer Monitor Economic Index, which tracked demand for legal services, attorney productivity, billing rates and direct and overhead expenses at large and midsize law firms during the second quarter of 2009.

The index has been on a steady decline since the second quarter of 2008, but it ticked up slightly last quarter — an indication that the economic situation for law firms may be bottoming out.

"The message is that demand is still pretty soft and pricing is still pretty soft, but the management decisions firms have made has helped," said Hildebrandt consultant Lisa Smith. "We're not seeing significant drops anymore, and it seems like we are stabilizing."

Demand for legal services and productivity both remained weak during the second quarter compared to one year earlier but those drop-offs were not as large as they were during the first quarter. For example, productivity was down by 11.5% during the first quarter and just under 9% during the second quarter. Demand for transaction work including corporate, mergers and acquisitions and capital markets was still far below where it was during the second quarter of 2008 but was flat or slightly up compared to the first quarter of 2009.

The biggest element helping law firms compensate for low billing rate growth, slow demand and low productivity was that their cost-cutting measures were paying off, according to the report. For the first time in the four-year history of the index, both direct expenses and overhead expenses at law firms declined. Direct expenses, which primarily refers to compensation, were down by nearly 2% compared to the second quarter of 2008.

"Much of this has been achieved through headcount reduction along with adjustments in compensation structures," the report said.

Law firm headcount fell by 2% during the second quarter, a "slight acceleration" compared to the first quarter, the report said. Due to severance packages and lags in departure times, firms were finally feeling the full effect of the



layoffs that began in late 2008.

Overhead expenses dropped by 0.5% during the second quarter, which indicates that firms have become more successful in controlling their costs, according to the report. The document forecast that both direct and overhead expenses will continue to drop during the second half of 2009, with firms taking even bigger steps to roll back costs.

"The legal industry's success in systematically reducing expenses will give firms greater confidence and leeway in addressing other issues and exploring new approaches to the law firm business model, such as alternative compensation and pricing models, to position themselves for continued success in a low-growth environment," the report said.