Risky business

By Peter Scott

For many law firms there has rarely been a more challenging time than now, given the current economic outlook and the regulatory changes affecting them. The 'R' word is being spoken about again and the credit crunch is having an impact which many firms have not experienced since the early 1990s. This will require those running law firms to be on their mettle as never before.

In the light of worsening economic and market conditions, the measurement and management of partner performance is taking on an even higher priority as firms are forced to review their objectives. Maintaining profitability and managing cash flow will be high on the agenda for many, and performance by everyone will need to be aligned with achieving firms' objectives. This will require performance to be measured against a broad range of criteria if individuals are to be fairly and objectively assessed.

Whilst financial measures are only one way of assessing performance within a law firm, appropriate financial reporting can be invaluable in evaluating the contribution of partners. Financial performance is like the tip of an iceberg – it is the only visible part of what is happening below the waterline and will point to how well (or badly) partners:

- Build practices and teams;
- Delegate work;
- Develop relationships and share clients;
- Manage working capital; and,
- Manage their non-billable time productively.

These priorities are important for many law firms, but how well do they measure what matters to them?

The purpose of financial measurement should be to provide clear information to those running the business and to indicate what actions may need to be taken to maximise financial efficiency and the overall well-being of the firm. Too many firms produce voluminous financial reports which not only achieve very little, but more often than not are binned. If reports are not going to be used, then why produce them?

Firms should test the state of their financial reporting by asking questions such as:

- Why do we produce this information?
- Do we ever use this information?
- Does it tell us what we need to know about our business?
- What information do we not produce, and how is this preventing us from effectively driving performance?

Analysis is vital to good performance management. If a firm can be clear as to its objectives, identify the performance indicators it will need to best manage performance through difficult times and then produce clear and understandable financial reports accurately reflecting that performance, this is likely to be a valuable step forward. Otherwise, 'financial information overload' can be a serious hurdle to improving performance management by partners of their practices. Instead, a firm should keep it simple and focus on what it is seeking to achieve.

On the other hand, throwing financial reports at partners (even clear and informative reports) is unlikely to be an effective way of improving performance if there is no explanation of what the reports mean and no indication of what partners are supposed to do with them. A great deal of the financial information produced by law firms is, I suspect, not used effectively for this reason.

A starting point in the process, if financial knowledge and skills within a law firm are to be raised significantly to help enhance performance, should be to educate partners and others in the firm so they have an understanding of some basic financial principles relating to, for example:

- The 'levers' they need to pull to improve their firm's profitability; and,
- The steps they need to take to better manage cash flow.

Such knowledge is, unfortunately, often lacking at many levels in law firms and partners are sometimes unaware of the most basic factors which contribute to good financial management. How much better off would many law firms be if partners were able to accurately evaluate financial reports and then know 'which levers to pull' to enhance performance? For example, explaining clearly to partners the often dramatic effect that improving pricing, recording and recovering billable hours can have on profits can be more effective than telling them what to do.

The benefits which can flow from educating partners in this way and providing them with appropriate measurement tools, in the form of clear and focused financial reports, are likely not only to help drive higher performance but also to identify areas of weak performance as well as attitude problems. These issues will need to be dealt with if law firms are to emerge as stronger and more profitable businesses in an uncertain future; and in this, finance directors will have the pivotal role to play. However, will they be allowed to grasp that role and run with it? FD*Legal*

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