



## STAYING OUT OF THE RED

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*A general economic recovery will not be sufficient to assure that your firm returns to a healthy, profitable state. Here are some suggested strategic steps to help nourish profitability at your firm*

Although the economy is slowly turning around, it will be a long time before the majority of law firms feels the change. Most firms experience a delayed impact to marketplace changes. For this reason, many law firms were not immediately impacted when the economy took a nosedive. Ultimately, with narrow practice-area exceptions, the economic downturn took its toll on law firms of all sizes.

Some firms faced the downturn proactively by implementing strategic initiatives to maintain profitability. The majority of those were able to weather the storm and will emerge faster and healthier as the economy sluggishly inches out of the pit. Many of the strategies employed were not pleasant. But they were necessary and effective.

Most firms were predictably reactive instead of proactive. And that delay in taking action increased the financial pain considerably. For some firms, it spelled a death knoll. Each of us can name at least two or three firms that vanished ingloriously during the depths of the downturn. And the fallout has not yet settled.

Thousands of lawyers cast out from large firms struggled to set up solo practices to create a new source of income. Struggling solos closed up practices at record rates, becoming affiliated with larger firms. Small and mid-size firms merged to gain what they hoped would be economy of scale savings and cross-marketing opportunities for all.

No doubt about it, the past few years have been extraordinarily challenging for lawyers and firms. But here's the rub: Our marketplace will never return to where it was. So for those of you who have been hanging on by a thinning thread, trying to avoid making changes at your firm, it's time to recognize that if you don't think and act strategically now, you may not survive in the new "recovered"

economy. And for those of you who have taken modest belt-tightening actions, you're going to find that you've not done nearly enough.

Here are my top suggestions for strategic actions to take now. Not all strategies will apply or work for all size firms, but I have included some strategies for each size firm.

### **Reductions**

First on the list has to be improving utilization. We all observed the massive layoffs at large and mid-size firms. Some firms, mostly large, were smart enough to anticipate that there would be a sharp fall-off in utilization. Too many lawyers and too little work leads to a drop in billable hours and a major hit to profitability and compensation for owners. It becomes critical to spread the same work across fewer attorneys, so that each has sufficient work, directly driving firm profitability. It's a matter of right-sizing.

Right-sizing is tough. It applies not just to staff. Many firms feel a few terminated clerks and a secretary or two might be sufficient. For a small firm, it might be. But that's not where the major impact to the bottom line lies. We know, but do not like to admit out loud, that there are a lot of service partners and senior associates still remaining at firms who don't have enough work on their plate.

Helping you face this fact is not a job I relish. It signals that the business side of the practice is now as equally important as the professional side. The simple truth is that the generation of those who became lawyers because they wanted to work in a respected profession, not because they had to earn an income from doing it, have largely died off. Most of the Boomers want to maximize earnings in order to face retirement in uncertain times. We're witnessing firsthand how the miracles of modern science are causing people to outlive their retirement savings.

For the generations following the Boomers, they're concerned with unrealistic expectations of retiring Boomers trying to salvage sweat equity upon retirement. How will they earn sufficient compensation if paying off retiring partners? The firm's Boomers need to keep these next generations at the firm or there will be no ability to salvage sweat equity. The only solution to this dilemma is to improve the bottom line, as well as the quality of work/life balance, at the firm. Your firms, all firms, must respond if you are to thrive or even survive.

For larger firms, it's time to make department leaders responsible for the



budget and profit of their departments. Mid-size and large firms also need to innovate where billing strategies are concerned. A number of firms have employed a pricing analyst – although the title may vary from firm to firm – to assist each department in doing proper analysis to enable it to offer flat or alternative fee arrangements, to develop quality improvements that help the firm stay within client budgets and so forth. Mid-size firms should pause to actually listen to the thoughts of their controllers or administrators. In doing so you will likely find the data available to make significant improvements that can increase your competitive position.

I still run into firms that have a 1:1 attorney-to-secretary ratio. I know you're thinking it's just the Boomers getting ready to retire, but I wish that were true. Your firm needs to become more staff-independent. No, I'm not asking you to be a secretary. Let me share a fact: Document production, e.g. simple word processing, has been shown to improve up to 40 percent just by providing one large (32-inch) or two dual standard (25-inch) monitors.

Digital dictation enables the workload to be split more evenly. That increases teamwork and lowers the need to over-staff just to handle emergencies and surges in client demand. I find firms that run as high as 4:1 on a successful basis. Typically they are highly leveraged but effective teams that are supported by filing, copying and other services. In other words, they utilize an effective division of labor, pushing work down to the lowest cost level.

While we're talking reductions, you should be examining expense categories from a different perspective. Look at some of the expenses that have formerly been "sacred" and think about whether it's time for the sacred cows to go. For example, do you really need the cost of a physical library? Might that space be better used as an attorney office or conference room that will generate additional revenue? Do you really need the electronic package you've always had or will free electronic research offered by your bar association do the trick 90 percent of the time?

Are you holding on to too much office space? Are you actually determining whether you are getting a return on investment from your marketing expenditures? Figure out how to track how much revenue paid efforts are producing, by source. Salespeople are highly skilled at calling about renewals days before contract expirations, in hopes you haven't done your homework and will just renew. Mark your calendar to do your analysis long before you hear from them the next time around.



## Improving Practices

The length of this article precludes me from covering all the ideas that come to mind. I've already written a number of "Best Practices" articles, and I invite you to write to me at [lawpractice@pabar.org](mailto:lawpractice@pabar.org) for copies. But here are some thoughts, just to get you thinking creatively.

I have no doubt most of you believe that you have a well-run practice. The reality is that there is always room for improvement. And small improvements can have significant impact on profits. When times get tough, lawyers with bad habits need to improve how they manage their practices.

All lawyers should record time on a daily basis. Lawyers who wait until the end of the week to construct their time sheets may miss out on 30 to 50 percent of their billable time. Simple translation: Lawyers who do not record time on a daily basis lose substantial dollars.

Bill regularly for hourly work. Not less than every month. And remember there's nothing that prevents you from billing more often during particularly active times in the life of the matter. Rather than be displeased, be assured that clients would prefer smaller but more frequent billing. It's much easier on their cash flow.

Know when to put the pen down and walk away. Don't hesitate to take your possible loss and walk away before it grows into something you can't afford to walk away from. Always look at your receivables with this question, "If I have to eat this, what impact will it have on my firm?" If you even start to think that your firm might seriously suffer from the loss, you've already passed the point where you should stop working for the client. Yes, you have ethical responsibilities and often you cannot cease representation without filing a motion and getting court approval. All the more reason to put the pen down earlier, while you can extricate yourself without prejudicing the client.

Get serious about managing your receivables. It's time to get someone properly trained, either someone on staff in your office or a part-time outside contractor, who can run your receivables-management program. Consider it customer service, not collections. It should start when the bill comes due and continue until paid in full. And it should apply to all clients. Communicate billing and credit terms clearly to clients at the start of the relationship. When you handle billing and receivables in a business-like, consistent fashion, you will not alienate clients. They will respect your good business practices.



Enforcement of evergreen retainers, initial retainers and even mandatory use of credit cards in some practice areas when balances exceed a certain limit of dollars or time are important business practices to observe.

If your engagement agreement calls for interest charges on past due balances, charge them. Don't wait until the receivable is a year old and you are totally ticked off to send a retroactive interest invoice. It will have no impact. It only has an impact when it arrives as soon as the bill becomes past due and continues to accrue until the bill is paid in full.

Consider offering early payment discounts. Put the actual "end of discount date" on each invoice to avoid abuse. Since the average receivable write-off rate is 7 percent, offering a 10 percent discount for early payment is a smart economic move. The less time the receivable is on the street, the less chance it has to go bad.

### **Rewards**

OK, I'm ready to tread on tender toes. Nothing strikes fear into lawyer hearts more than the possibility of a change to the compensation system. But the truth is that at many firms there is a disconnect between the values and behaviors the firm desires and what it really rewards. It's time to think hard about whether you're actually encouraging the behaviors and results you want, which is the ultimate form of accountability.

While we're talking about compensation, let's acknowledge that owners are paid by profits. If firm management is using the line of credit to meet profit shortfalls and shore up owner compensation, it's time for a change. It doesn't matter if your business entity is a professional corporation and you call it salary instead of draw. The fact is that if you don't have profit, you don't have compensation. And related to that is the fact that most firms are carrying entirely too heavy of a debt load.

### **Communications**

Every single lawyer and firm should be paying serious attention to client communications, expectations and satisfaction. Failed client expectations create an uneasy relationship between the lawyer and client. This usually results in billing write-downs and write-offs. Often there is accompanying self-editing of recorded time. It becomes impossible for the lawyer to obtain full value for services rendered. Communication is the key to understanding and managing client expectations, and improving service in order to avoid disappointing the client.



Hopefully this article has given you food for thought. The most important takeaway is that the economic recovery will not be sufficient to assure your firm returns to a healthy, profitable state. Let me remind those of you who need some assistance in determining how to take a hard-eyed assessment of your firm that I am here to assist PBA members with these issues and more.

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