

Red paper

Preparing for Economic Recovery

The current question

The important question that we now ask is, have we escaped the worst? Have we endured the recession and survived and will things return to the optimistic, liberal, economically vibrant environment to which we have grown accustomed?

The legal profession faces a period of uncertainty. The transformation that confronts the profession is unprecedented and will lead to unpredictable changes that will require creativity and leadership skills of a kind not traditionally associated with legal practices.

Recovery from economic recession and the imposition of the alternative business structures envisaged by the Legal Service Act will combine around 2011 to inflict an environment in which the old certainties, the status quo ante, will be undermined.

The legal profession will need to learn new techniques of management and adopt new business models.

It will be a period of great challenge.

The recession

The 12 months from September 2008 to August 2009 will be studied for years to come and mythologised by those of us who witnessed the events unfold. There has been no other year like it in three generations.

Optimism, science, economic growth, liberalism, individualism, the idea of progress; these are the secular ideas that lie at the root of western civilisation but they were all shaken to their foundations by the near melt down of the banking system.

The realisation that our society could be so easily destabilised not by war or terrorism but by the collapse of a single component of its superstructure is shocking and the forced recognition that our trust in the resilience of our economic foundation was misplaced is sobering.

We never quite believe in the disaster movie scenario in which the civilised world is brought to the brink of collapse by a single unanticipated event. We're smarter than that, aren't we? We have checks and balances in place, don't we? Well we all thought so!

Perhaps the problems of our banking system have done more to undermine or belief in the superiority of western values than any terrorist group. This was economic self harm and the realisation that being 'in charge' did not mean being in control.

We shall need the perspective of recent history in order to form a view of these events which enables us to set them in a context that fosters the confidence that our financial infrastructure is more resistant to similar systemic failures.

The current question

The important question that we now ask is, have we escaped the worst? Have we endured the recession and survived and will things return to the optimistic, liberal, economically vibrant environment to which we have grown accustomed?

The truth is that that the events of the last year are unprecedented and no one really knows what the after effects will be.

Studies by the IMF¹ reveal that a year before the start of economic contraction most economists predicted the continuation of economic growth and that it was only around 3 months prior to the recession beginning when economist were unified in their view that we faced recession. So we are understandably reluctant to rely on this somewhat discredited profession for reliable forecasts of recovery.

We do know that recessions have different 'shapes'. They are normally described as 'V', 'U', 'W', 'L' and even an inverted square root sign. They also have an internal structure of four phases; decline, early recovery, late recovery, growth.

We have endured the decline and most people think we've reached the lowest point. Market sentiment is optimistic and confidence has replaced despair. We're in early recovery. The notion that the bad times are over and we can look forward to an economic spring has created a euphoria that we would have thought delusional six months ago.

Are we so capricious? I'm afraid the answer is probably yes. Recessions are, in one part, a form of social hysteria both in the decline into gloom and despondency and also in the renewal of optimism that eventually emerges to be followed, in maybe 6 or 7 years time by another period of irrational exuberance and the formation of a new but different bubble that will sow the seeds of the next recession.

¹ International Monetary Fund

This is not pessimism. It is the realistic recognition that our economic life is cyclical and that something deep within its structure and therefore within our psychology causes these events. There are no 'external' factors just our collective behaviour. So, a little like the movie Groundhog Day, we are apparently compelled to live in this cyclical economic world. To some extent we have the tools to delay a recession, as we did in the early 2000's, but at the eventual cost of a more painful adjustment subsequently. The politicians who claimed in the early 2000's that the business cycle had been eradicated were very badly advised and our future political leaders will surely not repeat this error.

A new beginning?

This recession is not the end of western society as we have come to know it. The values of optimism, science, economic growth, liberalism, individualism, the idea of progress will continue to dominate. But the foundations have been shaken and, for a least a generation, we will never be entirely as confident as we were in the possibility of continual growth.

Moreover the economic environment that follows will not be the same as that which preceded the decline. This event was a discontinuity and not a pause.

The phase of early growth is difficult for that reason. We cannot rely on the past to guide us and we cannot predict the future with any confidence. As a result our horizon of expectation remains short. Not quite as close as it was during the phase of decline when survival was the predominant concern but nonetheless we are not yet sufficiently confident to risk the farm on the expectation of uninterrupted economic vigour. Moreover the banks would be unlikely to support such ambition and we may no longer trust them entirely to do the right thing.

How long will the phase of early recovery last? Again no one knows. It may be punctuated by another quarter of economic contraction (the 'W' shape recession), in fact there is probably a 50/50 chance of this occurring in early 2010. Others argue that we will endure a long period (12 months) of little or no growth (something between a 'U' and an 'L' shape). We hope that fiscal stimulus will create a 'V' shape but this seems too good to be true.

The key characteristic of the early growth phase is uncertainty mixed with optimism. The late growth phase remains obscure both in terms of when to expect the transition from one to the other and also in terms of what conditions will be present in late recovery. Our expectation can easily turn into impatience.

It does seem likely that we will know more in the spring of 2010 when the fiscal stimulus that has prevented the continuation of the decline phase will be withdrawn and, just like weaning a patient off drug dependency, we may experience the unpleasant effect of withdrawal. Only then will we begin to learn whether the treatment was a cure or a palliative and whether recovery will be painful

and distant (2012 before we enter the growth phase) or simply uncomfortable but endurable (early 2011 when we enter the growth phase).

2010 will, nonetheless, be a period of greater demand for professional services as companies refinance, damaged survivors are acquired by healthier competitors who have access to capital markets, demand for corporate insolvency advice grows and the improved availability of mortgage finance stimulates a moderate recovery in the domestic property market with the growth in transaction volume exceeding that in value.

Alternative Business Structures (ABS)

For the legal profession the planned introduction the ABS provisions of the Legal Services 2007 Act in 2011 will change the competitive landscape and compound the changes that result from the recovery from recession.

Exactly which new structure will emerge is unclear but that the way legal practices do business will be different is unquestionable. Tesco Law becomes a real possibility.

This paper is not the place to analyse the possibilities in depth but it is necessary to state that any relief felt as a result of the recovery from recession is likely to be replaced by anxiety about managing the uncertainties of change created by the introduction of ABS. Legal practices must adopt new business models, be creative about the services and products they offer, become flexible, imaginative and adaptable. This is a time to embrace change and not for denial based on a misplaced allegiance to a world that is in the process of dissolving.

This is a time for leadership and not for management. The imposition and enforcement of controls remains necessary but the key concept is to allow enough decentralisation to encourage creativity and sufficient control only to ensure consistency.

Flexibility and adaptability are the organisational features that will characterise the successful organisations. It is a time in which being vaguely right is preferable to the tendency to be precisely wrong.

It is a moment to learn new skills and adopt new methods.

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