Definitely Mabey

Increasing law firm profitability—what's working and what's not?

When I advised back in January that I had invited a few folks to write on topics they were both passionate and knowledgeable about, I was hoping that Colin Cameron would be one of those guest columnists. So I am very pleased to say he has graciously agreed to write this month's column.

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While Colin and I come from opposite ends of the country, our passion about and interest in the legal industry are identical. So it was another no-brainer to ask him to do a column on law firm profitability and how firms are striving to achieve their profitability goals in 2012.

*For a brief background, Colin is the founder of **Profits for Partners Management Consulting**, which provides law and other professional service on key aspects related to profitability, including profitability improvement, strategic planning, firm governance, partner compensation, and financial and operational management. He is also the founder and moderator of the LinkedIn discussion group Law Firm Profitability and a chartered accountant who spent 1983 to 2009 as the COO of the law firm Clark Wilson LLP in Vancouver, prior to establishing his consulting practice in 2009. He can be reached by e-mail at **colin@profitsforpartners.co** or telephone at 604-512-8104.*

Leverage

One of the fastest and easiest ways to increase profitability is to increase leverage by moving work down to the most efficient staffing level. I've noticed some firms are adding non-equity partners to increase leverage and profitability, and this is a trend that continues to build. Clients are pushing hard on rates and don't want to pay to train associates. Non-equity partners, by contrast, hit the ground running and don't incur training and supervision costs. Firms don't break even on associates until three to five years of call on average, while non-equity partners are profitable right away.

Other ways to use leverage:

- Large national firms are pushing out underperforming partners with practices that don't meet their minimum size standards, as they continue to lever themselves for maximum profitability.

- Personal-injury firms are outsourcing legal work to India to reduce costs. This is quite a step forward in Canada, where until recently our privacy laws have made law firms hesitate to make this move. If the outsourcing company's servers are based in Canada and the work is being checked by Canadian lawyers, then this option can work well.

- Large national firms have outsourced administrative tasks such as word processing and billing to reduce costs. Many firms are also outsourcing entire facilities-management, technology, and marketing departments to local outside vendors such as Ricoh Co. Ltd. and Pitney Bowes Inc.

Cost containment

“New business-model firms” such as Delegatus services juridiques inc. in Montreal and Cognition LLP in Toronto are effectively acting as outsourced general counsel for large clients. They operate on a virtual basis to contain premises costs and have also stripped down the management infrastructure required to run their operations. Their lawyers spend most of their time at clients' offices, using clients' support staff on files, which helps keep overhead costs down to as much as 50 per cent of the average large firm.

Some firms are getting into project management in a big way, and find that clients are very happy to work with them to reduce their overall legal costs by getting more effective and efficient in how their legal matters are handled. This is a significant trend, and one that some law firms are using as a warm-up to alternative billing.

Centralized management

Firms of all sizes are centralizing their governance systems to increase their efficiency and profitability. By giving managing partners the power to affect partner compensation, these firms allow the managing partners to motivate partners to do non-billable tasks that help to achieve strategic objectives.

"...top-down, centralized management is the most efficient and effective way to manage."

Setting up file-approval systems under the control of a managing partner can lead to significant gains in profitability. In my experience, top-down, centralized management is the most efficient and effective way to manage.

Selecting the right clients is also crucial to becoming more profitable. Successful firms evaluate clients for their profitability, their ability to pay, and their fit with the firm's strategic goals.

Utilization

Some firms are using “full-day” time accounting where lawyers track all non-billable time in addition to billable time. The idea is to get lawyers to account for all of their available time at the office, e.g. eight or 10 hours a day. By having lawyers and staff track all of their time, firms are capturing 10- to 20-per-cent more billable time and adding significantly to profitability as a result.

Firms should also attend to this non-billable information to ensure that their lawyers are not just focusing on the short term and their own billable hours. As management guru David Maister would say, how you spend your non-billable time is where your real profit is in the long term—for instance, your business-development efforts. Tracking lawyers' non-billable time can also reveal whether project-management techniques are working effectively and efficiently.

Another recent innovation is smartphone time-capture technology that allows lawyers to log their time while they work it, rather than afterwards, when their memory is hazy. This is the key to maximizing time-capture percentage.

Strategic planning

Firms that proactively carry out strategic planning are more profitable than firms that don't. Today's highly competitive legal market demands that firms maintain a continuous planning mindset if they want to succeed. In the successful firm, the managing partner takes charge of executing the strategic plan and focuses on getting partners to follow through on their assigned tasks in order to achieve the goals of that plan. The most profitable firms reward partners who complete non-billable tasks and penalize those who don't.

The firms that do the best in today's market are the ones with a tight vision. They keep their team closely focused on the firm's strategic goals, as opposed to taking a silo approach in which everyone operates independently. The days are past when a law firm could make easy money while letting every partner do whatever he or she wanted.

Partner compensation

Your firm will make better profits if it rewards partners for the value they provide to clients rather than if it rewards them only for hours billed. Partners also need to be rewarded for profitable practices, in addition to sheer volume of billings. Those who expend extra effort in the firm's best interests should be rewarded the most, and those who lever work down to others and unselfishly lead their practice groups should get special rewards.

> ***"Your firm will make better profits if it rewards partners for the value they provide to clients rather than if it rewards them only for hours billed."***

Generally speaking, firms with subjective compensation systems are more profitable than formula-based firms. This is because the formulas usually drive partners to focus on personal production, instead of helping grow the whole firm. An eat-what-you-kill approach can stunt the growth and profitability of a firm.

People

Firms with strongly defined core values for their people do better than firms without them. In order to succeed, a firm needs a strong culture, where everyone buys in. This helps it achieve its goals faster, and makes its staff work harder and feel more fulfilled.

As the push to acquire the best talent continues, small firms are capitalizing on opportunities to hire senior partners who are close to retirement and are being pushed out of large firms. Some are leaving early, taking their clients with them, to join small firms and enjoy better work-life balance. This can be a great win-win for both the senior partner and the small firm, as these partners can bring big-firm institutional clients that are coveted by small firms and can significantly increase their profitability.

Colin has provided solid insights on a range of steps firms are taking in order to maintain and grow their profitability in the current legal market. In presenting a selection of alternatives Colin has re-affirmed there are no "cookie-cutter" solutions but rather the approach to profitability needs to be customized to the firm and its culture.

Until next month's column, remember as Herbert Spencer (coiner of the phrase "survival of the fittest") is reported to have said,

"opinion is ultimately determined by feeling and not by intellect."

Comments or Questions?

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