

KMS ProfitPower Tips for Lawyers™



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Robservations

Welcome to Issue 40 of ProfitPower™ Tips For Lawyers, March 2011. I trust you find some thoughts herein of interest and/or value.

How on earth does law firm cash dry up so quickly...so often?

“Annual income twenty pounds, annual expenditure nineteen six, result happiness. Annual income twenty pounds, annual expenditure twenty pound ought and six, result misery”.

Charles Dickens, *David Copperfield*, 1849

All too often, over the last twenty-three years of my consulting to law firms, principals have bemoaned the apparent “sudden” tightening of cash availability...

The impacts vary with the situation of each firm, and range from just an uneasy feeling about the immediate future, to difficulty paying bills, and in particular, wages, and on to the ultimate, banks refusing to meet cheques and even calling in loans...

The banks classically demanding their umbrellas back during a decent downpour is every principal’s worst nightmare...the ultimate stress test...

Observing so many firms, and helping many out of “the crisis of the moment”, it is clear that often those with their hands supposedly on the levers do not fully appreciate how easy it is to allow cashflow to slow down...or at least they often seem to do not nearly enough about it...early enough.

Usually there is an enormous burst of activity to chase fees, bill unbilled WIP, collect more on account of fees and disbursements, and of course, cut costs, slashing expenses (yet again) and putting off staff...

Once the immediate crisis has passed pretty well everyone on the team goes back to operating exactly as they were

The Editor, Rob Knowsley, is a lawyer, admitted 37 years, who practiced successfully with firms of all sizes – city, suburbs and country... in Australia and New Zealand. As KMS Senior Consultant, his insights are further based on the experience of twenty-three years of consultancy assignments, and telephone/e-mail support, for lawyers...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 business through his practical help...as multiple referees attest.

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before...happy that things have returned to “normal”...

Sometime systems are changed for the better in response to a cash flow crisis, but often not, and even when systems are changed there is all too often a complete failure to ensure that the systems are consistently followed in the future...

Despite a writer of the stature of Dickens making it so clear way back in 1849, I’m not at all sure that enough principals truly understand how little room there is to move, how thin their real margins are, and exactly how working capital is utilised in their firm...and this must impinge upon the effectiveness of their responses at least as much as other causes like perceived lack of time...

Working capital moves variably through a firm with different types of work, even when fee-earners, support and management are doing everything right...and, almost invariably, as a firm grows it needs more working capital, whether systems to optimise cashflow deteriorate or not.

There is a big range of reasons why working capital can become tied up longer than desirable, causing cashflow to slow and money, for the purposes you need it for, to be in short supply...

It’s just part of being in business that “things” will happen and suck in additional working capital, and you need to be geared for that...

However, a well-managed business does not need to run poor systems, or good systems poorly, such that working

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capital is tied up unnecessarily...

When you put a dollar of working capital into your practice, for rent, interest, wages, power, insurance etc, you do so with the intention that it will be tied up for a while, but come back to you after a reasonable time, with an element of true commercial profit attached to it as a reward for running the business well...

Let's assume the margin is 10% (after principals salaries) and you **do** actually get the original dollar and margin back on time...what happens next?

Of course the original dollar almost always goes immediately back into the firm again as the next, never-ending, slew of expenses, leaving you with just 10 cents!

That paltry 10 cents has to be spread very thinly!

- Many firms will set aside a reserve for a rainy day...
- Some of it will be required to retire debt on principal and interest borrowings (the interest already being covered by the dollar invested in expenses)...
- More of it will be needed to be "left in" if the firm is growing and needs more working capital invested by partners' retained earnings...
- Capital purchases are made that are not included in expenses and are "too small" to have borrowed specifically for...
- Hopefully there are some meagre cents left for a principal's profit drawing...remembering that some firms also helpfully set aside funds for principals' anticipated tax obligations down the track...so that's more cash that doesn't actually ever find its way into your pocket.

There are a lot more places cash can go even when we get it all right, but it can be seen that, as indicated earlier, there's never much room to move.

Very often principals are asked to inject more loan funds back to the firm...and often they do that without doing nearly enough to address going forward why it was really necessary, and how it can be most likely avoided in future.

It's obviously one heck of a lot worse if the original dollar doesn't come back to you with it's profit margin attached in a reasonable time...and seriously dangerous if it comes back late with no profit margin attached at all!

One of the built-in laws of business that gives us all so much joy is that the outward stream of cash is pretty consistent, and it's been under the microscope for so long

anyway there's not much available scope for managers to alter it...

So when new working capital availability is tight, and banks and principals do not want to, or cannot, provide more, even restrained outgoing cash causes a squeeze very quickly.

Reserves that were set aside are used up in a blinding flash...it becomes very hard to make loan payments, purchases are limited to desperate essentials, creditors get delayed even more than usual, tax payments are not made, and principals become very scratchy because they can't get any drawings beyond salary in the early stages, and even that dries up in due course, usually initially so staff can be paid on time...

In trying to make sure that the continuing working capital you need is there from the operations of the firm itself, what sorts of things go wrong most often?

- Firms allow the time it takes to get paid by clients to blow out once bills have been rendered...

Obviously this means you do not have available to you the same cash you would have if everyone paid on time or at least only as late as they were paying previously!

- Firms do not bill every matter at the earliest possible time commensurate with the arrangements they have with the client...

Unbilled Work In Progress is unnecessarily high and it's average age increases...holding working capital in "suspense", tied up in files without clients even being asked to pay!

- File velocity drops on the work in hand, so you do not reach the points where arrangements might allow you to bill clients...

Even when the human resources engaged in the matters are diligent, a workload that is too big for the allocated resources will cause a slowing in file velocity, again meaning matters take longer to reach a point where a bill can be rendered...

- Fee-earners simply do not have enough productive client file work to do, so even if diligent about what they do have, cannot produce enough fees to meet their KMSWorkPlan™, and will thus generate far less than the planned margin on your costs of having them on the team...
- Disbursements are incurred without funds in from Clients to cover them, in situations where that makes no good business sense.

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Obviously there are many other key causes of cash drying up fast, but in many firms there are not even the most fundamental tools in place to identify potential problems early enough.

For example, far too many files may be commenced where your ability to get paid in full on time is not protected. Work is done, often very large volumes of work, where you may never get paid. These jobs suck out of the firm much of the profit margin on your “normal” jobs, and may well mean that the employee(s) involved are a large net drain on your financial resources rather than a healthy contributor to profit and cashflow.

Fee-earners regularly fail to bill every matter they are entitled to at the earliest possible time...they simply do not get around to it, and usually can trundle out every “reasonable” excuse in the book...but of course expect to get paid for every day that elapses... while their properly accountable team members are doing what it takes to try to keep working capital moving and the firm soundly afloat.

The simple acid test for all unbilled Work In Progress must be applied and monitored at least once a month...Bill it now? Hold it to bill later with good reason? Write it off now with good reason?

If someone with experience applies the acid test to all unbilled WIP of every fee-earner much will be learned about the way work is being done on those files, and again, early action can be taken to prevent more waste and future serious bleeding.

All too often, the inability to bill large slabs of WIP is not discovered until after a team member leaves. A once-a-month proper analysis is far more effective in weeding out problems.

People sometimes take on far too much client work without a proper appreciation of what the resulting reduction in file velocity does to cashflow. The velocity of all Work In Progress must be monitored closely and causes of deterioration scrutinised so effective solutions can be found early.

In the majority of situations cashflow problems are caused by people not doing the right thing, and exacerbated by management taking its eye off the ball.

Managing lawyers is a difficult skill, made more difficult by managers not engaging lawyers enough in understanding the essential, non-negotiable, behaviours required of a thoroughly competent professional.

Too much leeway is given, usually born out of a desire to avoid confrontation, and there is far too much surprise

expressed when people let the team down in a big way.

The lesson is there for the learning. In most businesses the gap between financial “happiness” and financial “misery” is very small indeed, and leaving team members alone to try and get it right, without strong non-negotiable guidelines, is a pathway to serious unhappiness.

The Keys To Practice Success According To Your Peers...

Some time back I asked principals in KMS Client firms what they considered to be the keys to success...

I have simply cut and pasted their comments here for your interest...the important themes are very evident...

1. **Equity owners who are focused on the marketplace and prepared to change as it does...**
2. **Staff who understand:**
 - a) **the goals of the practice...**
 - b) **that the client service is all-important...**
3. **Management that is focused on effective and efficient production of work...**
4. **Client engagement and management being a top priority...**
5. **Having fun and keeping your staff**

1. Passion – if staff at all levels (and particularly partners and team leaders) do not demonstrate in practice a passion for what they do, then mediocrity will eventually become the benchmark. I don't mean passion in any wacky motivational sense, but in the sense of having pride in what you do, commitment to clients and each other, and constant improvement in what you do and how you do it;

2. Persistence – the future lies not only in doing good work but also in letting everyone know it. Marketing does not come naturally to lawyers, but networking often does. However, it is rarely an instant fix and the real results follow long effort, sometimes years of contact, before landing a particular client. You just have keep consistently marketing and networking – something that is hard to instill in the younger Gen Xers who expect instant results;

3. Pride – not the ‘it comes before a fall’ type, but a genuine pride in your firm, its people and what it does. Often demonstrated by the response to being asked what you do – so many lawyers appear to almost apologise for being a lawyer, or have trouble articulating what exactly their area of work is. All staff should be proud of where they work and what the firm does, and easily answer the question ‘What do you do’ with obvious pride and clarity.

These 3, with hard work (which inevitably follows if you have these 3 characteristics), are my ideas for the foundations for success.

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I think there are different ways to build a successful practice. There are the obvious ones like recruiting, training, and keeping skilled and motivated staff, and promoting your business to your market.

But one that no-one seems to talk about is the quality of the work you do, perhaps because it is so intangible and hard to implement and measure.

But a firm can be built up, simply by doing work for clients that causes them to keep coming back and recommending others.

It involves really understanding the client's goals and providing intelligent solutions, in the interests of the client. This applies even if the advice you give is not in your interest, such as telling the client they don't need the expensive legal work they thought they needed you to perform.

If you ask clients what they really want from their solicitor, they will refer to factors like this, rather than impressive marketing.

Practice success - my definition of it changes with the seasons!

...but here are some keys that have helped me stay sane, and keep the Handicap at a respectable level...

1. Stay on top of your financial reporting...a decent financial return for me is fundamental, otherwise you are only buying a job for yourself...
2. Surround yourself with WINNERS - be they clients, staff, partners, professional associates, bag carrier etc...
3. Act for people who appreciate where you are coming from, on jobs you want to do, in areas you are competent in and mostly enjoy...

What makes for a successful law firm?

In my view the following three things are key:

- ◆ Trust between partners, and between the partners and staff.
- ◆ Fairness between the partners, and fairness to staff.
- ◆ Open and proper communication between the partners, and between the partners and staff.

1. Enforce your behavioural values
2. Err on the side of taking decisions for the long term rather than the short
3. Get the Rates v. Leverage equation right

Three thoughts on what is success for a solicitor, looking at it as 'success in his work' as a solicitor.

- A) That you have clients who seek your advice, and that the work they give you allows you to practice and use the full array of your experience and skills.
- B) That you have working with you a team of people who assist you in your work so that there is an appropriate delegation of work and that this works effectively.
- C) That you have learnt to be selective when you accept instructions, and that you do not embark upon work that would be better for other firms to do, and that there is a proper balance of pro-bono work.

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"Success" for me are those things about a legal practice which give me the buzz to want to get out of bed in the morning, and come racing in here in the mornings to get cracking. It is not all about financial matters but some of it is.

It is a full day of client work in which I get to bill lots of work, minimal wastage of time, minimal wastage on administrative matters (except for supervision of others also billing to get good leverage). It is achieving a lot in a day without undue interruption and the feeling of fulfillment received from achieving desired (and promised) outcomes.

Success is also about working in a positive happy environment where each team is genuinely striving to do its best, where there is little staff turnover, and each person is working to achieve his/her own goals, whether they be to attain partnership, or to earn that little bit of second income by working here 3 days a week as a receptionist or secretary.

Success is working in an office where everyone gets on pretty well, and where, even if they don't, everyone respects everyone else, and the efforts of the team as a whole to produce the best that we are able to offer. No bitching, backstabbing or petty jealousies allowed in my model of success.

Success is when you do an annual budget that is realistic, achievable and challenging, and you realise it, achieve it, and meet the challenge.

Having good staff that can understand why, and then follow, the WorkPlans, and record what they do...

Having good staff that can provide quality advice to clients to add value to the client...

Making sure clients/potential clients know the value we can add to their business/private lives so they come to us with their issues for resolution.

In a nutshell I believe that the keys to success in practice are...

- 1 Purpose/Objective...**
Identify very clearly what you are trying to achieve by being in practice...
- 2 Outcomes...**
Identify the outcomes that you clearly need to enable you to achieve the above...
- 3 Focus...**
Adopt a very strong focus on the above...
- 4 Consistency...**
Make sure that everything you do, and all decisions, are consistent with all of the above...
- 5 Passion...**
Do all of it with a real passion.

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Management Errors In Law Firms...

KMSTIP #2

(#Tip1 appeared in the previous newsletter #39)

Inability to be effective in using Business Development to take the business to the size and shape you want it to be...

This topic ties strongly in to productivity and to proper generation of profit because a sound use of marketing can ensure that well-managed employees are actually operating for you in the profit zone, with a permanent healthy backlog of client work.

The reality is that in most firms partners are far too busy all the time and employees properly busy almost never... a situation that is more than slightly back to front!

Far too many lawyers in small-medium firms are still either shy of marketing, or actively averse to it, treating marketing with suspicion, as expensive hocus pocus to be avoided at all costs.

In teaching what I prefer to call “Business Development” I stress that thinking about what it really is correctly can help lawyers get the right mindset.

Marketing is identifying what clients and potential clients really need from you, and organising your business to supply that service consistently well... and profitably.

Because you see this now as a **helping** activity, it fits neatly with the professional service ethic, and removes the inhibitions you may have about “blowing your own trumpet”...because you never need to do that directly.

People and businesses have known and unknown needs...you deliver services that meet some of those needs so you need to build clear reputation for being the firm to at least call for a chat. Get the phone ringing, and the email humming! From leads and enquiries come jobs.

So, what’s the best way to do it?

Far too often when lawyers think marketing they really still think advertising...and I’m here to tell you that often advertising isn’t the most effective thing to do per se, but also that it is often not a very cost-effective thing to do either...poor return for your dollar often.

Further, advertising tends to need to be fairly continuous,

so once you become dependent on a flow of work from it you can tend to find you are locked in to the expense for so long as you want that level of enquiry.

There is a far better way most of the time, and again it fits with lawyers’ natural inclinations and skills.

Use **information** freely available to you to educate client, prospect and referrer groups, so they are more aware of their needs and also can see you demonstrating your skills and your reputation builds.

Demonstrating your capabilities is far more effective than merely alleging what you can do...so in simple terms a newsletter full of practical, relevant, helpful information is far better than a sales brochure or capability statement.

It should go without saying that different services need to be marketed in different ways to different marketplace groups...hardly ever is Business Development a one-size-fits-all situation.

For this reason I’ll just give you a few of the simple tools from the toolkit...and then give an example of how you might choose from the available tools for the particular job.

Small seminars, newsletters (Electronic and hard copy), short emails, articles in suitable publications including websites, articles on your own website, How’s Things visits and calls, talks to suitable interest groups, blogs etc.

N.B. I have a simple list of 55 Business Development tools for lawyers that I’m happy to email to anyone who emails me with a request for it...

bdevtools@lawfirmprofit.com

So, for example, if you were interested in building reputation for your services in Estate Planning, advertising would often be of limited benefit, but a strategy of educating the right parts of your own client base, and educating the best referrer groups such as Accountants, would be far smarter and more effective.

You would test the results of the use of each communication tool over time, building emphasis and reducing emphasis on the various chosen tools as you track results.

In educating the Accountants you could test the value of visiting their offices to talk to groups as part of their own professional education program, could put on seminars, and could back up this program with an E-newsletter, or

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more preferably simply a series of short emails packed with practical, relevant, helpful information, and usually containing a simple War Story (case study) to help get the point across.

Use Plain Language and keep right away from case names, names of Judges giving decisions, and sections and sub-sections of Acts...in this context not only do they add nothing, they make the material less likely to be read and enhance your reputation in one area only...your skills in verbosity, pompousness and boredom!

Social media is developing fast for communicating information, expanding networks and building relationships, so don't discount options such as LinkedIn, Twitter and Facebook. Don't rush blindly into them either!

I'm generally not in favour of narrowly-based formal networking groups (one lawyer, one plumber, one IT person, one Real Estate agent etc) simply because in my experience they take too much time for the results achieved and can divert lawyers from far more useful Business Development activities.

A final point...you and your employees do have the time... no one spends all day doing client work...and I regularly find employed lawyers averaging less than five hours a day legal work...not all of it recovered!

I suggest employed lawyers should be averaging at least half an hour a day or 115 hours a year in normal times, and doubling and trebling that effort should tough times be on the horizon...or have already kicked in your door!

Partners should always be doing more, as generally they have more contacts and more experience and so usually a greater chance of getting a full return of the investment.

Think your peers could benefit from hearing my views on areas of practice management you consider important?

Every year I speak to conferences of lawyers in Australia and New Zealand on practice management topics.

My experience is wide, involving 1182 small-medium legal firms, and spans 37 years.

My approach to things is fresh, practical and very effective...certainly not the "same old same old" paradigms of many commentators.

If you think your peers in your group would benefit from hearing my views on matters of real importance to them... profit, lifestyle, people management, succession planning etc. feel free to lobby your group's committee members to contact me to discuss potential arrangements.

Mandatory CPD/MCLE deadlines approach fast yet again...

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