RUN, FD, RUN!

Be the first on the front line for the upturn

By **Tony Williams**.

In the past 12 to 18 months, the leadership of many law firms has been tested in a way that has never occurred in the past. The speed and severity of the market disruption caused activity in many transactional areas to collapse. For most firms, the usually countercyclical areas, such as litigation and insolvency, have not grown sufficiently to counteract the impact of the fall-off in transactional work. Profits for many firms have fallen dramatically, cashflow has been constrained and bankers have proved to be fair weather friends. Firms have needed to address the difficult issues of restructuring the business and redundancy programmes of both their lawyers and support staff. Partner performance has also received an unprecedented level of attention with many partners being asked to leave their firms or accept a significantly different status.

Even now, it is unclear how sustained and rapid the general economic recovery will be and how soon it will translate into new transactional and other work for lawyers. In addition to the issue of overcapacity, firms have to come to terms with clients demanding more competitive and innovative approaches to billing.

Given the raft of issues the leadership has faced and will face over the next few years, it may appear fanciful to suggest that we could be entering the best of times for law firm leadership. Leaders who have earned their credibility during the first stage of the downturn have a golden opportunity to refocus and reposition their firms in ways that they would not have thought feasible two years ago. Leadership has an unprecedented level of permission to effect change. Only very few will have the courage and vision to grasp this opportunity.

So, what should the leadership be doing now?

Where is your firm positioned?

Take a hard and realistic look at where your firm is positioned as against its competitors, whether in terms of geographic coverage, practice strength, industry sector expertise and client service. Now is the time to seriously address these issues. Laterals, teams and merger opportunities are available in unprecedented numbers. Care will be needed, a rigorous approach is necessary and extensive due diligence is essential, but some good talent is and will be available for a number of reasons. Firms need to prioritise the areas of growth and can only hope to get partner buy-in for very limited investments. A clear strategy and detailed business case will be needed, but these provide a great opportunity to start to reposition a firm for the better. It is also necessary to look at your own bench of talent. Is there better talent available that, if hired, would be able to replace all or part of your current team? Not an easy process, but potentially an outstanding opportunity to upgrade the firm's 'gene pool'.

It's the clients stupid!

Many clients are facing unprecedented pressure. Some will not survive; they will either become insolvent or be taken over. Firms need to get as close as possible to their clients, listen to their issues and concerns and respond with constructive and innovative solutions.

Many general counsel have had their legal teams cut and their external budget severely restricted. Their workload, however, is increasing. They have to do more for less and make their spending more predictable so that they keep within their quarterly and annual budgets. They are bored and cynical of lawyers who say they know about their business, are responsive and cost-conscious, but then never enquire about their issues, suggest innovative solutions or propose (without being asked) ways in which legal fees can be saved.

Many large clients have traditionally been very poor buyers of legal services. In an era of undersupply of top quality lawyers, this was perhaps understandable. With the financial pressures on clients, and the current oversupply of top quality lawyers, they can expect and demand what they want. Panel reviews will be more rigorous – a place on a panel will merely be a prequalification to be considered for work, not a preordained right to a share of the client's legal spend. Pricing pressure will continue even once on the panel, as clients look for certainty and cost reductions.

Leaders need to meet with a range of the firm's major clients to understand their issues and how their firm really performs, to learn what concerns the client and to think how the firm can really help. This first-hand contact is not only essential when formulating the firm's strategy, but gives the leadership a level of direct experience and credibility when addressing these issues and any necessary remedial action with practice groups, client relationship partners or teams and individual partners. Any law firm strategy has to be focused on the clients the firm has and wants to have in the future. Only by understanding their issues can a strategy be real, rather than an academic exercise dreamt up by a management consultant.

Partners

Many firms have seriously addressed partner performance in the past year and have exited a significant number of partners or revised their status. Unfortunately, many other firms have been too timid or have ducked the issue altogether. These are difficult issues to address, especially for the leadership who may have known the relevant partners for more than 20 years.

Firms do, however, need to make clear what is expected from a partner in the firm. Woolly language should be avoided – use clear and precise language, and, where possible, measurable criteria. What are the consequences of failure? What time is permitted for remedial action and what support internally and externally will be provided? If the remuneration system is flexible enough, a significant number of partner departures are avoided. Leaders often kid themselves that they are the only ones in the firm who know who the underperformers are. If they ever asked the trainees or secretaries they would get a surprisingly consistent and insightful list. Accordingly, some partner departures can actually lift morale in the firm as the leadership is seen to be fair and decisive rather than protecting its own cronies.

Lawyers

Many lawyers will be very insecure about their jobs. Some will already be working a four-day week. You cannot give them false promises, but you must ensure that work is pushed down to the appropriate level of lawyer, not only to provide a cost-effective service to clients, but also to ensure that the lawyers gain the appropriate experience and are kept motivated.

Partners and more senior lawyers will need far more face time with their clients and prospects. Some clients will welcome secondees. But consider carefully who you will send – they will be an ambassador for your firm. Don't send someone you do not intend to keep as otherwise you will damage not enhance the client relationship.

Support services

In the good times, the size and cost of a firm's support teams often becomes bloated. Don't cut indiscriminately – consider what is needed for your business and what adds value (or avoids costs) and restructure accordingly. Is some degree of outsourcing appropriate or desirable? Give the support teams clear objectives, appraisals and goals. In many cases you will find you have able and motivated talent that is not being properly utilised, and if you explain what you want and why, the improvement in performance can be substantial.

Pricing

Given the clients increased focus on pricing, this is now a hot topic for many law firms. Disappointingly, many pricing decisions are made without any consideration of the effect on a firm's profitability and whether the proposed pricing structure meets the clients' needs. It is essential that you prepare a range of robust profitability models capable of showing the underlying profitability of practice groups, teams, individual partners, client relationships and even individual matters. Some of these models may, initially, be imperfect, but it is essential that individual partners understand the profitability of work that they do, not just the top-line revenue generated.

By way of example, if a firm is used to 90 per cent utilisation and 90 per cent recovery of guideline rates, that produces a profit margin of 25 per cent. If utilisation drops to 80 per cent and recovery also drops to 80 per cent, then the profit margin will be down to eight per cent or down two thirds. Currently, a significant number of firms are pitching for work at significantly less than 80 per cent of guideline rates. These models provide a great opportunity to examine all parts of the practice and to compare levels of profitability.

When this exercise is done, often the noisiest part of the firm is found not to be the most profitable! This review will enable you to focus investment in areas that will produce the highest return and will identify other areas where remedial action is clearly necessary.

Cash is king

Firms are at last starting to understand the importance of cash in the bank. With the banks reluctant to increase

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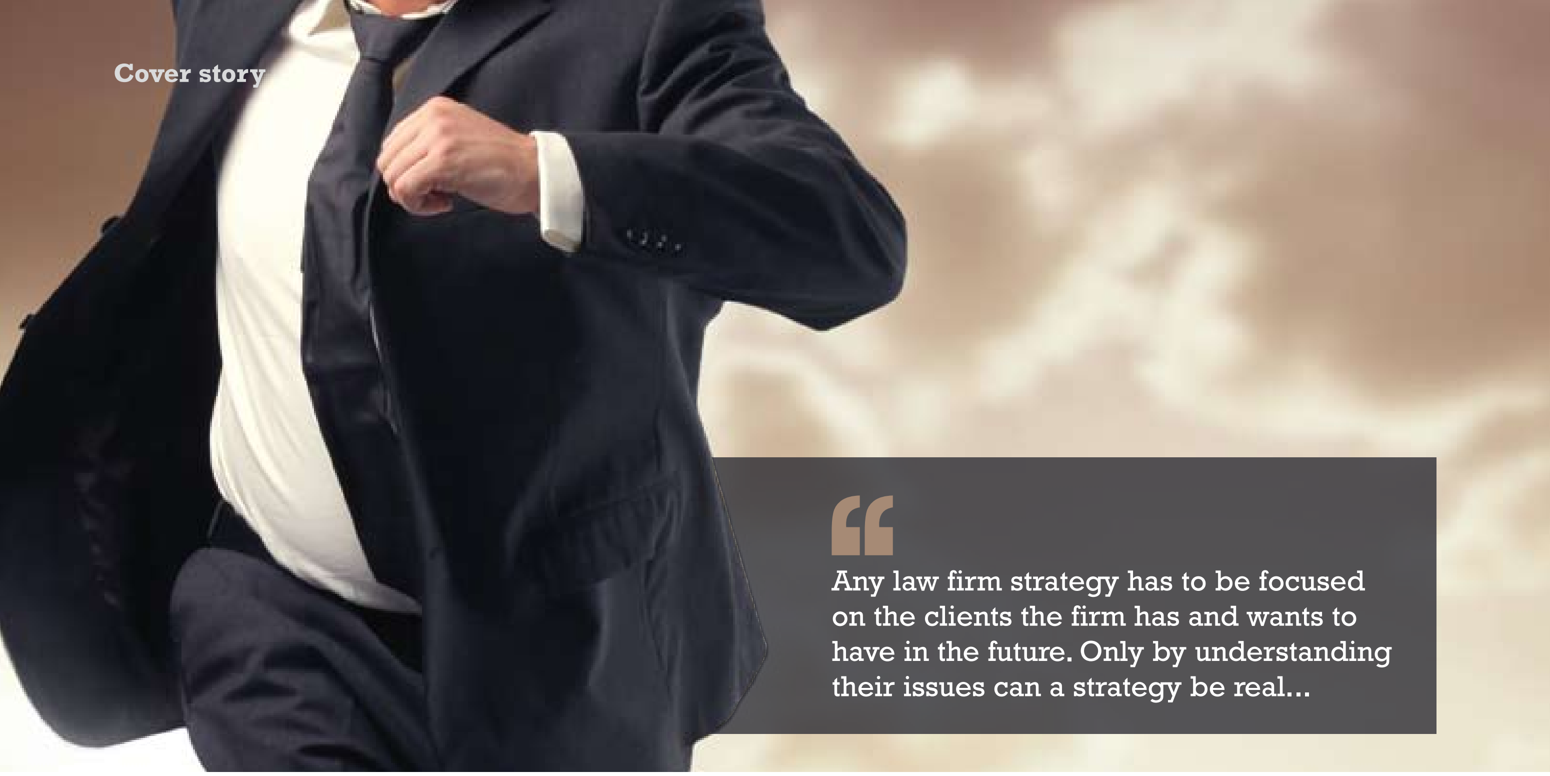

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their exposure to law firms (and where they do they want arrangement fees and higher margins), there is a clear need to conserve cash. With profits (and the partner tax reserve) reduced, there is also less working capital available in the form of undistributed profits.

You now have an opportunity to ensure that cash management is taken seriously. The terms agreed with clients should be strictly adhered to. If monthly billing is agreed, the bill for one month should be issued on the first working day of the next month. If a specified bill format or supporting information has been agreed, it should be sent with the bill so that it is fully compliant and not rejected after sitting on the client's desk for two months. Those responsible for billing and credit control should have copies of all engagement terms so that a partner is presented with a compliant bill for sending out at the right time. Any queries must be logged and dealt with by return. There must be a clear bill chasing mechanism as clients want to conserve their cash too and many will not pay until chased hard. This may all sound like common sense, but to-date it has not been common in most law firms.

But it is not just 'cash in' that needs to be controlled. 'Cash out' also needs to be subject to a strict regime. What terms have been agreed with our suppliers? Do we pay too early? Are their bills compliant with our contract? Can we renegotiate the price and payment terms? Do we need so many software licences? Should we put certain supplies out to tender? Some of this may sound like small beer, but benefits in both cashflow and profitability can be material.

Finally, in relation to cash flow, you need to prepare robust cashflow projections over at least the next 18 months. They probably need to be flexed on a good, budget and worst case basis. The leadership will need to agree action points if the worst case is being hit, which may include delaying partner profit distributions, a partner capital call, further cost reductions and considering other sources of bank debt. The obvious pinch points of the end of January and July, when large tax payments are due and the normal quarter days for rental payments, need particular attention.

It's a business – so run it

In many law firms, we have enjoyed a 16-year bull run with a blip after 9/11. Revenue and profits have increased year-on-year, and many have developed a sense of entitlement that this should continue. Accordingly, for many firms and even more partners, 2008/9 was something of a rude awakening. However quickly markets recover, we have no real idea what 'normal' will look like in two or three years time. Law firms are now large and more complex businesses – they have a high fixed-cost base. Many clients are encountering an unprecedented period of change. In such a market, the leadership of law firms can clearly demonstrate their value. They will have to make some tough decisions, they will often become unpopular. But, if they show the ability, vision and energy necessary, they can lead their firms if not to the Promised Land then to a market position that is both profitable and sustainable.

Will it be easy? No. But it will be clear to see, in two or three years, which firms had such leaders. FD*Legal*

Tony Williams is principal of Jomati Consultants. He can be contacted at tony.williams@jomati.com