



SIX NEW YEAR'S RESOLUTIONS FOR YOUR LAW FIRM

By Vincent M. Bell

In the spirit of the season, here are six New Year's resolutions that will help your firm improve its profitability. They contain specific and easily applied business suggestions. Three of them are **micro resolutions** relating to specific functions within a law firm that should be examined and improved. The other three are **macro resolutions** that transcend specific internal functions and relate more to the philosophical focus and overall direction of the firm.

THREE MICRO RESOLUTIONS

Seriously Examine Your Cost Structure

It's certainly not coincidental that the three 2014 micro resolutions are all in the financial area. Most firms approach cost control in different ways. Smaller firms have a history of being extremely cost conscious because they automatically question every expenditure. Larger and older firms have an entirely different approach. They essentially ignore expense control except at budget time when it's focused on almost ceremoniously. Another time large firms focus on expense control is when they are not making enough money or because a general economic recession is setting in.

Every firm should go through an annual formal systematic examination of all of their expenses. This process should use zero-based budgeting (ZBB) concepts in order to truly measure whether each expense is necessary and that the amount is appropriate especially during difficult economic times. The difference between ZBB and what is traditionally known as incremental budgeting (IB) is simply that in incremental budgeting, the number that needs to be justified on an annual basis is the variance to the originally budgeted amount. The difference with ZBB is that the entire amount, not just the variance, must be justified and approved annually. The discipline and the benefit of ZBB is that it forces managers to annually review their requests for firm resources by requiring them to review and re-justify their expenses yearly.

Budgeting should be a serious annual financial exercise because since 2008 law firms have encountered strong client resistance to any pricing increases, especially at the billable hour level. Since then, controlling expenses and the resulting cost of legal services has become the most critical variable in a firm's profitability equation.

Bill Monthly and Collect Monthly

This dictum seems so obvious that it is amazing that so few firms actually do it. The legal industry's best practice is to bill all of a month's time at the end of that month and then to render a bill to the client on a monthly basis. There really is no excuse to do it any other way even if the matter is a bill-at-close one. It makes a lot more sense to keep the client up-to-date on a monthly basis about the investment in their matters so that there isn't sticker shock when the final invoice is rendered at the matter's completion.

It seems almost silly to have to say it, but many firms don't seem to understand that you can't collect money from your client until you bill them for your work. If you bill monthly you can quickly get into a monthly collections cycle with your clients. This will dramatically improve the firm's cash flow and reduce your reliance on lines of credit, especially in the first two quarters of your fiscal year.

Stop Discounting

All law firms discount their legal work to some extent though their discounting is usually more than they will admit or, in many cases, even know. If firms are asked whether they in fact discount, their answer would likely be that they do discount but in a very limited way. The obvious problem with discounting is that you realize less revenue for your efforts than would be generally projected in your budget. This issue raises an obvious question which is – why do firms not accurately price their work for their clients? Why do they continue in many cases to overestimate the amount of money that individual clients will be pay for certain types of services? The real answer is that it is simply human nature to overvalue one's own efforts.

The real pernicious nature of discounting is the additional discount creep, such as the informal discounting that takes place after the work is performed and before the client has received the bill. This process is called billing rate leakage. Many partners are not comfortable with billing their clients at their posted rates. They will go through a process of informal discounting before the bill is created, and in many cases, will accede to client's requests for further discounting once the client has received the bill but before the bill is finally paid.

From several perspectives, it is important for a law firm to accurately price its work. The most obvious benefit is that the firm can more accurately project its revenues. Accurate revenue projections lead to better budgets with increased predictive value. In the real world, most firms will continue to discount. But they should seriously consider taking immediate steps as early as possible in 2014 to limit the amount of their discounting.

These three financial resolutions are clearly interrelated, but they will lead to increased profitability if firms follow these them throughout the year.

THREE MACRO RESOLUTIONS

Write and Follow a Realistic Strategic Plan

Strategic plans are probably the most violated set of rules except for posted speed limits. Several decades ago, it became de rigueur for firms of all sizes to develop their own customized strategic plans. Many books were written about how to do strategic plans, many consultants put their kids through college by advising firms on how to create the right strategic plan, but yet everyone continued to “drive above the speed limit.”

It is important for every firm to have a realistic strategic plan which they actually follow. Writing a plan requires that a firm answer a series of important questions about itself, such as: From a practice area point of view, what are your strengths and weaknesses? What are the practice areas that you should invest in over the next five to ten years? Which practice areas should you shrink? Do you have the right mix of lawyers to staff these changes? These are just some examples of the types of questions which must be answered honestly if you are writing a good strategic plan.

If the plan is well conceived and has measurable and achievable goals, then it is a powerful tool that allows firms to achieve their financial and practice growth goals in an organized and predictable manner. A good strategic plan interfaces with your annual budgets and allows you to better plan your expected revenue and future cash needs. Most partners are too busy managing their practices to think about these management questions, but getting the answers right for your firm is essential for stability and future growth. Being financially predictable leads to happy partners and happy partners are a wonderful thing for firm management.

This resolution is difficult because it requires self-discipline. But there is a significant return on its investment for any firm that creates a customized strategic plan that is an effective road map to pilot the firm through difficult economic times.

Become an Entrepreneurial Law Firm

Many managing partners operate their law firms by looking in their rear view mirrors. Tradition – “what we’ve always done” – governs their future actions. When a partner goes “off the reservation” and makes a suggestion that his/her partners think is crazy, the first questions that the other partners ask are: “Who else is doing this? If no one else is doing it, it’s insane for us to do it. If other people are doing it, we need find out how successful it’s been for them before you even think about doing it”. For better or worse, we are not part of an innovative industry. Most firms are unwilling to leave their comfort zone until it is too late. They are trying not to lose, rather than trying to win.

It makes sense to become an entrepreneurial law firm because it will give a clear competitive advantage over other firms with whom you compete. The discipline of being different requires firms to examine alternate approaches to their traditional ways. Some new approaches may fail but others will succeed. But you will only try this approach if you have decided to be more entrepreneurial. If you differentiate yourself from your competitors by providing better legal services in a cost effective way you will achieve an edge which is difficult to compete against.

Question Your Traditions

This resolution is very similar to the previous one but there is one major difference. Deciding to become an entrepreneurial law firm is really an external strategy; it speaks to how you interact with the external marketplace. It's about how you are interacting with your clients and with the outside world and how you respond to external changes. Questioning your traditions is an internal discussion that has to take place between the partners within the firm. One of the major obstacles to effective change and growth for law firms of all sizes is the fact that they are hobbled by their own specific and subjective traditions that have governed the behavior of the firm over decades. It is very important to respect a firm's tradition, but it is dangerous for a firm not to change internally in response to changes in the external business environment.

Firms need to take a hard look at the present value of their traditions and keep the ones that are still effective by helping the firm to be profitable and productive. They need to replace the traditions that have become ineffective with new approaches to dealing with those issues so that the firm can grow its business and maintain its profitability. For example, firms must develop new compensation models that encourage cross-selling. An endless discussion at partner meetings about the value of cross-selling hasn't changed their behavior. Lawyers by training prefer to work alone, but one of the best ways to respond to client's demands for cost control is to structure teams that can do the work faster and more efficiently.

If you decide to make one or more of these resolutions, I am confident that 2014 will be a better year financially for your firm. It can be a year during which you begin to gain the upper hand in this very difficult "new normal" economy.



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Upstream Consulting Group provides law firms with strategic financial and operational consulting to improve profitability and facilitate growth.