Preface

This report exists to help law firms, and those responsible for their continued survival and performance, secure sustainable growth.

There are a number of challenges and achieving growth is perhaps harder now than for most of the history of the legal profession. At the same time, other demands on managing partner, CEO, partnership board and fee earner time have intensified. This is why it is so important to get it right and to both plan for growth and – critically – manage and align the resources of the firm to secure it, while at the same time reducing wasted effort.

Many firms make false starts in this respect, or place their hopes on one particular project or immediately appealing idea. In contrast, this special report is based both on my experience with many law firms, and the consultancy provided, as well as on detailed research and the expertise of others with many years' experience of driving performance forward. The ideas contained within have been proved to work.

The early chapters briefly review marketplace characteristics and current issues for law firms, as well as those factors which have contributed to the failure of the firms in the past to secure their future and grow effectively. The report then deals with how to think more clearly about the drivers of growth, and provides a framework for thinking about growth. It includes a range of self-review exercises that you can use to identify areas of growth, and then determine the gaps in the current approach of your firm.

In addition it provides insight into how you can plan and execute key activities, which may be missing in your current approach.

This is not about a quick fix, beguiling though that may be. It is not necessarily about merger as a 'silver bullet' unless that has a sustained beneficial impact on the firm's capability and ability to drive future growth – in other words, it is not just a 'bolt on' or a transaction done in panic mode.

It is important to recognise that it is also not just about marketing communications, visual branding, CRM systems, social media or new websites in isolation. These can help but they are secondary to what this report concentrates on. The focus is on giving your firm a clear strategy, and the tools to manage and align the efforts of its people to gain increased revenue and better profitability.

More centrally, this includes taking a clear look at the measures you use, the ways in which people – your biggest investment – spend their time, and is about aligning efforts more consistently around a clear vision of how to grow.

This report shows you the things to think about to give yourself a much better chance of 'successful execution'. The management approach is key – for whatever specific strategy or market the firm has.

I hope you find this special report useful and I am very happy to answer any questions or provide clarification of any of the points raised if any reader would find that beneficial.

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Chapter 1

The current market environment and the impact of growth on a law firm's future

Introduction

This chapter covers the outcomes of successful growth. It touches on the results in terms of:

- ability to reinvest;
- financial stability generated;
- ability to attract high quality fee earners;
- ability to deliver career progression for fee earners;
- ability to attract the desired client base;
- ability to invest in service improvement and technology; and
- impact on relationships with other counterparties.

According to TheCityUK's January 2014 report on legal services, the total gross fees earned by UK law firms in 2012–13 was some £28.5 billion. This has almost doubled since 2002–3 when the figure was approximately £15 billion.

At the aggregate level, and allowing for the undisputed hiatus in this overall growth pattern from 2007–10, we could thus say that growth in the legal sector and in the market for legal services has been extremely healthy.

Some in other sectors would, at face value, perhaps conclude that in such an environment it was not particularly difficult to grow the business of a law firm.

Their conclusion may be qualified a little if they then dug a little deeper and looked at the more detailed figures of revenue and profit per fee earner. Even in the 100 biggest firms, according to the same report, both revenue and profit per lawyer decreased by some 2 per cent during 2012–13. And even if we take a look at the headline growth figure of 5 per cent in gross fees during 2012–13 for the sector, once the impact of inflation is stripped out, growth does not look so healthy.

The current environment

Let us also accept that, uncomfortable as it may be, we do not operate in a vacuum. As well as the likelihood that growth of the sector as a whole will be inconsistent in the future, other influences on the firm's performance and how its partners and managers spend their time have multiplied.

Let's get the bad news out of the way.

The main aspects of this are that the 'traditional law firm' is faced with new entrants and different competitors, some with deep pockets and an appetite to invest in new models, processes and technology. The obvious 'villains' of this piece – to characterise them as they may be seen by those who have not needed to face such a competitive threat before – are retail 'brands' and others who are entering the market either via alternative business structures (ABSs) or via mergers and have economies of scale and resources on their side.

Some aspects of legal work, partly exacerbated by the ability of the entrants above to reengineer processes and to enable service via the internet, have become more commoditised. This poses a significant risk to the market share and, in particular, the margin of some firms.

Other influences have reduced revenue available from other streams. In the UK, the government is scheduling a total cut to the legal aid budget of 17 per cent throughout 2014–15. KPMG has estimated that firms who wish to successfully operate in this market, given the impact of these cuts, need to make efficiency savings of some 20 per cent (*Law Society Gazette*, 27 February 2014).

Generally, the difficult economic conditions seen since 2007 have intensified an already growing market demand for legal work to be good value for money. This is both from retail/private clients and from the commercial sector. Corporate decision makers are faced with tighter scrutiny and have to justify more strongly the level of legal spend. Indeed, this may be one of the reasons why the Law Society's own statistics show a doubling in the number of in-house solicitors in 2011–13. These requirements for value for money tend to be accompanied by expectations that fees become easier to forecast and more transparent. This requires firms to act more efficiently and speedily and to project manage work better. (This subject is covered briefly in **Chapters 3**, **7** and **9**.)

Regulation and compliance have become more pressing concerns and bigger risks to manage. For example, many of the 10 mandatory principles in the SRA Code of Conduct would have been absolutely part of the day-to-day fabric of operation for the vast majority of firms. However, principle 8 in particular, as replicated below, while dealing with a relevant problem, has impacted on management time and resources. You must:

> run your business or carry out your role in the business effectively and in accordance with proper governance and sound financial and risk management principles;

There is little doubt that the need for a clearly accountable compliance officer for finance and administration (COFA) and oversight by the compliance officer for legal practice (COLP) of a firm has also added to the demands on management time. In summary therefore managing partners, and others with a stake in the success of the firm, are faced with potentially increasingly intense demands on their time and skills (and indeed energy and fortitude!) as shown in Figure 1.1.

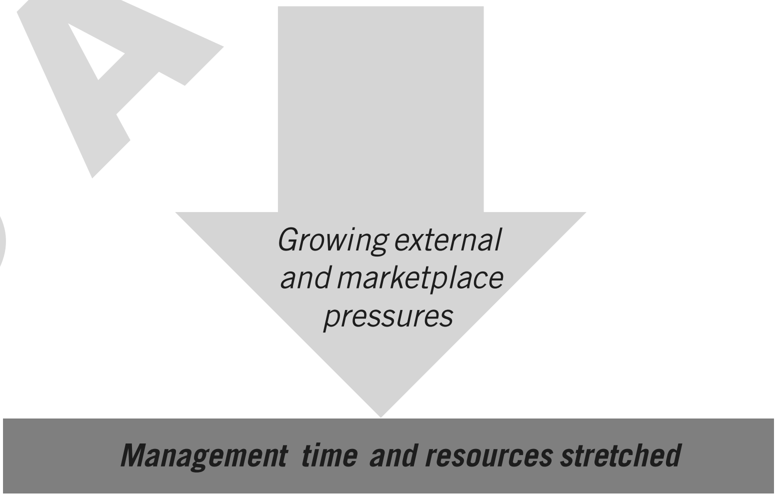

Figure 1.1 Some of the problems

Given this situation, it is more important than ever to use time and resources to best effect. Maintaining or improving performance in, for example, profit per equity partner means partners have to understand more clearly where to place investment of cash or time. If you are responsible for the survival of your firm, the reality that you have to face up to is that muddling through will guarantee decline.

So, we may conclude that 'yesterday' healthy growth in revenue and profit could be achieved by a law firm by, effectively, tracking market growth. Today, it cannot. When growth is more difficult to achieve, is it still a suitable aspiration?

Consider the alternative. A firm which is not growing may find it difficult to provide career progression to its best staff who may give up waiting for others to retire or leave. Growth provides the fuel for a firm and for its talented fee earners to seek more challenging, higher quality work as well as financial well-being. It enables the appropriate level of investment to improve the capability of the firm and to generate future success.

One 'obvious' answer is merger or acquisition. However, the frequency of mergers that fully meet aims and where all partners would declare it a success is not high. While it can unleash economies of scale, allow access to new client bases and build capability, the time and pain involved in a merger still do not fundamentally change the rules of the game and the basis on which any firm has to compete.

Equally, the effort involved in discussing mergers that do not come to fruition is considerable. As a recent research study covering more than 100 law firms commissioned by Smith & Williamson reports (Annual survey of law firms 2013–14, Smith & Williamson):

> More than half (56%) of merger discussions between law firms are ending in failure with a third of firms spending in excess of three months in negotiations before the decision to halt talks is reached. 15% of firms taking part in this research report spending more than six months in merger discussions which came to nothing . . .
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> 'Although some very high profile mergers were announced during 2013, the high level of failure and the time it takes firms to reach that conclusion, represents a huge waste of time, emotion and energy for management teams,' according to Giles Murphy, head of professional practices at Smith & Williamson.

As will become clear as you read through this special report, the underlying key levers of sustainable growth are the same whether a merger occurs or does not. One criterion which potential firm partners should consider is 'Will this merger improve our capability on the key levers more substantially than the effort we must expend to implement the merger?'

By better understanding those key levers, and how to move them, firms can secure healthy future growth in revenue and profit.

So we have a conundrum. We need to grow the firm as otherwise there is increased risk of financial instability, the loss of talented staff, inability to invest, and a declining quality in the client base. But at the same time, even in late 2014 when the indications are that economic growth in the developed world in general and the UK in particular appears to have returned, this does not necessarily translate into a large increase in legal spend.

Indeed, to take one example in respect of spend by medium and large companies, commentary by *The Lawyer* magazine on the results of its 2014 in-house attitudes survey noted that:

> Those who said their budget would grow accounted for 20 per cent of the 864 respondents; the percentage of those who said it would shrink was exactly the same. For 41 per cent, spend would be static. The economy may be recovering but assumptions that there'll be a domestic upsurge in demand for legal services are wide of the mark.

If we have a situation where overall legal spend is static or growing slowly, that also means:

1. All things being equal, there is always likely to be some client loss, simply as a result of individuals dying or companies closing. However it is absolutely critical to reduce the amount of client loss from avoidable factors. Unless the firm retains clients, it cannot sustain value from them, or extend the relationship with them. It has no platform for growth. Every client loss that you could have avoided hurts the firm badly as it represents compound revenue you have forsaken. The impact of this is shown in Figure 1.2.

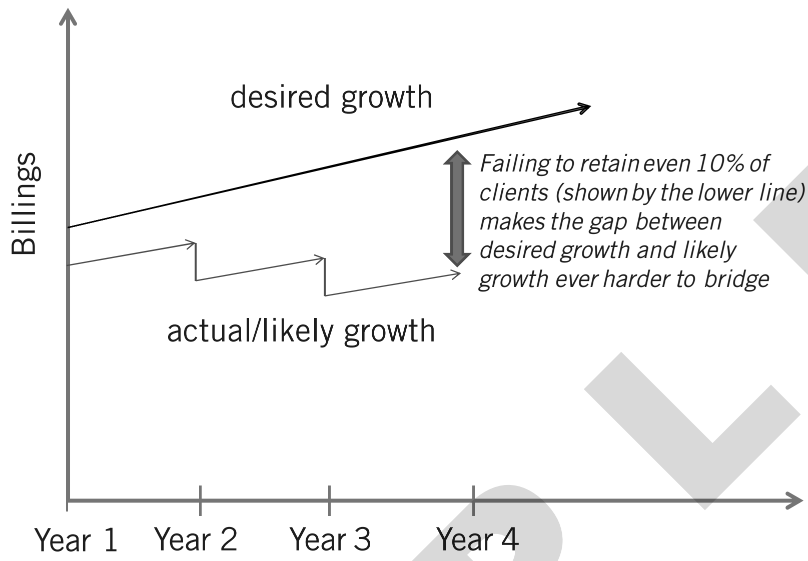

Figure 1.2 The risk of an increasing gap between desired and actual/likely growth

But who is the final arbiter of whether you successfully retain a client? It isn't the firm's management and it isn't the individual fee earners. It is, of course, the client. We will return to this theme later in this special report.

2. In a situation of no or slow growth in overall legal spend, a firm will only achieve healthy growth if it performs better than the overall 'market average'. Put bluntly, this means it has to do better than competing firms.

   Clearly some firms are doing better than others in this respect. The NatWest '2013 Financial Benchmarking Report – Law firms' of 337 small and medium-sized law firms reported that profit per equity partner (PEP) varies from £11,000 to £459,000.

   The rest of this special report aims to give partnership boards and other managers and decision makers within law firms the tools to equip themselves to think through how to achieve growth for the firm.

Managing the financial health of the firm – the key levers of profitability

At the simplest level improving profitability is about increasing billings and maintaining (or reducing) costs. This is shown in Figure 1.3.

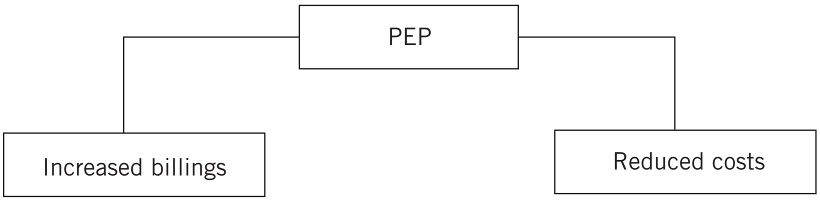

Figure 1.3 Improving profitability

Achieving better financial health requires efforts across the firm to be better aligned, by understanding the key elements that build profit per partner and performance, and pinpointing actions to improve the firm's performance in these three key elements:

- Improving your ability to grow revenue through securing value for clients, extending client relationships and improving your ability to acquire new clients.
- Improving the productivity of your assets and resources, including making better use of your key asset – your people.
- Using technology and processes effectively to manage costs and secure efficiencies.

Looked at this way, there are five key drivers for increasing billings, as shown in Figure 1.4, that contribute to a more sustainable revenue stream:

- Reducing write-off ensures that the genuine receivables per hour of fee earner time are increased.
- Improving the firm's ability to acquire new clients by definition creates a greater pool of potential revenue.
- Improving the firm's ability to extend the relationships with clients reduces sales costs, increases billings with less effort and locks in more sustainable revenue.
- Ensuring that the firm secures the value from clients and bills and prices effectively means the firm has to deliver work which is valued by clients, in ways which are valued by clients.
- The ability to secure more productive relationships creates significantly increased revenue at often marginal cost. The firm needs to maximise this potential.

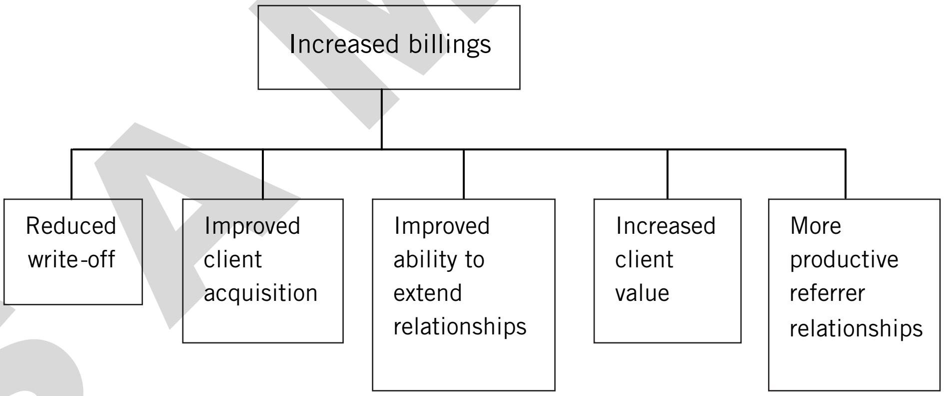

Figure 1.4 The five key drivers

Relatively few firms 'look ahead' and manage or even measure performance in these areas. There is a key opportunity to move these levers in the right direction.