A Rapidly Developing Law Firm Profitability Battle

By Michael D. Short on December 14, 2020

As a result of the global pandemic and the impact that it has had on law firm operations, platforms, and business models, there is a rapidly developing competitive threat that could, particularly in small markets (by geography or by the small number of participants in a highly competitive space), upset the competitive balance among law firms. This newfound disruptor emerges from the broad concept of "profitability" because any law firm partnership, right now, can create a more disruptive operation over the coming years by keeping a significant portion of its reduced remote-working expense structure, thus generating relatively higher profits and putting those profits to good and disruptive uses. Such an outcome could throw any long-standing set of firm rankings and pecking-orders out of whack and would, in turn, necessitate a strategic response from others. The net result would be a profitability "arms race".

Due to the pandemic and remote working, the two largest expense line-items in most law firms' profit and loss statements – occupancy and staff compensation – are in play, allowing them to potentially be reset at much lower levels. This is an unprecedented situation and a unique opportunity for any partnership that wants to make a strategic move of any degree.

The simplest example of this involves expiring leases. What if your firm's largest lease doesn't expire for 10 years but a major competitor has an expiring lease and gives back 20% of the occupied space in its largest office, while also resetting rents in a down market? Due to circumstances beyond your control, you now have a competitive imbalance to address. If your competitor invests much of its newfound profits in programs such as focused recruiting, strategic business development, and/or innovative improvements that clients notice and value, you will have an ever-increasing competitive imbalance across a decade that allows this firm to either catch up with, or pull away from, your firm's strategic position.

A much more remote, but not impossible, example would be a lesser competitor who is tired of being a lesser competitor taking full advantage of this situation, allowing a significant portion, or all, of the lawyers and staff to continue to work remotely and reducing the number of administrative support staff to the number needed for a truly remote operation (which is fewer than the number needed for full in-office operations). The resulting increase in profits from such decisions would be very significant and would – if applied effectively – create major marketplace disruption.

To be successful, all law partnerships must find the profitability level that is commensurate with the value of the services rendered and also –

- Retains existing talent;
- Attracts required talent;
- Funds needed capital improvements;
- Pays for needed strategic investments; and
- Is reasonably close to the profitability level of key competitors.

Many law partnerships are currently planning how they will operate in a post-Covid world. Such discussions feature questions such as –

- Who gets to continue to work remotely?

- Can we properly develop young talent remotely?
- What is needed to maintain the firm's culture and connect it to young lawyers and staff?
- How many administrative support staff members do we *really* need? And what kind of skills should they have? (Do we even have the right people?)
- What are we going to do with each expiring lease?

Most partnerships approach these questions with an implicit goal of minimizing change and disruption while reaping as much benefit as possible from each opportunity. They also generally assume that all competitors will respond in roughly the same manner and there will be no resulting outliers…as is often the case in the law firm world.

For those partnerships that choose to return to a more traditional approach to practicing law (i.e., how they operated in February of 2020), everything will be fine unless/until a key competitor either a) benefits from good fortune and timing (of an expiring lease per my example, above), or b) chooses to take a more aggressive posture. The resulting profitability gap – particularly in a small market – can develop into a major disruptive and re-defining force that will require an equally aggressive and challenging response from the traditional partnership.

Our industry (and, of course, our world) changed dramatically this year but our situation remains dynamic and developing. Now is NOT the time to be sentimental and drawn back to the old days. Rather, now is the time to –

- Keep the "wins" realized while working remotely (e.g., paperless practice, speeding up the billing and collections cycle, getting time entered regularly);
- Evolve and push any changes to the platform, systems, and processes right up to the point of serious discomfort, rather than slipping back into the high comfort zone of February; and
- Watch the moves and changes that key competitors are taking or considering and respond quickly when appropriate.

Failure to do these will result in short-term ease and comfort…and, quite possibly, serious long-term threats that will require very painful and costly changes later on.

The choice is yours.