10 Key Traits of Law Firm Profitability Execution

By Mark Medice on February 11, 2020

For many law firms, 2019 was a good year, as improving demand and effective pricing strategies supported bottom-line results. As we look to 2020, profitability remains a hot topic for most law firm leaders. The industry is steadily moving away from just counting hours and fees to understanding their contribution to the bottom line.

Our LawVision profit maturity assessments reinforce the point that establishing a successful profit management system in a law firm does not happen in a single step. It requires a commitment to modernizing your firm's profit operating system, which can take multiple years. It includes metric design, financial modeling, data strategy, education & training, and reward system modification, all connected to client strategies. It also requires an enablement step to disperse the principles and processes throughout the firm, to produce a maximum gain.

Profit programs often emphasize the mechanics over the strategic picture, causing them to fall short of desired results. To offer a broader perspective on profit execution, here are key traits to consider as you think about your firm's journey to creating an effective profitability culture.

Knowledge & Expertise

1) Profitability Building Blocks. To start your profit journey, your lawyers should understand its basic building blocks. That doesn't mean partners need to be accountants. It does mean having an appreciation for the basics of cost allocation, cost basis rules, leverage, as well as understanding how vital performance factors like discounting, budgeting, and matter management affect it.

2)Pricing Strategy. Pricing has a substantial impact on profitability and should be a core element of your profitability framework. It includes value pricing principles matched up with the capability to apply them to appropriate client situations. Pricing is often confused as a numbers exercise, but it is more than that. It defines your identity, brand, and market position. Clients view indiscriminate discounters differently than those who hold the line on their value. Creative partners deploy pricing strategies not just for profitability but also as a business development tool.

3) Profit Context. Understanding profitability isn't just about mechanics but also means learning about its proper application. Using profit principles like a blunt force object can lead to trouble. For example, if your intellectual property practice has lower margins than corporate, but they are bundled together, you should assess their combined firm contribution. One of the dangers in profitability is that people get bogged down in the mechanics, and spend less time thinking about their proper use. Give thought to your profit workflow design, data sharing strategy, profit education & training, and communication campaigns required to enable your program to succeed.

4) Data Acumen. Partners don't need to be data jockeys to be successful with profit programs. But they must be willing to engage and understand the numbers and be willing to take appropriate actions when identified. With today's advanced tools, profitability insights and visualization are made more accessible to the masses. So do not push this off exclusively to your finance teams. Too frequently partners will play coy and feign a lack of understanding, in hopes of getting a pass on the subject. Don't let this happen — lawyers are smart and can handle the basics of firm profitability.

Attitudes

5) Profitability Trust. The idea of profitability can be threatening to some. After all, many lawyers have spent careers believing performance statistics like billable hours and realization rates are the core profitability metrics, when, in fact, they can be quite misleading. Consequently, dissonance may occur when introducing these ideas, resulting in distrust and rejection. It is imperative to create a trusted learning environment, not only about the use and application of these metrics but also about how they connect to performance assessment and compensation. Metrics should be consistent with the firm's strategic focus and direction as well.

6) Partner Buy-in. Many partners have achieved their status through strategies that may be contrary to profitability principles. Two rainmakers that generate equal books of business with varying profit margins are not contributing the same to the firm — at least financially. Set out the rationale of the profitability program, with its principles, fairness policies, and applications, creating an open communication environment. Transparency and clarity are essential.

7) Business Curiosity. One of the byproducts of a good profitability program is its connection to other core areas in the firm: client service design, teaming, cross-selling, pricing, service mix, and firm innovation. As lawyers embrace and understand profitability, this exercise will better prepare them for other significant changes coming as the industry evolves. It will make them better business thinkers and more open-minded to new ideas and change.

Behaviors and Process

8) Profitability Routine. Many firms incorporate profit principles into their daily routine. Create budgets for matters and, where appropriate, provide formal project management. Even the simple step of creating a reporting cycle can help improve results because it creates organizational habits, awareness, and accountability.

9) Metrics and Accountability Loops. Do you have and regularly communicate metrics? Accountability loops provide checkpoints to assess progress, provide feedback, and signal needed action. They also convey to the masses that the firm is serious about the initiative. Modern profit operating systems have alerts and triggers to course-correct problems before they become too big (financial or otherwise).

10) Upstream Profitability. A profitability mindset is relevant across all phases of firm operations. However, there are certain moments in the client and matter lifecycle that can have a disproportionate impact on results (akin to the 80/20 rule). Upstream profitability focuses on detecting risks as early as possible, mitigating problems at inception, or even before they happen (one of the basic tenets of any quality discipline). Consider establishing upstream profitability checkpoints, such as:

- When you provide pricing to a new client
- At matter intake, predicting matter profitability
- When pricing your most premium services
- When setting your highest rate
- When a retainer isn't paid or on receipt of partial payment of an invoice
- When you are designing a success fee
- After you have achieved a significant result for your client
- In the first year of a new client relationship

- When you have created a major budget

In summary, profitability execution is more about calculating margins. It involves people, process, and technology. And it means creating a trusting environment for lawyers to learn its purpose and goals. After that, the mechanics become much more readily accepted.