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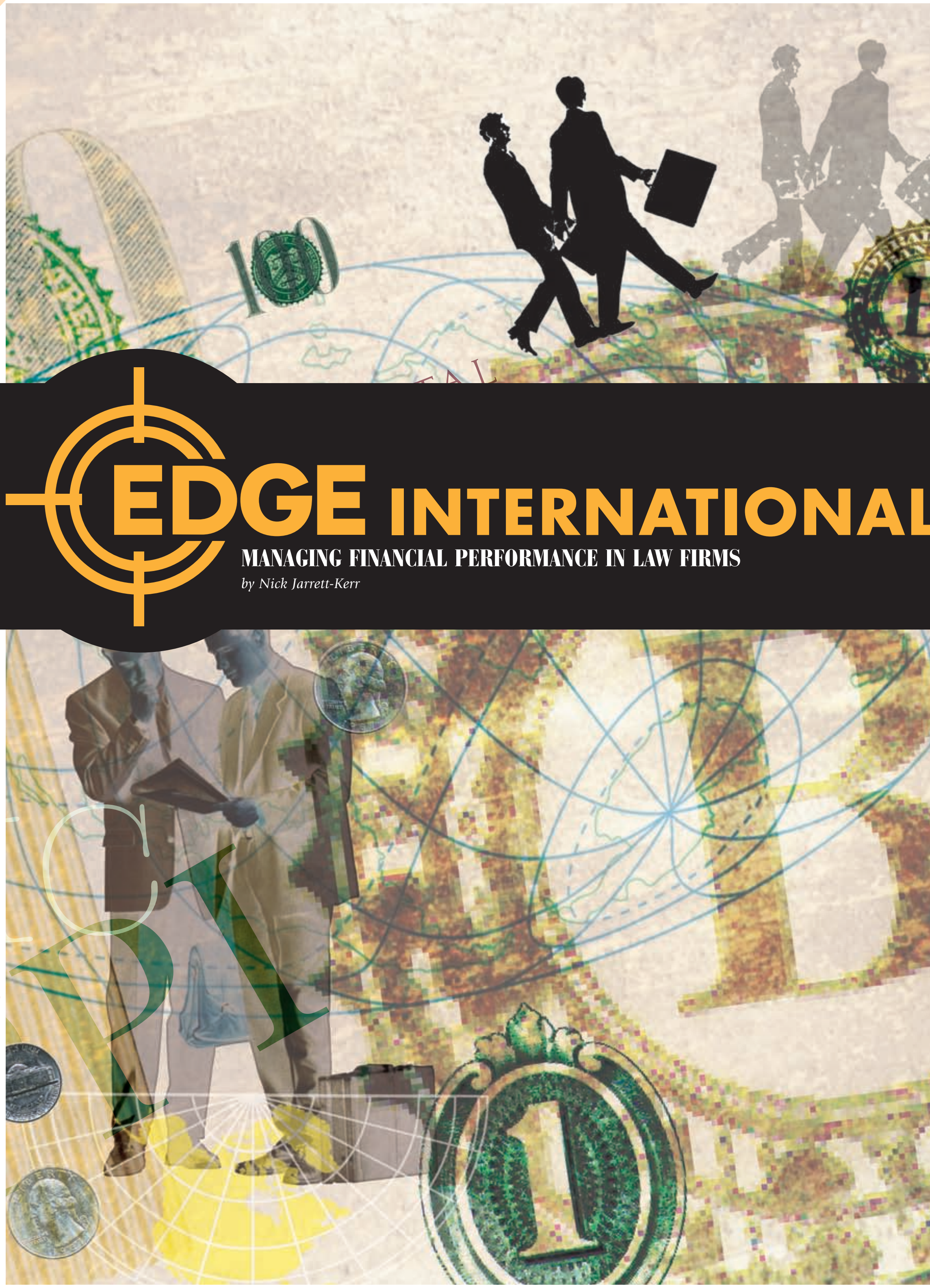
MANAGING FINANCIAL PERFORMANCE IN LAW FIRMS

by Nick Jarrett-Kerr



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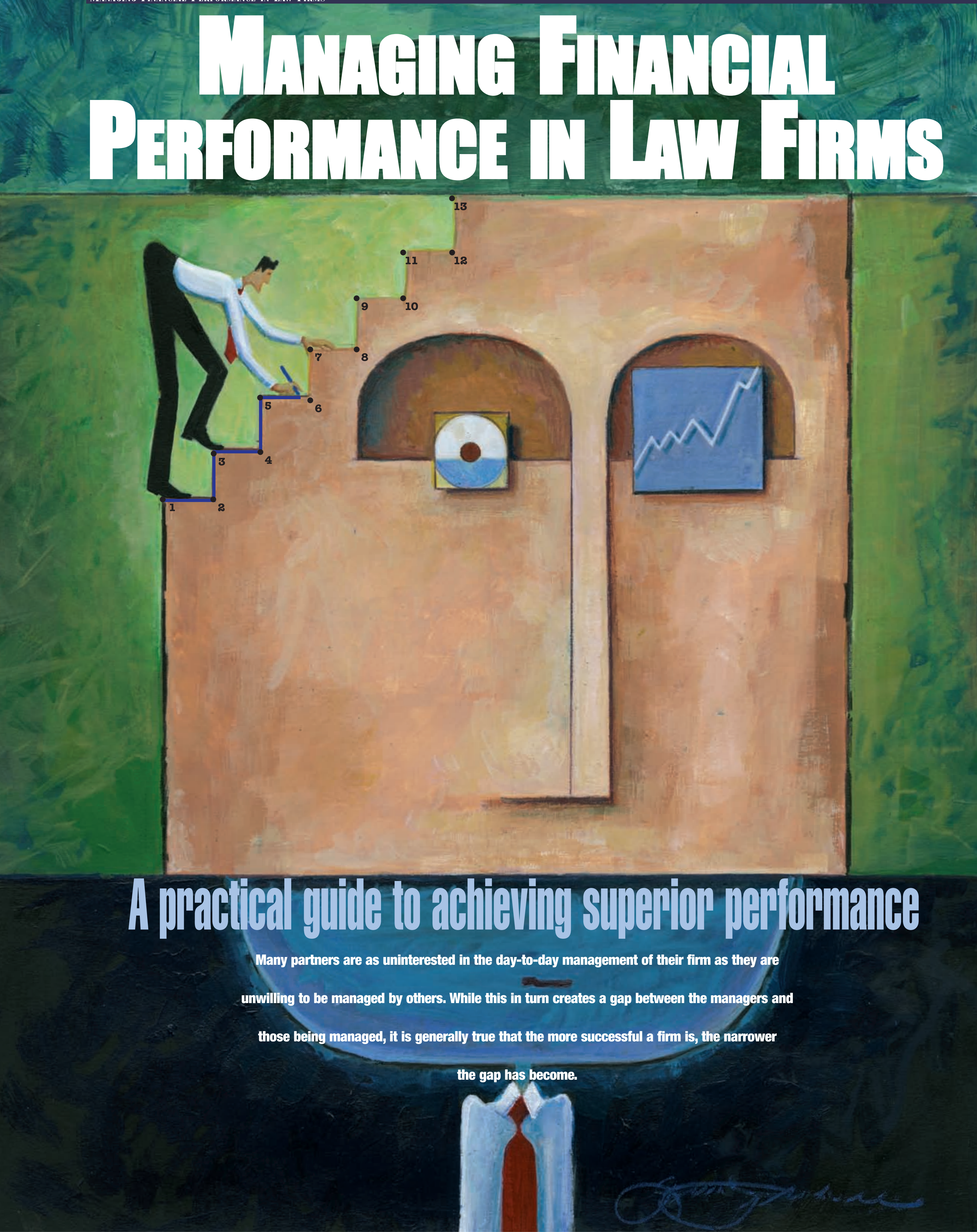

A practical guide to achieving superior performance

Many partners are as uninterested in the day-to-day management of their firm as they are unwilling to be managed by others. While this in turn creates a gap between the managers and those being managed, it is generally true that the more successful a firm is, the narrower the gap has become.

by Nick Jarrett-Kerr, **EDGE INTERNATIONAL**

It has been wisely said that the best way of managing people is one at a time; but, however focused, charismatic or financially literate the managing partner might be, he cannot be everywhere at once. In order to achieve performance and manage towards targets, therefore, the task of management must be spread throughout the firm so that all partners have some role and share of responsibility for the people in their teams, groups and departments.

To accomplish this, we suggest that well-managed firms, regardless of size, should follow six general steps:

Step 1: ENGAGEMENT OF PARTNERS

Considerable effort should be spent to ensure that partners not only understand their roles but actively engage in the management effort, and there are at least four ways in which they can achieve this.

First, they should understand and accept the links between quality of work and practice profitability.

Partners take pride in the quality of their work and are understandably more responsive to issues of technical excellence than to the achievement of financial targets. This consequently helps to explain the widespread reluctance of partners to invoice their clients. One of the probable reasons why partners in law firms seem to hate billing is that they are often far from confident that their bills will be properly understood by the clients. Other reasons can be connected with the lawyers' failure to manage their clients' expectations adequately. As one law firm partner told me recently, "I used to hate talking to my clients about money. But it's something you have to do. Not only does it get easier, the more you do it, but it makes billing and cash collections easier too."

BOX 1

WHY LAWYERS HATE TALKING TO CLIENTS ABOUT MONEY

- The clients may "gag" on the level of estimate
- The invoice may not match previously given estimates
- The lawyer may only have given an hourly rate and is nervous that the number of hours worked on the matter may come as a nasty shock
- The lawyer worries that the client may not feel that value is being been added
- The lawyer is concerned whether anything substantive has been achieved by the amount of work done
- The lawyer thinks the client may not be pleased with the quality of the work

Common problem areas (see Box 1) often involve issues of consistency and perception. The positive lessons here are that careful attention to such issues will reduce the likelihood of professional indemnity claims and bad debts, and result in happier clients, improved work and greater profitability.

Second, partners should fully accept that progressive personnel practices drive improved business performance. Firms ultimately profit from concentrated and sustained efforts to recruit, develop and retain the best people and one decisive competitive edge depends entirely on the quality of the people in the business.

Third, partners should, regardless of preference or prejudice, try to understand the financial aspects and issues of their firm.

We have found that the better partners understand the financial issues, the better firms will perform. Yet, lawyers often seem scared to admit that they do not understand some of the more basic accounting principles, such as the relationship between working capital controls on the one hand and an expanding fee-base on the other.

I spoke to one managing partner of a large UK law firm which had recently won an award for its successful working capital management. He clearly attributed his success to training and development of partners so that they understood the importance of sound financial management.

> *We have found that the better Partners can come to understand the financial issues, the better firms will perform.*

A sense of real financial ownership by partners can only be achieved by assisting them to a greater understanding of the financial foundations of their practice. Financial workshops, training, and team meetings can help a great deal. But our own experience is that the best way of training is on a one-to-one basis. Regular meetings should occur between each partner and the managing partner, the practice area head and the finance director, with the focus here being on patient coaching and support (see the suggestions in Box 2).

BOX 2

SUGGESTIONS FOR COACHING PARTNERS ON FINANCIAL REALITIES

- Patient training and coaching on financial realities (stripped down to an individual level) including break-even, operational margins, and direct overheads
- Dialogue and negotiation to agree on achievable but expanding team and individual financial targets, both long-term and short-term
- Early identification of issues of underperformance
- The constant challenging and removal of excuses for sins of commission and omission
- As a last resort, consider two weapons of last resort
  - "Name and shame" for consistent offenders
  - The withholding of partner current account balances either on an individual or on a team/firm basis

Fourth, emphasise how the balance sheet can be strengthened without the need for extra capital calls.

While most partners realize that the best way to strengthen a balance sheet is through accelerated profits, many are puzzled to be told, on gaining a material piece of new business that they have just increased the firm's working capital requirement. Even in the best run law firms, the extra working capital required can be approximately one third of the annual fee revenue of the new work. This is because the work in progress and the bills delivered but unpaid both have to be funded. In poorly managed firms this lock-up of cash can of course be painfully high. This in turn can drive up the firm's borrowing needs and in growing businesses, the appetite for funding further expands. There is clearly a limit, though, to the extent to which law firms can or should borrow money. However, obviously the only way of keeping borrowings under control in any business is to generate more cash internally.

We suggest therefore that managing partners should focus on the following essential points:

- **Ensure that the breakeven point rises at a slower rate than the increase in fee income**
- **Improve fee rates wherever practical**
- **Dump unprofitable work**
- **Shorten billing and cash collection cycles where possible (and discounting for early payment?)**
- **Manage partners' expectations for cash draw-downs so that sufficient profits remain in the business to improve the gearing**

Step 2: FIRM-WIDE AGREEMENT ON RULES AND DISCIPLINES

Law firms – with a few notable exceptions – lack rigour and discipline in the way they manage their finances. The partnership model, where equality of ownership can also create an equal confusion about member roles, can be partly to blame for this.

In response, some firms have found that a clear set of partnership rules or definitions leads in turn to greater rigour and accountability and that superior financial performance subsequently follows.

Partnership rules tend to vary enormously from firm to firm. The small firm can, through sheer sense of partner collegiality, achieve its own systems of ad hoc responsibility. The larger firms, however, need some form of corporate discipline in place before implementation and action can happen. The mid-size firms often struggle as a result, proving too big for effective collegiality, but also unwilling to sacrifice partner autonomies on the altar of corporate discipline.

Whatever the firm, the issue of accountability is therefore critical to success and, as with many professional partnerships, there are substantial structural and cultural barriers.

- **Partners are frequently obstinate and obstruct or ignore attempts to persuade them to manage their people or to accept management disciplines themselves. In extreme cases, they will agree to actions which they never have any intention of carrying out.**
- **Other partners are arrogant and fail to see why, as proprietors, they should be accountable to anyone.**

- **Partners focus on their chargeable work, and (sometimes vital) non-chargeable activities suffer accordingly.**

- **Partners tend to want to interfere with (or have the right to veto) management decisions.**

In order to overcome these barriers, it is well worth persevering with efforts to agree to some essential disciplines and accountabilities. Real agreement, with heart and head, is needed among partners to establish the right level of management intervention into each others' activities. At the same time, concerted efforts should be made to ratchet up partner ambition and performance. Here, also, a change of management approach is necessary in order to develop a new sense of urgency, responsible ownership, and acceptance of methods and improvements.

Proper accountability simply does not happen unless a clean, new environment has been created. There need to be trade-offs between the freedom of each partner to act on the one hand, and the creation of a set of enforceable rules on the other hand to which he or she will submit. It is vital to foster the entrepreneurial partner spirit without foregoing essential structures and disciplines. More importantly, there has to be an agreement on the amount of time each partner diverts from chargeable work to investment time. Partners need to achieve a healthy balance between profits in the short term and longer term objectives and create an environment where partners feel safe to do that. It is the job of senior management to communicate the firm's strategy and what a particular partner or practice group has agreed to do in order to help this strategy. These ratios between short-term profits and medium- to long-term investments need to be managed as aggressively and conscientiously as billable time.

Step 3: DETERMINE THE CLIENTS' PRICE SENSITIVITY WITH RESPECT TO THE ENGAGEMENT

Monitoring financial performance requires consistent and regular attention and the best managed firms constantly coach and cajole to this end. This – like consuming a salami sausage – is best achieved in small and frequent bites rather than in huge and indigestible gulps. We know from basic time management techniques that frequent and moderate interventions are better than occasional large bursts of effort. Therefore, those charged with the overall financial management of the firm should hold regular meetings with the partners who report to them and this behavior should be cascaded through the firm. The managing partner or finance director might, for instance, meet weekly or monthly with the department heads to review the overall performance of each department. Each head might then have a similar meeting with those partners with team responsibilities who can then meet with team individuals in turn. The structure of each meeting should be – as far as possible – on a one-to-one basis. The focus is on actual performance against the key performance indicators (KPIs) as well as historical data. Most important of all, action lists should be created at each meeting level with objectives, tasks, due dates and activities set out in measurable (S.M.A.R.T.) form.

Step 4: PERSISTENT FOLLOW-UP

Having scheduled regular meetings, managing partners can then activate appropriate follow-ups in between. Since many partners find it easier to make a promise than to keep it, it is vital to keep an adequate written record of what has been agreed. Similarly, the management of expectations is critical. The manager must take every opportunity to let his people know that he is "on the case" and that their promises have not been forgotten.

By such means, management can occur without anyone really realizing it.

Consequently, extreme measures are rarely needed and should be used only as a final resort – particularly the naming and shaming of consistent recidivists, or even withholding cash drawings from serial rule breakers. (Some very successful firms actually keep their timekeeper honest by "fining" late submissions of time at month end!) For efficient and persistent follow-up, it is important to lighten partners' loads by supplying timely performance data, regular management accounts and user-friendly financial information.

Step 5: PROVIDING FINANCIAL INFORMATION IN A WAY THAT IS USEFUL TO PARTNERS

Well managed firms don't just overload partners with numbers and tables but, like well-designed dashboards, should provide current, not botched month-old information. Properly informed partners should only have to spend minimal time on administration or managing the most critical issues. A list of debtors, for example, which is several weeks old, is worse than useless for a collections review. Timely headline information allows partners to speedily address problem areas or anticipate issues before they become problems. As each law firm will have slightly different needs in this regard, the responsible partners should also be trained or assisted in interpreting the specific performance data which they are given.

Step 6: CONFRONTING UNDERPERFORMANCE EARLY

Providing information in a way that partners understand does away with one more excuse for non-performance. There should then be less room for the serial underperformer in any law firm which prides itself on its quality and standards. Nevertheless, the consistent underperformer should be given the opportunity to reform and develop and should be given all possible assistance and encouragement by way of training, coaching and support. Indeed, we have found that in most partnerships, there is a deep-rooted reluctance to vote for an expulsion (even in extreme cases). To address this, partners need to be satisfied that every opportunity has been given for specific improvement to occur. It is vital for a program and timetable to be agreed for and with the underperforming individual, who must feel safe from attack for the period, and must become fully aware of what needs to be done to improve. A partner might be appointed to shepherd the underperformer, and the person who has this responsibility should frequently follow up. Such intensive care programs should be grounded in the firm's partner development criteria and balanced scorecards. All partners need to understand what is expected of them and to identify the standards of behavior and performance below which they must not fall.

The history of many law firms is just littered with failed or half-way completed initiatives, and maverick working practices which have not been confronted.

BOX 3

INTENSIVE CARE FOR UNDERPERFORMERS

- Coaching and individual training/counselling/mentoring
- Concentrated work with the other partners on the immediate team
- Peer pressure
- Skills training in relevant areas
  - Workload and time management
  - Financial management
  - People management
  - Legal skills
  - Marketing and business development

Some firms have carefully designed support programs for underperformers which include elements set out in Box 3.

The history of many law firms is littered with failed or incomplete initiatives and with tearaway maverick working practices. These six steps are designed to be practical and to provide a framework for ongoing and effective management and they have helped many managing partners, senior managers and department heads to address the stubborn problems of under-performance and under-management in their firms. But, just as they call for discipline and accountability from partners, the measures that we recommend also need great discipline and determination on the part of the managing partner to introduce them and to see them through to their successful and profitable completion.

Nick Jarrett-Kerr LL.B. *(Solicitor) is a Principal with EDGE INTERNATIONAL. In the last four years, Nick has rapidly established himself as one of the leading UK advisers to law firms on leadership, management and strategy. He is a regular writer on management and leadership topics with a particular interest in management/leadership development, as well as strategic planning, and business development.*