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Attorney's Report

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Law Firm Economics

Leverage Your Way to Better Profits

"Give me a lever long enough and a fulcrum on which to place it, and I shall move the world."

The Greek mathematician Archimedes no doubt understood the incredible power of leverage — a lesson that today's law firms can certainly follow.

That's because proper use of leverage (i.e., shifting work to its lowest-cost, most-effective labor source) is one of the prime movers of law firm profitability. In practical application, this means that partners should not be performing the work that associates or paralegals can perform adequately. Ignoring this basic tenet of leverage runs the risk of undermining profits for the firm.

Unleashing the Power

In essence, leverage in a law firm is the ratio of paralegals, associates and other non-owner fee earners to partners (or shareholders). In a firm with seven associates and three partners, the leverage would be 2.3, which is generally considered to be highly leveraged. For a firm with ten associates and ten partners, the leverage would be one.

Here, it's important to note that as the leverage decreases, a greater percentage of the firm's net income must go to partners to maintain or increase their income. Consider the examples in the table to the far right.

The Impact of Low Leverage

In an eye-opening white paper from Edge International, consultant Sean Larkan shows how low rates of leverage have a marked impact on law firms and their clients. For example, with fewer attorneys to delegate work to, partners are forced to work longer hours and focus more on billable matters — and less on building long-term business. "Partners are forced to do work that would normally be delegated down to the lowest competency level. This may mean higher write-offs, where certain types of work do not justify high rates, and unhappy clients."

Clients don't fare much better in Larkan's view. "They pay higher rates for work that used to be delegated … but that is now performed by partners or more senior lawyers, presumably at higher rates. They may also develop concerns that the firm is not providing for future continuity and succession for partners and their work."

Put the Right People to Work

Seen this way, the path to profitability becomes clear: leverage your work. Send as much work as possible to higher margin associates. Yet, you've got to use the right associates. Very 'young' associates generally don't generate enough revenue to create profits. As Tobe Brown, former director of the Utah State Bar, notes in his popular law blog: "The sweet spot for profit comes from experienced associates or other non-partners, whose revenue-to-cost ratio is high."

In his breakthrough book *Identifying Profits (or Losses) in the Law Firm*, Robert J. Arndt makes the distinction that even a highly leveraged firm can generate more income for the equity partners as long as associ-

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Leverage Example

Firm A: (highly leveraged)
2 Partners
Gross Revenues: $10 M
Net Income = 25% revenues: $2.5 M
Each Partner's Income: $1.25 M
Firm B: (barely leveraged)
10 Partners
Gross Revenues: $10 M
Net Income = 50% revenues: $5 M
Each Partner's Income: $500,000

Source: Law Practice Today

Planning for the Future

Surviving the Succession Tsunami

The wave started some 40 years ago when baby boomers entered the legal profession with a splash. Riding a generational wave, they built, grew and led law practices.

Now they are in their late 60s and 70s. Many of them are rainmakers at the top of their game, with deep client relationships and vast stores of institutional knowledge.

But what will happen to your firm when they leave? Demographics indicate that 30 percent to 40 percent of actively practicing lawyers are at the stage in life where they are ready to retire or phase down, or at least are contemplating phasing down.

Facing the Succession Issue

Forward-thinking law firms are already taking steps to address the challenges posed by the looming succession tsunami. But a surprising number have not faced the critical issue of succession.

Maybe they don't want to antagonize productive senior partners with talk of phase downs or becoming lame ducks. Or maybe they're leery of rattling clients by broaching the topic of transition. Or, perhaps they are simply too busy with the day-to-day pressures of serving clients and running the business to worry about what might happen next.

The reality is that it can take years (or even decades) to build new client relationships, replace outgoing expertise and develop new leaders. The key is to start *now* — before the tsunami hits.

A Demographic Analysis

Alan R. Olson, a principal of the legal consulting firm Altman Weil, Inc., suggests that the place to start is with a demographic analysis of your lawyers — specifically by age and billing responsibility. Olson's model starts with the construction of a simple chart showing the dispersion of attorneys by age in five-year increments — from ages 26-30 on up to 66-70 and 71-plus. Next, total revenue is shown by billing attorney (or originating attorney) using the same age ranges.

For illustrative purposes, assume that XZY law firm has 40 attorneys (associates, of counsel and partners) who are responsible for some $22 million in annual revenue.

With chart in hand, we can clearly see where the firm's legal talent lies on the phase-down/phase-out timeline.

Let's assume that the firm has 15 lawyers age 61 or over, 10 of whom are partners responsible for substantial revenues. Looking down a few levels, we find eight partners aged 46 to 60 who are next in line for assuming major client responsibility. Here, it quickly becomes apparent that more seasoned lawyers will be needed if the firm wants to successfully transition the clients of these 15 senior attorneys as they retire.

Successor Development

Ultimately, this demographic analysis points to the very real and immediate need to focus on developing successors. Such a succession plan will need to address the following:

Mentoring — Provide high-level mentoring and specialized training to junior lawyers in anticipation of a partner's retirement. Here, the firm may need to incentivize partners to mentor junior lawyers.

Grooming — Consider designating one or two partners to focus on identifying and grooming leadership prospects — the entrepreneurial young partners who will take the helm and guide the firm after the founders bow out. Reward them for achieving the desired results.

Administrative assignments — To fill the management/administrative gap in anticipation of a managing partner's retirement, groom and develop existing staff to fill the gaps. Try delegating short-term, low-risk management and/or administrative activities to selected mid-level and junior partners.

For example, appoint them to chair a practice area or one of its sub-specialties. And consider administrative assignments when establishing compensation levels to encourage the firm's "best and brightest" partners to accept these tasks and not feel uncomfortable because they may record fewer billable hours.

Phase-down programs — Set target periods for senior management to phase out of some duties, while also providing an effective way for these transitioning attorneys to make continued contributions. For example, they might assume consulting or contract, mentorship or specialty business development roles.

The good news is that a well-formulated succession plan allows for a seamless transition from current leaders to the next generation — in both client relationships and management responsibilities. The key is to start the process now. ■

Contact our office for guidance on reviewing your firm's succession plans.

Law Firm Economics

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ates at the lowest levels are working at their highest productivity. The key, he explains, is to manage your payroll correctly while continuing to bring in work.

Understanding the "New Leverage"

It's important to understand that leverage does not simply mean throwing warm bodies into the mix. Before they are profitable, new associates typically require several years of development. With this in mind, some firms are looking at levers other than non-equity workers. These include:

Contract lawyers — This can be cheaper and more flexible than hiring additional associates. These contract lawyers are practitioners who either cannot find full-time employment in the current economy or who prefer to work on a temporary basis.

Paralegals — Paralegals have not traditionally been included in leverage calculations, yet their contributions can certainly move the needle — especially in areas where they have traditionally been very productive, such as litigation, estate planning, and family and contract law.

Project management specialists — Larger and midsize firms are increasingly bringing in trained administrative personnel to bring efficiency to the management of matters and cases. Clients seem to like the attention to detail, and the attorneys appreciate having someone to keep the legal team on task and on schedule.

Outsourcing — A growing number of firms are partnering with so-called "virtual law practices." They are also leveraging the use of document management companies and legal research and legal process providers to perform functions that were formerly handled by associates but often required partner review.

Technology partners — Companies specializing in e-discovery are increasingly being utilized by law firms to provide the specialized software systems they need for handling large quantities of electronic documents. By leveraging their outside expertise, firms are able to minimize or eliminate their investment in software licensing, hardware and updates.

Action Steps

Leverage takes many forms. But at its core is the understanding that tasks should be performed at their cheapest, most effective level of timekeeper. When the entire firm, from associates to senior partners, fully understands the implications of leverage, there is serious potential for improved profitability. Just as important, properly employing leverage can also lead to lower costs of service for clients.

To that end, consider these three steps for building a culture of leverage:

1. Encourage delegation. Provide billable-target relief and financial recognition for partners who delegate to the lowest competent level — especially as it frees them up to build business.

2. Mentor and groom. To build a team of solid "mid-levels" to whom work can be effectively delegated, ensure that every lawyer in the firm has someone responsible and accountable for his or her professional development and progression.

3. Measure progress. Make building a leveraged team a key performance indicator for partners. It might even be a required skill for those on the partner track. ■

The Case for True Professionalism

In his classic book *True Professionalism*, David Maister makes the case for leverage with a distinction between "Dynamos" and "Cruisers." The Harvard Business School professor explains that Dynamos give away repetitive, "overly familiar" client work to others in the firm, even though they may be superb at it.

They employ leverage to deliver their services using less of their time — for example, through a less costly resource (technology or junior time). Unlike Cruisers, they don't try to improve profits by working more hours. As true professionals, they seek ways to make more money without working harder.

Law firm profitability depends on the proper use of leverage. Our team of accounting professionals can help with an analysis of your firm's revenue metrics.

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Lawyers and Their Tablets

With iPads and other tablets increasingly replacing the legal pad, the possibilities for making your practice more portable (and efficient) are greater than ever. Consider these popular apps that are designed to increase productivity:

Document viewers — GoodReader has earned its attorney accolades by the way it handles huge PDF and text files, manuals, large books, magazines and renderings with great speed. It easily integrates with cloud-based applications such as MobileMe, Box.net, Dropbox and Google Docs.

Legal research — FastCase is the largest free law library on the iPhone, providing access to case law for all 50 states and access to statutes for most states and the federal government.

Case management — Everything in Evernote instantly syncs across any computer or phone you use, allowing mobile attorneys to start working on one device and continue on another without missing a beat.

Pre-trial apps — Options here range from the free Mobile Transcript app, which allows attorneys to review and annotate deposition files or court transcript files, to the $89.99 TranscriptPad. This is the number-one rated transcript review tool on the App Store.

Calendaring — With Court Days Pro's rules-based calendaring, you choose an event (such as a motion's hearing date) and the app provides a list of corresponding events and dates, such as last day to file motion papers, opposition, etc.

Jury selection — Apps such as iJuror help organize the process of jury selection, allowing you to create profiles for each of the potential jurors in voir dire and keep detailed notes for each juror in an easy-to-use interface.

Litigation — Apps like TrialPad and Evidence allow you to connect your iPad to a projector and present PDF and image file evidence during trials or hearings. ■