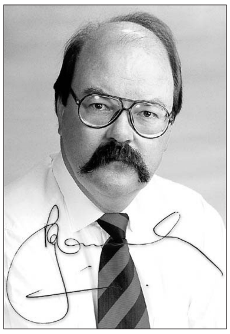

# KMS ProfitPower Tips for Lawyers™

EDITOR: Rob Knowsley LL.B MIMC www.lawfirmprofit.com February 2002

**Increase Your Profit Results Dramatically! Reading time... only 8 minutes**

## Feature Article...

### Traps When Adding More Equity Partners

**Covered in This Issue**



## Robservations

In the November 2001 issue we considered average levels of partner returns in different types of firms in different locations.

We commented that the 1999/2000 positions, "would surely improve", in the statistics out for 2000/2001.

The actual 2001 results were a mixed bag.

The Top Profit Firms in the 2001 Financial Management Research Centre Survey of the Legal Profession (excluding those firms billing above $25M) showed the following changes...

Smaller CBD firms... billing under $5M... average per partner returns rose from $332,000 to $542,000.

Suburban Firms in Large Cities... Average returns went down from $515,000 to $432,000

Regional City/ Large Country Town firms went down from $410,000 to $320,000.

The returns for these better profit firms are still quite healthy, even after the declines in returns in two of the three groups mentioned.

Readers should of course bear in mind that the mix of firms contributing to the Survey might well have changed significantly from 2000 to 2001 years.

The Regional City category for example has changed in the Survey since last year.

There were about thirty fewer practices in the Survey in 2001.

It should be remembered that the FMRC excludes from the main figures a few exceptionally high profit practices... with partner profit exceeding One Million Dollars per principal... and now profiles these firms (just four in 2001) separately.

While all four practices did a substantial amount of personal Injury work the Survey commentary makes clear that its other results show that PI work is not intrinsically more profitable than Commercial Litigation, and practices with a strength in Family Law also performed well.

The four practices were highly geared, but despite this did not suffer the drop in per person productivity that many other highly geared practices do. They are well managed.

KMS has consulting involvement in seven firms in Australia in which per partner returns exceeded $1M in 2001.

Not all presently participate in the FMRC Survey.

Our own analysis of those seven firms confirms that substantial leverage of effective, highly productive, employees to Equity partners is a key factor in profitability.

Management systems are geared to ensuring that team members have clear goals, there is good feedback, salaries are generally higher than otherwise similar firms, and marketing systems are generally better, capable of keeping the work up to the team members most of the time.

Productivity is maintained, despite a large span of control, through the practice-wide use of proven systems, rather than through reliance on a larger number of partners leading teams in their own personal styles.

This Equity Partner / Business Manager theme is picked up in the Feature Article which follows.

The FMRC Survey is a high quality publication, and is only available to those firms which participate. I urge those readers not presently involved, who are interested in getting good comparative data, to participate in 2002.

The Editor, Rob Knowsley, is a lawyer who has practised successfully with firms of all sizes, city and country. As KMS Senior Consultant, his insights are based on the experience of fourteen years of consultancy assignments and telephone support in all areas of practice management and profit building. Many practices have quickly reaped the monetary benefits and enjoyed the feeling of being in more control of their businesses through his practical help.

# Feature Article...

## So you're planning to add another Equity Partner... have you considered carefully why?

As discussed in the Editorial above, gearing of productive employees to Equity partners is a big factor in practice profitability.

Of the four Exceptional Profit firms in the 2001 FMRC Survey two were Sole Practitioners and the average number of partners was only 2.25, with a maximum partner size of four.

Nevertheless, the firms had average ratios of employees to Equity partners of over 40:1.

Traditionally many practices have assumed that it is essential to keep adding Equity partners to lead teams, bring in work and to keep the span of control manageable as a firm grows.

The theory may be fine, but in practice many of the smaller firms, operating without effective practice-wide systems, have found that per partner returns don't grow quickly after the admission of most new Equity partners, and in fact often decline.

This article explores why...and what the alternatives are to keep gearing high without losing productivity.

Many Equity partners are admitted for the wrong reasons.

- Because it was perceived that they otherwise might leave the firm.
- Because a partner or group of partners thought they were a good person.
- Because they were a high-billing employee.
- Because they'd hung around long enough without causing anyone any real pain.
- Because discussions with them, started lightly and without any planning, developed too fast for cooler heads to call a halt.
- Because they had a particular legal skill (the personality by-pass and total lack of team leadership skills somehow got overlooked until too late).
- Because although all they wanted was stability, status and a good income, someone offered them Equity when Non-Equity partnership would have met all their needs.
- Because when they were made a Salaried Partner...it wasn't made clear (where it should have been) that Equity was not under consideration, not a natural consequence after the passage of another year or so.
- Because an existing Equity partner wanted to get out or reduce share, and needed a buyer!

There are many other similar "wrong reasons".

What firms which are aiming to increase profit need is strong leadership, clear goals, good practice-wide systems, great project management and superb people management.

Nice people who can bill a lot don't always have the necessary skills to really help you take the business somewhere... and may actually go backwards when taken out of the comfort zone and required to lead and manage teams, develop business and manage it, plan projects and implement them with regular reporting to management, continually develop technical skills and develop new market-oriented services which are profitable.

Unless you are comfortable that a planned Equity Partner really is a terrific person to be going into business with, for all the right reasons, find out what their aspirations really are and find other ways to meet those aspirations.

Very few people will suddenly take on the characteristics of a real partner <u>after</u> having been made one.

Business development these days is more sophisticated than just relying on a rainmaker partner... it has to involve the whole practice.

Smart practices realise that allowing individual partners to run their teams as they see fit is not necessarily in the best interests of the partners as a whole, and firm-wide management practices are installed which do not rely on individual partners.

There is always a debate raging about whether Equity partners should be <u>equal</u> in equity... or whether smaller equity interests can still be consistent with a fully successful and harmonious firm.

Our view is that with proper definition of goals and roles, and with careful setting of Notional salaries (including differing salaries between partners) and levels of return on equity holders' capital, the main problems caused by varying equity levels can be eliminated.

Other issues to consider arise when existing Equity partners have multiple, often stand-alone, businesses within the law firm umbrella, such as Investment Advising arms, Mortgage Funds, Insurance Businesses, Real Estate firms, Rent Rolls and the like.

Always carefully consider whether a new Equity partner will genuinely add value to any of these entities before offering to sell or allocate an entitlement.

For your e-mail copy of a short article... "Ten traps to avoid when choosing a new partner" ...e-mail us at kmsrob@bigpond.com.

# KMS Practical Tips…

**Tip #1 Realisation rates… watch closely and learn the reasons in each area of law.**

The recent FMRC 2001 Survey highlighted what you all knew...that firms too heavily based on Property work will struggle on the profit side unless they are very systematised, using technology heavily, have good volumes, and are involving as few lawyers with high charge rates as possible.

If lawyers get too involved, the perceived fee constraints, which may be exacerbated by insufficient volume of work and low technology use, mean that apparent Realisation rates crash.

Remember that if you are time recording in Conveyancing and using six-minute minimum units, you will get a higher apparent WIP "value" than some other areas of work because there are many, many, small tasks needed in each Conveyance.

This will tend to give you lower apparent Realisation rates.

Don't over-react.

First…check that team members are in fact recording significant leverage units each day. It's no point assuming that they are… check it.

If they're really busy they will be.

Do your profit analysis in the team on a macro basis… not micro or file by file.

Work out the total cost of the team and see if the fees being banked are giving you a reasonable return.

Because volume will give you plenty of potential for generation of fees above the break-even point for the team, you may be now or may be in the future generating decent profits despite the apparent Realisation rates being quite low.

Check, check, and check again... or the profit baby may just be dumped out the window with the Conveyancing bath water.

**Tip #2 How to always optimise your billing…**

Good cashflow management is the difference between misery and happiness, success and failure. It ensures good productivity is heading down the path to being cash in the bank… rather than sitting idle as further capital locked up in the practice.

We are still observing too many firms where billing is not the subject of a tight, practice-wide management system.

Too many fee-earners are billing when they think they can get around to it, and/or aiming merely for targets, rather than billing optimally for the firm.

Management risks getting dragged into knee-jerk requests for fee-earners to "get on and bill budget"… when they may already have done so, or be quite incapable of doing so in a particular month for very good reasons.

Morale in your team members can be affected by this type of approach… apparent almost monthly in some firms, even quite large ones.

The trick is to implement a firm wide system such as KMS Cyclical Billing™, which, properly implemented, guarantees that the firm will optimise its billings every single month, every year, for ever.

Notice that we are not talking here about hitting your targets… optimising is actually better, because it will take you way above targets some months, and you can "relax" in the bad months, and spend your time more productively, looking for more fundamental reasons why billing has to be low until remedies are implemented… things such as poor file velocity, poor case management etc.

For an e-mailed description of KMS Cyclical Billing™ e-mail us at kmsrob@bigpond.com.

# Technology Tips…

**Tip #1 Who has access to your bank accounts?**

In November 2001 the NSW Law Society Journal published a letter from a concerned employed lawyer in which he pointed out that his employer's bank was giving him Internet access to two of his employer firm's Bank Accounts in addition to his own private accounts.

He had been given signing authority, in conjunction with the firm's bookkeeper, during specified periods of absence of his employer.

The bank's procedures allowed for Internet access to any account on which the Employee was a signatory… irrespective of the fact that the Firm did not want Internet banking as a facility.

Presumably a situation could easily exist where firms are not aware that their banks still think employees are signatories when they are not any longer and may even have left the firm's employ.

Access to Office and Trust Accounts is never a matter to be taken lightly, and as the letter writer suggested, practitioners may be well advised to check the current situation in their own firms… who does the bank believe is an authorised signatory and do they have Internet access?

# Critical Success Factors...

**Tip #1 What do the managers of leading profit firms think are the key issues in their success?**

In no particular order…

- **Gearing/leverage**
- **Having a clear per partner profit goal**
- **Focus on more profitable work**
- **Cashflow management**
- **Realisation rates**
- **Fun/profit axis**
- **Nominal charge rates set correctly**
- **Synergy of Individuals' goals with the firm's Business Plan**
- **Marketing culture and effectiveness**
- **The right people in the right positions**
- **Writing down values and acceptable behaviours for the firm and communicating them from day 1**
- **Increased productivity through technology**
- **Comprehensive time recording**
- **WorkPlans™ for all fee-earners**
- **Professional self-development**
- **Enjoyable working environment**
- **Credit control**
- **Planning premises needs carefully**
- **Management of Expenses**
- **Management focus through training**
- **People!!!**

**Tip #2 Where are Management Partners most effective?**

In the last six months or so we've observed many well-meaning advisers to legal firms suggesting to key management partners that their personal fee-generation was too low.

The advice seems to be based on a strategy of getting every potential fee-producing person producing as much as possible, especially partners with potentially higher hourly charge rates.

Beware… as other material in this newsletter highlights, the most profitable firms in Australia have heavy gearing, yet maintain high productivity in the many more people supervised and managed.

That doesn't happen by luck.

It is extremely difficult, if not impossible, to do that excellently while juggling a substantial hands-on case load.

In most of the Exceptional KMS firms, management partners do only that… they manage… and not only does the firm lose nothing by it... it gains substantially.

Most would not be where they are today had they not followed that strategy of a partner leading and driving with a clear focus…over time supervising more skilled managers at other levels and in disciplines where the partners as a whole have little expertise.

In a legal firm… "Many can produce fees… few can manage".

Only in areas where you can demonstrate that a non-partner can do just as good a job at a much lower cost should you free up a partner from the area… but in my experience there are always ten new challenges to be faced by a capable manager/ partner…he or she cannot and should not simply merge back into the fee-producing base unless you want to slide quietly backwards.

This is not to say that all partner managers are good at what they do… many are not, and often the roles have been thrust upon unwilling and under-skilled people.

Further, the Management partner does not have to be an expert in every area and carry out every management task.

These days there are too many areas and too many skills needed in each for that approach… if it <u>ever</u> worked well.

The management partner is a leader, a coordinator… keeping an overall perspective and pulling all the important threads of the firm together.

Could an appropriate CEO do that?

Maybe, but often the type of person needed to be really effective would want a similar remuneration to what the existing partners are earning, and few partners are prepared to wear that.

What works does differ from firm to firm but we have seen many firms stumble when attempting to introduce a CEO or General Manager allegedly to take the pressure of a management partner or partners.

The partners should not assume that they can substantially return to direct fee-producing work. They may however finally get time to concentrate on some of the issues, particularly strategic issues, which they have not had time for to date, to the continuing detriment of the practice.

**Tip #3 Pricing legal services… the problems are more in the lawyers heads than the clients' wallets…**

In our experience many lawyers undercharge for their services.

There are many reasons… too many to try to examine here, but most are in the lawyers heads rather than really in the marketplace.

In most under-performing firms in

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which KMS commences consulting there are revenue problems caused by under-charging.

Recently we prevailed upon a firm to take its Conveyancing charges back up the market, with a few value-adding twists.

The new prices were scary to the team members involved, but, assured that they would not lose all their work, they proceeded to introduce them at a level which improved profit on the average transaction 100%.

The market reaction was exactly as suspected... by us not them! Not a ripple.

As a simple example… if a firm is charging $750 for a Conveyance and making $250 on average per matter, it can increase profit per matter by 66% (to $415) by charging just $915.

Increases of amounts like $165/matter are easy to test in any market…all you are doing is getting closer to what the service you are rendering is really worth.

Keep away from rounded, threshold figures like $1000.

$985 is better and $1125 is really gutsy… adding another $140 profit per matter.

If you are doing 85 matters/month in the team, just $100 profit extra per matter is $100,000 extra profit for the team…maybe the difference between being seen as profitable compared to being seen as a dead loss practice area.

On the same theme… we recently introduced some simple Business Development into a firm, which increased the flow of enquiry and work, giving the partners the confidence to state bigger amounts of "Investment" to clients in the fees they'd have to pay for getting the help they needed from the firm.

The partners were startled and delighted to discover that work previously considered dead loss was now coming in with immediate deposits into the Trust Account, at levels previously considered impossible to get as the total fee, let alone a mere deposit.

"Ask and ye shall receive" is clearly a strategy worth exploring at every available opportunity.

Knowing that your Business Development is working… and that every matter is not a good matter and can be rejected, creates the confidence to ask for what you know you are worth.

### Tip #4 Why tracking collectable work in progress is so important…

In October 2001 KMS was able to point out to a senior Family Lawyer that despite having billed 102% of his first quarter fee budget he was on track to having a very poor year for billings.

Work in Progress shown on the KMS Feedback Report™ was falling, time recording shown on the same report was falling, and the annual projection indicated that based on the Work in Progress created in the first 57 days that the lawyer had worked in the year, he would only create about $278,000 worth of "Raw" Work in Progress for the full 230 days.

If he continued to realise it at his current average of 87% he would at some point be able to bill only $242,000 from the WIP that he would create in the year, compared to a budget for collectable Work in Progress of $339,000… which he had agreed, when setting his KMS WorkPlan™, was a perfectly reasonable goal.

The firm's graphs comparing files opened in Family Law and the projected values of those (projected both by the lawyers themselves and by using historical data) indicated that files had been running at a level which was too low for some months, and while additional marketing steps had been taken, they were not being taken with appropriate intensity, and were not yet bearing substantial fruit.

The days when legal firms could afford to be measuring productivity based primarily on current billing should have long passed. Hopefully this anecdote will reinforce that point for you.

To view the content of a sample KMS Feedback Report™ online - visit www.lawfirmprofit.com and click 'Management Communication'. ▲