May 7, 2014

Dear Friends and Associates:

Mark Twain said that, "Everyone talks about the weather but no one does anything about it." The same could be said about the issues facing law firms that aren't in the AmLaw 200 or located in a capital market city. But I suspect that's about to change. As always, your thoughts and comments are welcome.
Best regards,

Ed Wesemann

A Five Year Survival Plan for Mid-sized Firms

Not long ago, a friend and client who is the managing partner of a 150-lawyer mid-western firm attended a conference at which the main topic was the demise of the mid-sized law firm. After a couple of years of flat revenue growth and declining profits, trouble recruiting laterals, loss of clients to larger law firms and extreme client price sensitivity, he was hoping the conference would give him some answers. Instead, the attitude of the speakers seemed to be that mid-sized firms should either look for a merger partner or prepare to close their doors.

When my friend got home he called and asked me, "If you were in my shoes, what would your five year survival plan for our firm look like?" The following was my email response (which is slightly redacted and sent at his suggestion):

> Dear Mike,
> I think what the speakers at your conference were trying to say is that we are living through some permanent changes in the legal profession and just treading water waiting for things to return to normal won't work.   The biggest change is that we are in an era of extreme price sensitivity. Whether talking about appliances, airfares, auto insurance or groceries, for the majority of buyers, the concept of value seems to be largely overridden by a desire for the lowest cost. In fact, getting the lowest price is kind of a macho challenge to consumers. Spurred on by corporate cost cutting, individuals responsible for purchasing legal services rely on the same motivations they have developed as buyers of consumer products and, increasingly, price is playing the dominant role in the selection and retention of their lawyers.
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> Because of their client base and practice, mid-sized firms tend to be in the front lines of having to adjust themselves to the new normal extreme price sensitivity. While alternative fees and techniques like legal project management may help, the real answer is that law firms are going to have to squeeze every bit of profit they can from each revenue dollar. For years the law firm management mantra has been to worry less about cutting costs and more about generating revenues.   But the new normal seems to be dictating that firms must dramatically restructure their business model to focus on stringently managing costs.
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> While we have joked about your firm's concept of cost cutting being serving domestic wine at partnership meetings, I know that you, like most larger law firms, have already done some serious belt tightening. But that's nothing compared to the tectonic shift firms are about to experience on the cost side of their income statements. This is because cost reduction has a multiplier effect on profitability. That is, for a firm operating with a 40% margin, a 10% decrease in operating costs results in a 15% increase in partner distributable income. For a firm like yours that is closer to a 35% margin and the value of a 10% expense reduction is an 18.5% rise in partner income.
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> So here is my off the top of the head five year survival plan for your firm:

1. Stop making partners. The biggest problem with the partnership structure is the cost of keeping partner level lawyers busy at their high billing rates. Regardless of whether law firms in the future bill through fixed fees or by the hour, the win is going to come through increasing the margin on each hour by pushing work to the least expensive possible level - and that means there is not going to be a lot of work left over for partner level lawyers to do. The alternative of making associates non-equity partners only exacerbates the problem and we've already been 'round the maypole on trying to shed under-productive partners. Are there circumstances in which firms should continue to make partners? Probably, but they are few and far between. As the saying goes, when you're in a hole, the first thing you do is stop digging.

2. Stop hiring lawyers. Your primary motivation in hiring laterals is to fill the plates of the lawyers you already have. Like virtually every law firm, you suffer from excess capacity because your firm is staffed up to handle peak volumes of work the way that shopping malls build parking lots to accommodate Christmas demand. The result is a constant battle to keep lawyers' plates full and the evitable pressure to overbill to fill the time available.

3. Match resources to available work. Pushing work to the least expensive level means that large amounts of work must go to paraprofessionals and the primary job of some lawyers is going to be solely supervision and training. Of course this brings screams about malpractice risk. But, if you look at your professional liability incidence reports, you'll see that the bulk of most firms' risks are related to fatal dates and procedural issues rather than professional judgment.

4. Pay less for timekeepers. There are two ways to cut timekeeper cost. First, reduce salaries. We know that there is an abundance of college (and law school) graduates seeking jobs and that millennium kids tend to only stay in jobs a couple of years. Take advantage of the buyers market by hiring bright eager graduates and invest in some upfront training on how to do the specific tasks you need. In exchange for a couple of weeks of training, you'll get an inexpensive timekeeper for a couple of years. The other way to cut timekeeper cost is to avoid surplus capacity. Maintain a small cadre of experienced timekeepers to handle training and supervision, and to perform legal work when business is light, but hire all other timekeepers on a temporary or hourly basis. That way the firm only pays for time that is billable.

5. Digitize everything. Focus on a good document management system and scan every piece of paper that comes through the door into it. It won't be a big job because most documents and information arrive by email anyway. With the rare exceptions of documents that are legally mandated to be maintained in hard copy, eliminate paper and filing.

6. Eliminate assistants. We are rapidly reaching the point where all lawyers are proficient in keyboarding and document creation, and we've already gone to such high lawyer-secretary ratios that many lawyers effectively operate without an assistant anyway. In a paperless office, the higher end secretarial functions become billable when given to a low hourly rate paralegal.

7. Pay less for offices. Telecommunications are transforming the role of the physical office. Lawyers are increasingly telecommuting from home offices and clients seem to prefer on-line video conferencing to coming into their lawyers' offices. With fewer permanent lawyers and assistants, the space required will decrease over time, and with fewer visitors, justification for primo office locations and the palatialness of build outs will decline. Think suburban office park designed on an open space concept except, maybe, for private offices for partners.

8. Bring your own device. Make providing their own laptop and mobile device the responsibility of the timekeepers. It's not like the firm would realistically consider hiring anyone who didn't already have a computer and a cell phone. The role of the firm will be to provide technology that is accessible by any device rather than requiring that the devices conform with the firm's technology. Anyway, most of the hourly paralegals you're going to hire would rather use their Macs to your clunky PCs anyway. I'm sure there are some security problems but your tech guys have five years to figure that out.

9. Manage the place. To survive, firm's can't be a bunch of solo practitioners sharing office space. There is a specific way your firm practices law and no one is allowed to opt out. Develop a cost accounting system that helps you manage the operating cost per hour down to the penny.

1**0. Make reasonable fees part of your brand.** Whenever someone mentions lower fees in a law firm, the partners immediately say they don't want to be the Wal-Mart of legal services. Okay, but what's wrong with being Target? The key is to develop hourly rates that are less than your primary competitors and expand your margins by managing your cost to those prices, just like the rest of the free enterprise system. And then lead with pricing when you pitch potential clients.

Best regards,
Ed

So, that's what I told my friend. In fairness, his firm probably won't do much of what I suggested and they'll still trundle along for the foreseeable future. But it won't be long before someone in your market does something like I described above. Then what are you going to do?

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