

“Achieving the Objectives of Improved Efficiency and Profitability of Law Firms”

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President, ladies and gentlemen It gives me great pleasure to have accepted your kind invitation to speak at your conference in my role as Chair of the Law Management Section of the Law Society of England & Wales. It only increases my pleasure to add that some of you will also know me as a Past President of the Devon & Somerset Law Society, a huge supporter of the work of the FBE, and of course the Law Society of your Past President Michael Cosgrave, and your current Vice President (at least until tomorrow !) Rod Mole.

Professor Richard Susskind has of course just set out his vision of tomorrow's lawyers in a differentiated legal services market. I will now look at some of the ways that law firms can improve their efficiency and profitability in the more immediate term.

Before moving on to some positive messages about steps that firms can take to improve their performance it is important to understand the reality of the current situation that law practices are facing. I apologise for the fact that some of my observations will concern events in England but the generality of my comments will affect the vast majority of the Bars and practices represented in this room.

What we are seeing world wide is a rising number of failing firms – in the UK we have seen some major practices collapse – Halliwells, Blakemores, Cobbetts, to name but a few – substantial regional practices – and of course many smaller practices are failing as well. The key factor that is killing firms at the current time is debt – and if a firm is too debt laden then that affects their decision making process.

In England the Solicitors' Regulation Authority (the SRA) is taking a much tougher stance on financial due diligence – it is being much more aggressive in the pursuit of firms that they consider to be “financially at risk”. There is also the reality of the reduced appetite of banks and third party funders to provide finance to law firms – they are taking a very much closer look at what they will fund. So, if the SRA doesn't get you, then the bank may well!

Of course there are some key differences between the most recent or current financial crisis and previous recessions. Firstly, interest rates, which have previously been very high during recessions, have been extraordinarily low – resulting in reduced client account interest receipts for firms – in 2007 firms in England were generating 6.9% of their turnover in interest – that figure is now 0.9%. Secondly, the age profile of lawyers has changed. Everyone is working longer – senior lawyers aren't retiring – the average age of a partner is now 58. Thirdly, we are now operating in an oversupplied market – there are tens of thousands more lawyers than before. On the subject of over capacity it is worth noting the current position in England. There are currently some 150,000 practising lawyers, 120,000 of them qualified. At the same time, there are currently 25,000 people in law school or reading law at university. These people will be emerging from their training with big personal debts and will be looking for jobs. But, to see the scale of the problem it is

Firstly - Utilisation – what percentage of their target chargeable hours of time recording is each individual or department achieving?

Secondly - Value of time written off – once the management of a firm starts focusing on utilisation one of the dangers is that lawyers start over time recording, hitting much better utilisation, and then writing off the time. So report this along with utilisation and make it one of the areas considered and reviewed within each team.

Thirdly - Average hourly fee – having worked out each individual or department's actual chargeable hours divide this into the fees in order to calculate the average hourly rate – this is often a very interesting figure – frequently below the level of hourly rate that you would expect.

Fourthly – Departmental gross margin – this is calculated by taking each department's fees and deducting the cost of producing those fees – the salaries of the fee earners and support staff in the team and also factoring in a notional salary for each equity partner. The salaries of central support staff and other overheads should not be included. A reasonable gross profit margin to which to aspire would be 60%.

Fifthly - Debtor days by team or department – this is much more useful than overall firm wide debtor days and gives the management team a much better idea of what is really going on.

Sixthly and finally – work in progress days – which provide an idea of what is in the pipeline and is there to be billed. Some lawyers will be good at billing work in progress but many are poor.

These are key areas to concentrate on and by understanding the figures and keeping them under review you are likely to see an improvement. By concentrating on a small number of figures in this way it is possible to overcome lawyers' inherent dislike of looking at figures! It is also possible to create a mini profit and loss account for each individual lawyer, showing their utilisation (time recording) figure and their fees billed, then deducting their salary cost, plus that of their secretary and then their share of central cost, which will leave their personal profit or loss figure. Sharing this information makes it much easier for the individual lawyer to understand their own performance and also makes it easier to tackle underperformance at an early stage.

On the subject of underperformance it is important to recognise that underperformers can bring a firm down if issues are not addressed in good time. When the majority of lawyers are working hard it is quite unfair if their efforts are undermined by others. The firms' high performers are also the ones who can most easily find opportunities elsewhere, if they decide to leave because of their perception of unfairness. It is therefore an imperative, and not a luxury, to tackle underperformance. Generally firms are too "nice" and they need to toughen up. To remedy underperformance start with measures to improve performance and then assist with coaching or mentoring if that is appropriate – such investment can often pay dividends, but if there is no improvement then a dismissal is the usual last resort –

I have some tips with regard to cash flow in the context of pricing. If the client pushes you to agree a discount, then insist on payment upfront to aid cash flow – you’ll be surprised that clients will do anything you ask in order to secure a discount. In fact money on account or up front should be the default position with regard to costs. The number one complaint from clients is the failure to inform with regard to costs – if you take some money up front at the start of the matter, and bill regularly, then there’ll never be a nasty shock. Accelerated cash flow is aided by faster billing – monthly wherever possible, and prompt closure of files. Bills must be payable on receipt, and, particularly with corporate clients, engage with the client to understand their payment cycle so you can time the submission of your bills accordingly. And of course a tight credit control procedure is a must – don’t take any notice of the partner who says that you can’t chase a payment from their “very good” client – a client who doesn’t pay his bills is not a “good” client!

Firms must improve their cash management and understand that the client to cash cycle starts at the time of the first conversation with a potential client, so at the commencement of any matter concentrate on the terms of engagement by ensuring that matters of financial administration are well covered from the outset. It is an old truism that the best way of improving working capital is from within the firm rather than from external cash injections, so all efforts to improve and speed up the client to cash cycle are worth heavy investment.

One issue that affects profitability and the cash cycle is delay. The quicker a case is completed, the quicker the firm will be paid. In my view firms should pay attention to the optimum workloads of a lawyer in any given work type. Work and payment cycles will speed up with more manageable workloads. But beware the behavioural aspect of lawyers, particularly partners, tending to “hog” work which ought to be delegated or referred – this is often at the expense of achieving efficiency – if firms are to become truly efficient in the way matters are handled then their leaders must, sensitively but firmly, tackle work-hogging tendencies within the firm.

Firms should also be prepared to walk away from unprofitable work. The tendency is to take on more and more work, but as I have already mentioned efficiency is realised through a manageable workload. Lawyers who take on work outside their specialist area are unlikely to work profitably and may well end up with a negligence claim and a damaged reputation. And poor quality work should be pruned wherever possible. Knowing where your profit is generated allows an informed view as to what work should be undertaken. Many practices find that the Pareto principle applies whereby 80% of profit is generated from 20% of clients and that an annual review of clients and work undertaken serves to significantly improve overall profitability.

I have spoken a lot about improving the income generation side of the business, but of course controlling expenses also improves profitability. The job of controlling the firm’s overheads is never ending! It is not enough to say that the firm went through a cost saving exercise last year, or the year before, so this does not need to be revisited. Overheads need constant attention. Staff costs remain the highest element of expenditure in law firms, frequently around half of turnover. Law firms must have regard to their support staff to lawyer ratio and be working continuously to achieve efficiencies. Increasing numbers of