Growing Your Law Practice in Tough Times

Edward Poll
J.D., M.B.A., CMC

e-mail copyright.west@thomsonreuters.com or fax (651) 687-7551

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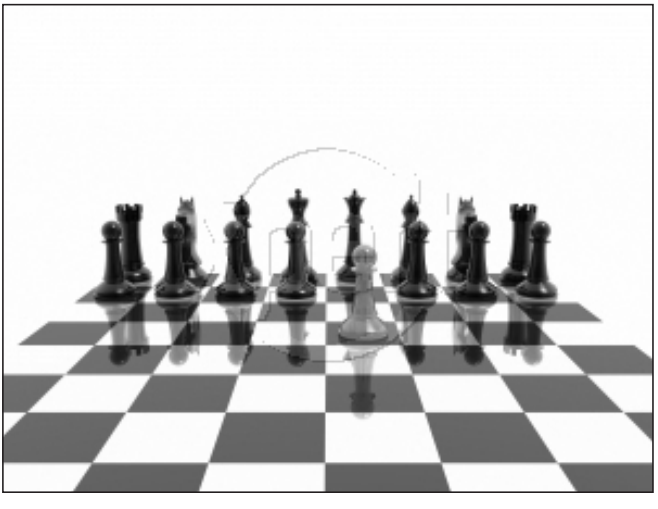

Taking a Fresh Look at How to Stay Viable

Law firms are no strangers to the boom-and-bust cycles of the marketplace. Today is an enormous case in point. Not long ago, the attention of the legal profession seemed fixed on million-dollar profits per partner and starting associate salaries of $160,000 per year. Then came the headlines about associate and staff layoffs, the de-equitization or demotion of underperforming partners, and the postponed hirings of new law school graduates. Compounding the problems, frenzied mergers, lateral hiring, and law school recruiting from prior years gave many firms overly high headcounts just as demands for legal services turned soft. Of course, smaller firms and solo practices tend to face the lean times more frequently, sometimes more than once a year, so a challenging economy for bigger firms is often what smaller firms consider business as usual.

"We must all obey the great law of change. It is the most powerful law of nature." – Edmund Burke

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Nonetheless, no law practice—regardless of its size—is immune from the economic and market cycles of today and years to come. That is why every firm needs a strategy for staying viable in the face of changing times. As we've learned through the years by watching the collapse of many venerated and long-established law practices, you have to keep a constant eye on the business fundamentals of the firm, whether the broader economy is at its bottom or at its zenith. Consequently, law practices everywhere will have

to reexamine how they currently operate and how they can adapt to meet the challenges and opportunities of the new economy.

What defines how a law firm operates, or, put more generally, what will drive many of its business decisions as it sets goals and makes plans for how to adapt? There are numerous factors, some tangible and others nearly intangible, but the following points highlight some of the more salient factors.

The Size of the Firm

Size is one of the key distinctions among law firms, which range from international or multioffice "BigLaw" ones to midsize regional firms and on to small or solo practices. There are advantages and disadvantages to each.

Pros for larger firms include working for larger clients who tend to have more sophisticated matters or bet-the-company litigations, so the lawyers in this environment tend to earn more money. Evidence the many million-dollar BigLaw partners. On the other hand, large firms are currently facing a perfect storm shaped by the economy, if you will, in which finance, transactional, and litigation work have turned downward with few offsetting increases elsewhere. In addition, even in the best of times, lawyers in the large-firm environment often feel isolated, with the firm being little more than a hotel for solo practitioners.

Many regional midsize firms seem to be doing rather well in the current economy, since they have less bloated operating costs than the big firms, but still have enough lawyers in the firm to put together cross-practice teams to service client matters. However, midsize firms often seem constrained, as they are too small to be free from competitive pressure or "raiding" of talent by larger firms, and too small to be competitive for the better, more lucrative larger matters and clients. At the same time, they are too large to have the "turn on the dime" mentality of smaller practices. So, these firms frequently feel in "never-never" land and usually seek to grow larger.

Small firms, including solo practices, typically have talent challenges. As most are generalists, it means that there are always knowledge gaps, that you have to learn more new law and processes to handle each new matter; seldom do you have the opportunity to do the same case or matter over and over until you become recognized as the expert at what you do. Thus, these practitioners can't usually charge the higher fees, and they also tend to write off more billings than large firm lawyers do. The net result is that small firm lawyers tend to have lower realization rates on their work, as they don't bill for all their time expended, let alone collect all they bill.

On the other hand, benefits that are usually raised for the small firm lawyer are the ability to work fewer hours, to have a closer relationship with clients, and to have a better work-life balance.

Lawyers, in big and small firms, work long hours. But in smaller firms, the longer hours are the result of the needs of the clients, rather than the requirements of the firm to reach a certain billable-hours level. In the small firm, the success or failure of the lawyer is dependent on the client's reaction to the lawyer. In the larger firm, that is also true, but with the added layer of firm management's reaction to the lawyer (office politics). Solo practitioners especially have the freedom to do what they want to do when they want to do it. However, every lawyer is subject to the needs and whims of clients. While lawyers may desire to grow their practices by adding partners if they deem it will provide more financial stability in the future, many solo practitioners are happy just the way they are.

Practice Areas: Full-Service versus Boutique Services

Law firms are also distinguished by the types of services they provide, of course. In the main, they can generally be defined as either boutique practices or full-service firms. Full-service firms are able to provide a variety of services to clients that extend across multiple practice areas and industries. And I will note that while most lawyers have heard the phrase "specialize or die" in recent years, I do not believe that is true—in fact, I have seen many instances where the generalist firms have actually survived *and* thrived because they were able to adapt to a changing market.

On the other hand, when a particular practice area is "hot" and the firm is a boutique specializing in that area, it may be better

able to differentiate itself in the eyes of its market and do far better than a full-service firm will do in attracting those particular clients. Examples of fields in which boutiques appear are intellectual property, immigration, litigation, family law, and labor and employment, among other practice areas. While many of them tend toward the smaller size, there are also a number of boutiques that are quite large, some with hundreds of lawyers. Thus, being a boutique doesn't necessarily mean that the firm has only a handful or fewer lawyers.

Yet another way to couch the type of law involved in the practice is to quantify which areas provide the most work to the firm, where the firm works in more than one area but isn't exactly "full-service." For example, you might do, or aspire to do, litigation work at 30 percent, real estate at 20 percent, corporate and transactional at 35 percent, and so on for the balance. In this model, you have specific goals for doing work in specific practice areas.

Thus, to adapt the type of law you practice to the changing needs of the market, you could take one of these approaches: Either watch the market like a hawk and change your practice area when the one you are practicing in declines; or be a larger firm with numerous practice areas where lawyers can shift from one practice area to another within the firm as the need arises; or be a general services firm while marketing one, or only a few, specialty areas to differentiate your firm.

The Firm's Compensation System

In most law firm partnerships, compensation is based on how much work the individual lawyers bring into the office (their books of business) as well as what the lawyer bills (and the firm then collects). This is often referred to as the "eat what you kill" system. In addition, if a lawyer is a genuine rainmaker and responsible for a large book of business, he or she may receive a higher compensation irrespective of how many hours are billed by this lawyer. This system has its benefits, in that it is good for promoting business development and spurring entrepreneurship—but it is not good for cross-selling services and promoting firm harmony.

And there is this aspect to consider: Most partners are, understandably, concerned with how much they take home. Thus, there may be little, if any, left over in a capital account in these firms after the partners take their draws. However, if there is a dip in revenue at the beginning of the next annual period, there is a danger point. The result at that point is the firm needs to be far more aggressive in marketing, or in getting a line of credit to pay lawyer draws and staff payroll, or in decreasing draws (something most partners will not want to do).

For associates, the best-known compensation model, at least in larger firms, is called the "lockstep model." This is where associates are paid a given amount of money based on their number of years out of law school, with all associates in their "class," or hiring year, receiving the same pay as they move up levels in the

firm. Lockstep, however, is often bad at rewarding exceptional performers and penalizing subpar performers—which explains why more firms are moving away from this model today, seeking to pay based on merit instead.

Then there are the firms that base their lawyers' compensation on the team approach—meaning how much the given team works, bills and collects, and then the firm divides the team compensation on a predetermined formula. This is akin to the corporate model which says that compensation is paid based on what is generated for *the organization*—not for any one individual. Ultimately, promoting teamwork and cooperation between its lawyers can help any firm increase revenue. However, promoting the kind of team effort that increases collections requires changing to a more cooperative corporate compensation model that depends on the *entire* organization's success.

Another way in which compensation ties to the promotion of the organization as a team relates to whether lawyers in the firm know what *other* lawyers in the firm earn. At first blush, "transparency" in this area might seem like a good thing in that regard. However, in firms where everyone knows the compensation of others, the tendency is that lawyers will be concerned whether someone down the hall makes a few dollars more which can create bad feelings within the firm as well as the inclination to move to another firm for a relatively few dollars more. In firms where compensation is completely confidential, on the other hand, expe-

rience indicates that the focus is on one's own opinion about the value of his or her contribution to the firm, not on the compensation of others in the firm.

There are, of course, various formulae for determining compensation based on a firm's size and culture. The system needs to recognize that people respond to what they're rewarded for. One might suggest, however, that it's not important *what* formula is used as long as all involved perceive that the process of determining the numbers is fair.

The Firm's Approach to Fees and Billing

Another element that distinguishes how firms operate is the way in which they charge for their services—as in, are the fees based on hourly billing, contingent fee billing, alternative billing methods (which would include value billing), or some combination of these methods? Most lawyers today still charge clients by the hour, so their billings are essentially "features" lists: This is what I did, this is the amount of time it took to do it, and this is what you owe me. However, as many sources are reporting today, that approach can breed dissatisfaction among clients because it doesn't address value and benefits—the worth to the client, as opposed to the cost of the service. Hence, all types of law practices are increasingly looking at how to address that concern.

There are already a number of practices that do only contingent fee billing. The types of practices where you find this billing approach include personal injury, mass torts, and debt collection firms. Also, some other practices use part of the contingency model, such as a reduced hourly rate coupled with a percentage if the result exceeds expectations. Or, as an example of another variation, in defending an insurance carrier the lawyer might charge a low hourly fee, with a bonus paid if there is a defense verdict, defined as a result that is less than the carrier's reserve for the matter.

Yet another billing approach is the flat or fixed fee, negotiated at the front end of the engagement. Here, the law firm is well advised to know its cost of operation before entering into discussions with a prospective client. Having had previous experience with similar matters goes a long way in setting a realistic fee. Likewise, preparing a budget (or forecast) of events, time, and costs also is important to be more assured of payment in accord with the engagement agreement.

A variation of this is "value billing," in which the firm bills the client but allows the client to increase or decrease the bill based on the client's perception of the quality of service delivered to the client. This approach takes a great deal of trust, candor, and collaboration between lawyer and client in order to work well. (Pricing methods and budgeting in collaboration with clients are discussed in greater detail in later chapters.)

Since there is much discussion about client dissatisfaction with hourly billing, more firms will have to address it, as they consider how they will operate in the months and years ahead. Yet at this point, I believe that true value billing is still a distant dream for most law practices. Clients typically don't know enough to fairly evaluate the lawyer's performance and therefore cannot properly evaluate what the fee should be—that's why I say that this process will work only with the openness, candor, and trust levels being high between lawyer and client.

Sustaining Economic Well-Being: The Three Core Elements

As noted at the outset, there will be other factors that drive the business planning and decision-making processes in any particular firm as it explores whether, and how, to adapt. The challenge for all law practices, however, is to build a practice using an operational model that works for your comfort zone and your economic well-being. Simultaneously, it is essential to realize we can make our future happen to a far greater degree than we think is possible—and that we actually have the ability to decide what model we want to operate under.

This requires a hard look at the basic business equation, which is: Profitability (P) = Revenues (R) – Expenses (E). Most firms today are looking at the E because they feel they have more control over this area. However, in the professional services arena, which is where law firms live, you get more bottom-line benefit by increas-

ing your revenue by a dollar than by decreasing expenses by a like amount. It's nice not to pay too much—but it is even nicer and far more effective on a long-term basis when you increase the revenue side of the equation.

How do firms do that? To the extent that law firms provide the services their clients need, in ways that add value and efficiency, at a price the clients are willing to pay, firms will grow their profits. Otherwise, they will be challenged to stay in business. And make no mistake about it, every law firm *is* a business. And every business has three common elements: (1) getting the work, (2) doing the work, and (3) getting paid—all indisputable elements of surviving and thriving under any economy, be it boom or bust. And all require behaving in a businesslike way, which begins with setting goals and having a proper business plan. Let's turn to that subject next.