PETER SCOTT CONSULTING

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Law firm challenges in 2017

2017 looks like it could be a year full of challenges for law firms and the chart below sets out some of the major issues firms will need to address if they are to achieve and maintain their competitive edge over rivals. In this Briefing Note I offer some thoughts for law firms to consider as they face up to the New Year.

<u>Brexit</u>

Since 23 June 2016, no longer can law firms assume that their futures will not differ greatly from what they knew pre – Brexit. No one (including the UK Government) knows what Brexit will mean. If firms are to make valid decisions with confidence, then they will require foreseeable outcomes, but in the post – Brexit world, elements of certainty are only likely to return over time as political developments unfold.

To safeguard their futures, firms now need to consider what they should do to be ready for all scenarios which could arise from Brexit. This is where ***scenario planning***, used as a strategic planning tool, can help to develop flexible longer – term plans by using scenarios which can help to explore what the future might look like. Scenario planning helps businesses to effectively plan and to execute strategies even in times of high uncertainty, and indeed was developed to do just that.

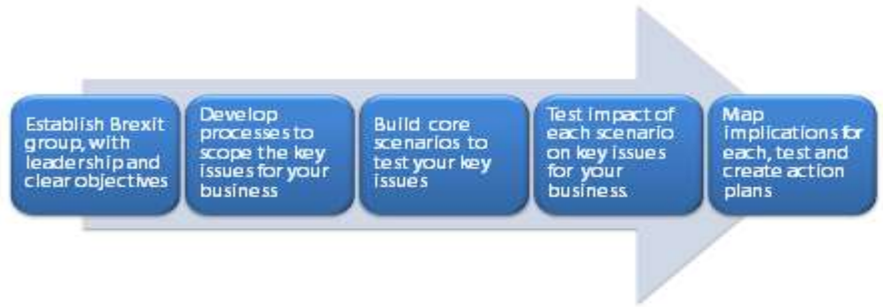
For many law firms the likely areas for developing possible strategic planning scenarios around *Brexit* will focus on:

- ***Risks*** to the business and will require firms to build risk management scenarios for the development and implementation of contingency plans.

New business ***opportunities*** which will arise and including ***new services*** to be provided in the future to meet changing client needs; and

- ***Innovation*** and new or improved working practices which will need to be brought to bear on the business to take advantage of opportunities or to mitigate risks;

We have developed the methodology shown in the flowchart below to enable law firms to use scenario planning on a continuing basis as events unfold. This has been designed to help law firms prepare for the uncertainty of Brexit by developing flexible strategic plans capable of responding more quickly to changing circumstances and to take advantage of the opportunities likely to be created.



Firms should not ignore Brexit or pretend it will not impact their businesses because they have exclusively UK practices – it will impact on their clients' businesses in as yet unknown ways with potentially serious consequences for law firms.

Your People

Their performance

In today's highly competitive legal markets, any law firm that wants to be successful must ensure that the performance of its people is actively managed. Ensuring that a law firm's people are highly trained, skilled and motivated should therefore be a priority if a firm is to effectively compete with its rivals. However, unless a law firm makes high performance a priority, it is destined to fall by the wayside in today's competitive legal world.

How can law firms bring about higher performance from all their people?

Training and development need to be focused on raising each individual's performance in ways that matter to clients and are regarded as valuable by them. How much training which is undertaken by people in law firms is focused on real needs and could be delivered more efficiently? Similarly, if the wrong things are measured and rewarded, performance can become skewed and wrongly focused. There still seems to be an overemphasis on personal billings and matter related hours, with still too little focus on client-facing performance and building the business.

Achieving higher performance

There is a virtuous circle for higher performance involving the following elements:

- Define and align individual objectives with the firm's strategy;
- Support development;
- Monitor and provide feedback;
- Reward higher performance.

It is possible to develop performance metrics (not just financial ones) – a balanced scorecard – and to measure performance against those metrics for such aspects of performance as:

- Client development (using client feedback and measures of the quality of relationships that a partner develops with clients);
- Marketing and business development (looking not just at new business wins, but at the number and quality of contacts being developed);
- Leadership (using feedback from staff about the way they are led, and measuring group leaders not on their individual achievements but on the success of the group they lead);
- There is a growing interest from law firms in obtaining broader-based performance feedback using 360-degree surveys to create a more comprehensive view of performance.

Where should you start?

A good starting point is usually an objective review of a firm's current approach to achieving high performance, relative to best practice and the achievement of its strategic objectives: what is working well, what could be improved, and what is absent? However, changing attitudes to learning and development should be one of the highest priorities for those managing law firms. Without this change taking place, training will too often continue to be wrongly focused, underused and ineffective.

For many firms, elements of the type of performance methodology described here will already be in place, even if they are not as effective as they could be. These can often be built on rather than introducing a new approach. A review will in particular identify the hotspots and quick wins that could easily be changed to bring about higher performance.

Rewarding high performance

High performance should be recognised and rewarded, because what gets rewarded gets repeated. Offering evermore challenging and intrinsically satisfying work, acknowledging and saying 'thank you', celebrating successes and giving public recognition are all positive and inexpensive ways of recognising and rewarding performance. They should be used liberally to reinforce positive behaviour.

However, as competition between law firms for the best talent becomes more intense, the manner in which firms manage how they reward their partners becomes ever more critical. Partner reward is driven by market considerations because all law firms exist in markets where performance by their people is all-important. Competition between firms for 'top talent' increases and firms which are unable to offer competitive rewards in their markets risk losing their outstanding people and will be unable to recruit the best.

The ability to *recruit and retain the best* which should be a critical element in any law firm's planning will however not be possible without the ability to remunerate partners at a level which is at or above the market rate. Financial strength becomes paramount.

Financial challenges

Whatever else a law firm does in 2017, it should work to strengthen its financial performance so as to be better able to deal with problems the challenges of 2017 may pose.

1. Build profitability

With many law firms reporting flat lining turnover but with increasing overheads, the imperative to build profitability is urgent if 2017 is to be a good year. While the level of work coming through the door is important, it is just as vital that you make the most of whatever work you have. This will depend on the **financial performance** of your people. Here are a few areas of people performance you may wish to look at as part of putting in place a profitability plan.

To discover just how much more profit could be generated in 2017, a firm should carry out a **financial performance audit** to find out how its people, its support systems and structures are performing. The focus of the performance audit should be on those factors which can most strongly improve profitability.

For example –

- ***Are people fully capturing all their matter-related time?***

Matter-related time should be regarded as only one component in arriving at what is the *'right price'* for the job. Even so, it is an important component because apart from anything else, without recorded time and descriptions of the work carried out, a firm may have very little evidence of what work has been carried out on a matter and will be ***at risk*** if bills are challenged.

There is clear evidence in many law firms that for a variety of reasons not everyone fully records their time spent on client work. People are likely to record just enough to meet their targets. However, are their targets realistic? / too high? / too low?

An audit of how much matter-related time is being recorded, compared to how long people are in the office each day and how busy people are seen to be on client work, is likely to show that there is a gap between the time people are actually spending on client work and the amount of matter-related time recorded.

- ***How much time which should properly have been billed to clients, was written off last year?***

The action which can have one of the greatest positive impacts on profitability and which requires the least work and effort is to improve the rate at which you recover (or realise) work in progress when a matter is billed. Introduce a **write off policy** requiring your managing partner's agreement to write – offs over a certain figure.

- ***Is work being carried out at an appropriate level and cost?***

Ensuring work is carried out by those with the appropriate level of expertise and at the most appropriate cost level is key to building higher profitability. To achieve this will require effective *delegation* and *supervision*, which in turn will help to build teams and better manage risks. A financial performance audit should aim to identify in particular which partners are doing work which others should be doing more profitably.

- ***What would a performance audit reveal in relation to pricing and managing work?***

Actively managing people's performance in a firm to provide clients with what *they* want on a **'value for money'** basis is one of the factors which will place a firm ahead of its rivals.

Clients are increasingly knowledgeable and sophisticated nowadays when buying legal services and understand the value or 'worth' to them of their lawyers' services as well as being knowledgeable about the cost bases of law firms. Accordingly they require legal services to be priced on a basis which is in their eyes 'value for money' relative to the results a firm achieves for them; and they will require their chosen law firm to do this 'better' than its competitor law firms. For example -

- Do you just quote hourly rates and provide an estimate based on those rates? If so, it begs the question – *'How do arrive at your hourly rates and your estimates?'*

- Or, do you consciously think about the profit you want to make on a job and then price that job with a view to achieving that desired profit margin?

- Do you exercise any controls over how your people scope and price their work or are they free to agree whatever price they want to agree with clients?

- Do your people know how to profitably manage work to an agreed price?

2. Build stronger cash flow

Cash flow cannot be left to chance – it needs to be **actively managed.**

One of the challenges for 2017 will be that even though firms may be able to identify the changes that they know need to be made to transform their cash flow, they may not be sure of where to start and may be unclear about the follow up processes they will need to pursue if they are to achieve success. Being required to contribute additional capital to a firm, or having to retain large current account balances, should not be substitutes to putting in place more effective cash management processes to ensure that a firm operates with no more working capital than is prudently required.

A more business - oriented 'culture' needs to be built into firms if cash management is to improve, because unlike a crisis which can force partners to change, just offering 'carrots' to partners to drive stronger cash flow will often achieve very little. If partners can live comfortably on their monthly drawings, then promising to pay them distributions of profits from the previous year or years to reduce their current accounts is unlikely to provide the necessary incentive.

Sometimes the only thing that will work is to hit the pockets of partners and so there is likely also to be the need for ***sanctions policies*** linked to cash generation targets, to penalise partners through their drawings and profit distributions.

Above all, an urgency to bill and collect has to become instilled into the collective mindset of partners.

Some firms which have been particularly successful at cash management have from the outset embarked on major initiatives to raise the awareness of partners and other fee earners to the importance of following 'best practice' financial disciplines related to cash management. Firms have launched extensive education programmes in an effort to help partners and fee earners develop a keen culture of financial awareness relating to providing credit to clients and educating those in the business as to what is required to maximise cash flow. Education as to ***'why'*** best practice financial disciplines should be followed is often one of the key elements in successfully implementing more effective cash management.

While 2017 promises to have its challenges, if law firms approach the problems these pose with sufficient forward planning and then implement necessary changes with energy and determination, then it is likely that they will end the year having made good progress.