THE PRACTICE

Face It, Firms — The Good Old Days Are History

Client expectations are changed for good, and law firms must adapt to new ways of doing business.

By Vincent M. Bell

The National Law Journal

October 21, 2013

Credit: Paul Dilakian

When the recession started in 2008, most law firms believed that it was another temporary, though serious, industry downturn and that the good times would soon return.

As we now know, it didn't happen.

Initially, firms felt that they could successfully respond to their client requests for cost control by addressing issues only relating to pricing and the staffing of matters, without examining their own internal production costs. It was a short-term solution, which responded only to clients' initial attempts to control their ever increasing legal costs.

The response by law firms was flawed because clients viewed their cost-control demands as ongoing, while law firms had no intention of continuing to lower their pricing, which was only further compressing their margins.

Most firms now recognize that clients were not seeking a one-time, recession-driven reduction, but rather a fundamental redefinition of their ongoing expense relationship with their outside lawyers.

Law firms have learned that they must adapt to a new set of market rules to ensure that they will continue to grow. But the question is: "How?"

What most law firms have not done, but need to do, is systematically analyze their own internal financial procedures and workflows to identify changes that will improve the quality of their legal product and, at the same time, reduce their internal production costs. The changes can be difficult to execute but will give firms an ongoing competitive advantage. Obviously, improved profitability also will make a firm more competitive in tomorrow's search for new clients and new matters from current clients.

IMPROVING PROFITABILITY

Here are some suggestions to improve profitability now and into the future.

Staffing ratios. Rationalizing staffing ratios involves much more than just reducing headcount. Firms must develop a new customized staffing model to provide the support that today's lawyers actually need to be more productive and efficient with lower fixed support costs. Today's young lawyers are completely different from those who started out several generations ago, but firms are still providing them with the same old outmoded secretarial model.

Lawyer-secretary ratios have improved at many firms and are now as high as 8 to 1. But the most innovative firms are experimenting with document support groups that are a combination of secretaries and word processors. The goal is to move away from the old model of fixed secretarial assignments — regardless of the number of lawyers assigned to a secretary — and move toward a group of support professionals who are there to assist the lawyers and maximize their productivity while minimizing the cost of the service.

Billing and collections. Billing and collections optimization will improve process workflows, enabling the firm to bill and collect cash sooner. This approach involves creating flow charts for all financial operations, controlling discounting, improving time entry procedures and compliance, and eliminating as much manual, duplicative work as possible. Firms lose revenue due to billing-rate leakage, such as "informal" discounts and multiple billing rates for the same client. Frequently, the partner fears that the actual amount invested in a matter is more than the client is expecting and willing to pay. This fear leads to the partner's decision to write off time or hold back time before the bill is created. It may also result in yet another discount to get the client to pay.

It is important for firms to be aware of this situation and to have systems in place to monitor and control it. If the firm ignores the leakage, it may be surprised by a drop in its realization rate at the end of their year.

Receivables management. Many law firms are still "managing" their receivables in the same way that they have for decades. This traditional approach involves a frantic collections campaign to bring cash in at the end of the year — cash that, in many cases, was billed six to nine months ago. Such a last-minute approach makes the firm susceptible to additional client discount demands. The best strategy is for firms to have a monthly focus on getting all their time billed, sending the bills to clients and following up on previously billed and now aging receivables. Ideally, the firm should aim to collect 30 percent to 40 percent of its aged receivables on a monthly basis. This goal keeps the amount of uncollected amounts within a reasonable range, and it provides for operating cash.

Larger firms should invest in a collections person or larger staff that can motivate and assist the partners in their monthly efforts. Many lawyers are not comfortable with asking clients for money. A collections person who can call an accounts-payable person at the clients' office can be quite effective.

Every firm, regardless of size, needs its own formal collections program, which holds each partner accountable for collecting invoices. The lawyers did excellent work for their clients, and it is perfectly reasonable to expect to be paid for their work on a timely basis.

AN OPTION FOR SOME

Outsourcing. Firms should consider outsourcing some of their tasks as a good option to reduce expenses. But it's also important to keep in mind that the economic benefits of outsourcing can vary significantly depending on a firm's size and culture. Outsourcing can be very effective at a firm whose culture will accept standardization and is willing to reduce exceptions, but it's not right for every law firm.

Firms of all sizes can outsource in a variety of ways. Many firms have outsourcing companies operate their mail, and their copy and records operations. The workers who perform these functions are employed by the outsourcer, but they generally work on a daily basis in the law firm's offices. The firm pays a monthly fee for these services based upon a contract that defines the headcount and the number of hours worked.

Another option is to have appropriate work done at the outsourcer's site rather than in the firm's offices. Such tasks include word processing, duplication and commodity-type financial operations, such as accounts payable.

In recent years, larger firms have set up their own "captive centers" in less expensive areas of the country. These firms have moved almost all of their back-office operations to these centers and have reduced expenses as a result of lower labor and occupancy costs. In addition, these centers often qualify for tax incentives for the local jobs created.

REDUCED OVERHEAD

Occupancy costs. Occupancy costs represent one of the three major expense categories in every law firm, along with salaries and benefits. One of the most effective long-term ways to improve a firm's profitability is to control and reduce these costs.

If a firm is nearing the end of its lease, it can consider moving to a less expensive building, or negotiating with the current landlord about less expensive space. The strategy is most effective if the market has changed since the firm signed the expiring lease, so that current rental rates are below what it had been paying. As an alternative, the firm can reduce costs by renting fewer square feet from the same landlord. The landlord may be willing to take some of the space back before the lease is up, especially if the landlord can rent at a higher rate than the firm is paying under its lease.

There are ways to lower a firm's occupancy cost per lawyer even though these costs are fixed under the lease. One method for shrinking the cost per lawyer is for a firm to double or even triple the number of junior lawyers in a large office or conference room. Reducing the amount of space allocated to the firm's library and records storage is another option to better use the space. These strategies are most effective when the firm is growing and can then continue expanding without leasing more space.

Firms must be more creative about how they use their space in order to reduce the need for additional space if they are growing or to free up more potential sublet space if they are shrinking.

These suggestions are just some examples of the changes that are part of the professionalization process that all firms must seriously consider in this "new normal" economy. Since the recession, law firms' profitability rules have changed, but if a firm is focused and disciplined, it can improve its financial performance from the inside out.

Vincent M. Bell *is former director of administration in Akin Gump Strauss Hauer & Feld's New York office and is president of Upstream Consulting Group LLC. He was executive director at Moses & Singer and has a Master of Business Administration degree from Fordham University.*