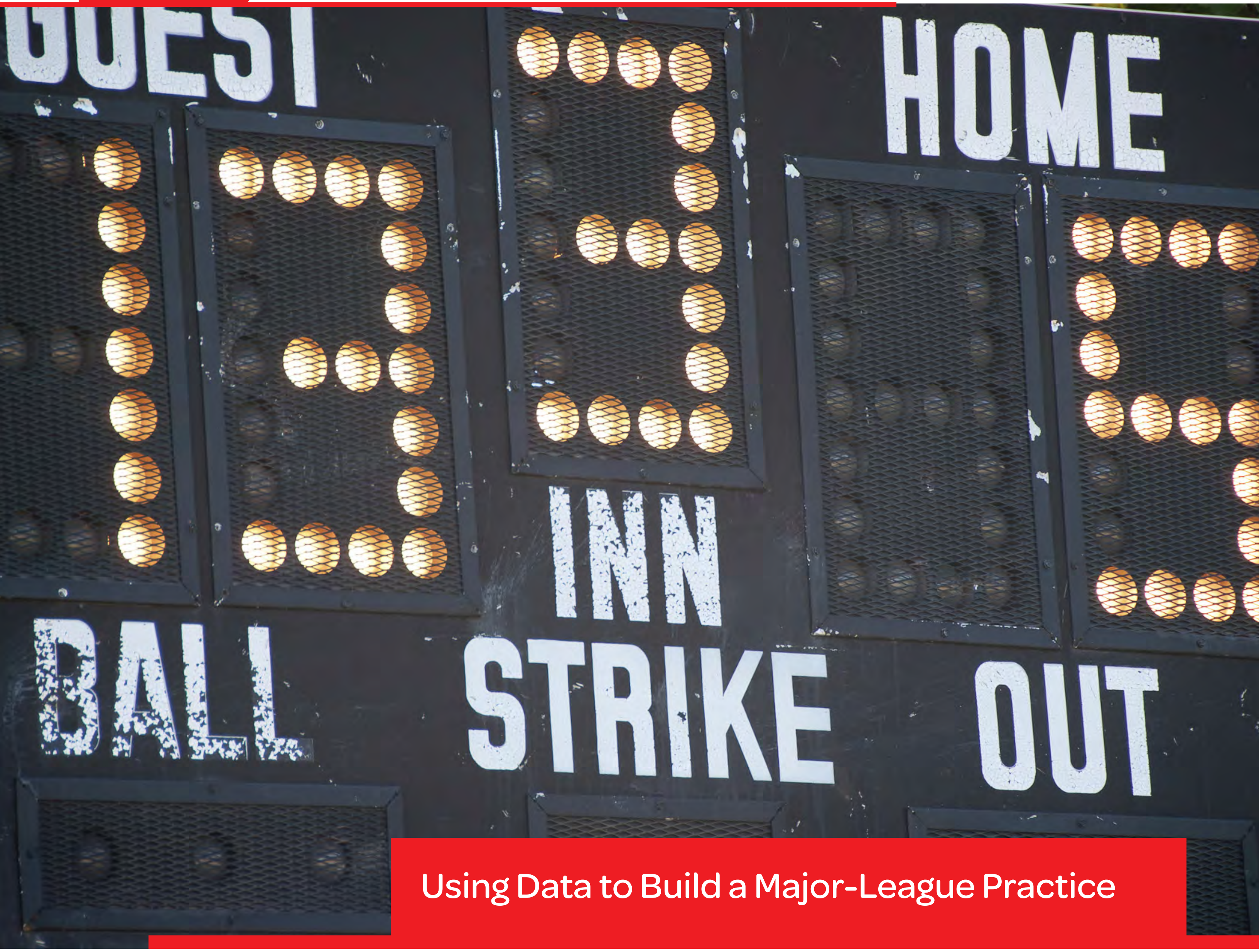
Moneyball for Lawyers



Using Data to Build a Major-League Practice

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Many of us, as practicing attorneys in our law firms, get caught up in what we were originally taught or, more likely, not taught in law school about the way to manage our practice.

The lessons that we were taught were basically, “if you build it they will come.” As if, working hard, practicing better law, doing a great job representing out clients, and being highly ethical and professional were sufficient, in and of themselves. They are important, no doubt. However, to the extent that we were taught that doing those things would mean we would not have to worry about the money coming in, and not worry about the profitability of our firms, that, simply, is not the case today. I don’t think it ever really was.

In today’s world, one of the most ethical things we can do, is to acknowledge that our law firms are also small businesses. We owe it to ourselves, to our stakeholders, and to our clients, to run our firms properly, like a business. When working on a client’s matter, the last thing that we should be worried about is our own financial issues. When we have a well-run business, we can be focused more completely on the issues and problems of our clients.

For those of you who haven’t seen the movie Moneyball, it’s a film from 2011 about baseball, specifically about the Oakland Athletics. And what made the Oakland Athletics ball club interesting at the time was that it was managed by a former player, played by Brad Pitt. And this is sort of relates to me in the management of a law firm. Before you start thinking I’m comparing myself to Brad Pitt, let me explain.

At a point in my legal career I became the managing partner of an eight-lawyer law firm, but prior to that, I was a practicing lawyer. And so you base that transition of moving from a practitioner, from an expert in what you do, to management of a business—something that you may have received more or less training on, much like Billy Beane, the real-life manager of the Oakland Athletics, had received little training in how to actually be a general manager of a ball club. But in this movie, he takes this ball club, on a fraction of what other ball clubs are making, and leads them to a great deal of success. It is interesting to learn about the strategies that Billy Beane used to study data and lead his team to major-league success. It is inspiring to know that in our businesses, there are metrics that we should be watching to lead us, and our clients to success as well.

Attorneys Ask the Wrong Questions for Law Practice Success

Fact: When it comes to running our law practice we, as attorneys, tend to ask the wrong questions. We think about what to charge our clients by working backwards from what we want to make, and/or by working upwards from what it costs us. We make decisions (or fail to) about what kind of clients we take, what clients we don't, on metrics that don't make any sense, or worse yet, on no metrics at all.

Instead, our focus should be on providing value to our clients, and deciding the profitability of the law firm. From there, setting rates makes more sense, and it also becomes clearer what kind of law we should practice, and what cases we should, and should not, take. It's all about analyzing the data in your firm that's already there, and knowing your numbers. You just have to know how (and where) to look for them.

Why Should You Care? Several Reasons

Why should we care about these numbers in this game of practicing law? The answer is that the times, they are a changing. For the past 10 or 15 years, I think there's a fair argument to make that law schools have been failing students in not teaching them more about running a business. Worse yet, there has been a passing-on of the folk wisdom that it is not all that important. There was a time when, the idea that if you built a great practice, and practiced great law, it would bring the money in without having to be too concerned about it was truer. Today, it just isn't.

Altman Weil did a survey in 2012, and asked them whether several factor in the legal market were permanent changes due to the economic crisis of 2007, 2008, 2009.

More Price Competition

In 2009 about 42% of attorneys believed that more price competition, i.e. competition from the lower end, was going to be a permanent problem. Just three years later, by 2012, over 90% of lawyers acknowledged that non-traditional price competition is here to stay.

More Commoditized Legal Work

Similarly, that legal work has become more commoditized. While previously, only 25% believed that, now that number is up to 84%! It has become impossible to deny the influence of LegalZoom, Nolo Press, and others who are commoditizing legal work—unbundling it, and offering what used to be considered work for hire from an attorney, as a thing that's something that somebody can buy for $19.99 on the internet.

More Non-Hourly Billing

In other words, alternative fee arrangements. Again, that change was seen as temporary in 2009; 80% now believe it is permanent.

Fewer Equity Partners, More Contract Lawyers, and Dwindling Profits

The number of equity lawyers, equity partners in law firms being decreased is seen as a permanent change by more than two-thirds of attorneys. And, of course, the converse to be more contract lawyers, also being seen as a permanent change. And then, finally, that profits for partner either becoming smaller, or at least increasing at a slower pace, is seen as a permanent change by almost half of attorneys in this survey.

So, what to do?

Six Numbers Every Law Firm Should Measure

You have to start somewhere. Let's examine six numbers that all law firms should manage, to deal with these trends. Watching these numbers can help you take control of your business, make it more profitable, and make the energy that you put into it benefit your clients, your stakeholders and you more consistently.

1 The Cost of Servicing a Client

Talking about focusing on numbers with law firms, in talking about profitability, and talking about running your law firm as a business, there are still so many in our profession who balk at this idea, and believe that this is not what a lawyer ought to do.

What is striking about these conversations, is that the lawyers and professionals who object to discussing a law firm as a business, is that they are all experienced people. There is a lot of wisdom among them. There is a lot to listen to from these folks. And there's a lot to listen to in the people that have been practicing law for a long time. But in listening to that, we have to be able to separate what was from what is, and not get caught up in what used to be important, lest we become unable to focus on what's become important now.

It's more than knowing what your share of the profit is. The first metric here is understanding your overhead: in general terms, what it costs to keep the doors open, what it costs to keep the lights on. You have to look at the infrastructure cost. You've got to keep the lights on, electricity, all the things that you have to pay whether you do one lick of work or not. And the cost of client acquisition. How much does it cost to bring in a client? What are your marketing costs, and your other fixed costs, for bringing clients in the door? Finally, what is your payroll that is not tied directly to performance? These are the things make up your overhead.

You then divide the overhead by the number of fee earners that you have working

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Overhead: What it costs to keep the doors open and keep the lights on.

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in the firm. This, then is the bottom line that the fee-earners need to be earn, on average, just in order to cover the costs of keeping the firm open.

Then of course, there is servicing the work. There will be a compensation component to that, as well as direct costs if you have copying, deposition fees, court reporters, et cetera. You add all that in, and so you have the fixed cost and overhead above, which you divide across all of your clients. Then the cost of servicing a particular client, which could be different across practice area, and even case to case. Putting all this together, you arrive at an understanding what you need to make in order to just break even.

Which has nothing to do with what you charge! It is not the start or the end of our analysis on what to charge for the services that we render. But surely, it shows us a point below which we cannot maintain an operation. We may be tempted by the price competition and commoditization discussed earlier to think that we have to go below this number. If we know our numbers, we avoid this "race to the bottom," because we know we can't make it work. This enables us to focus on what we should be doing, which is delivering more **value** to the clients.

In the movie *Moneyball*, Billy Beane asked, "What's the problem?" The problem is that we need to understand these numbers. That we need to get away from the anecdotal, and the long-held wisdom, and understand the numbers.

I've heard a lot lately that it's an unfair game: that we work under pressures and constraints, that we make it difficult to compete with the large firms, and difficult to compete with the likes of Nolo Press. But it's only an unfair game until you start asking the right questions, and playing the game the way a small business would.

2 Your Firm's Profitability

The second number to understand is how to measure profitability. We think we do this, because we know how much we are able to take home from the firm. This is not a sufficient measure! There are a lot of other ways that we should be looking at that number. If we don't understand our profitability by practice area, by partner, by client, and by timekeeper, then we don't really understand anything.

It is essential to also look at profitability by partner. When deciding what to pay, and to whom, you must identify who is really contributing to the bottom line and who isn't. This enables you, as the owner, to help your team become more productive, and to take other actions necessary to keep the business running well.

If you don't understand profitability by client, then you don't know what kind of clients you should be targeting in your marketing, or even which clients you should fire. Most law firms have a small cadre of clients who are eating up a majority of the work of the firm, and a providing a *de minimis* amount, if anything, to the profits or to the bottom line.

And then, finally, measuring profitability by billing staff. It's not just partners that

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we have to that we have to focus on as far as profitability. The entirety of the business requires paying attention to making a profit on all of the timekeepers; on the associates, and on the paralegals.

Good, Better, Best: All Clients are Not Equal. Most attorneys have good clients and bad clients and medium clients—no attorney has clients that are equally profitable, equally pleasant to work with, equally delivering of referrals, et cetera. Not all clients are equal. And if we accept that as an argument, then let's accept that if we had more like best ones, and fewer like the worst ones, our practice might be more profitable.

The Pareto Principle. We often hear the 80/20 rule. And I've found that it actually is very true. Many firms find—mine certainly did—that about 20% of our clients brought in about 80% of the revenue, or at least 80% of the profits for the firm. Conversely, and annoyingly, when we first started to analyze this, we also found that we were spending 80% of our time and energy on 20% of the clients who brought in very little. This is common!

You begin by ranking all of your clients on a bell curve: A's, B's, C's, D's, and F's.

It can be very powerful to grade your clients, and focus more of the firm's energy on the more profitable ones.

If you have some A's, you've got to have some F's. If you have B's, you've got to have some D's, and they can't all be C's? Then, once a quarter, you meet as a firm about your ranked cases, and you fire all the F's. You just do it. I've had attorneys come back to me and go, "But I don't really have any bad clients." I say, "Well, listen, do you have some better and some worse? Then the worst ones are the F's." You get rid of the F's, and it, all of a sudden, your average client is better! Your profitability goes up; your workload goes down.

Then, twice a year, sometimes once a year if you can't manage twice, you should get together as a firm, and if it's just you, get together with the number one stakeholder in your life, and defend the D's, and explain why you should keep those. I submit to you that at least half, if not three quarters, of those will go out the door as well. Now, I understand that in some practice areas, getting rid of clients can be difficult, and that's why client intake becomes much, much more important, as do your fee agreements. The truth is that if you can't get rid of them today, you can begin the process. You put them up to be fired of at the next possible moment.

The bottom 20%, those F's and D's, are bleeding you to death. Cut them off, and cut them off quickly. Believe me, not everybody is reading this! There are other lawyers that will take them.

3 Marketing Spend as a Percentage of Total Revenue

The third metric that law firms should be intimately familiar with is what the firm is spending on marketing, and what they should be spending. According to LexisNexis market research, done in May 2011, most solos and duos limit their marketing to personal networking, and marketing through their website. In 2012, American Lawyer Media did a survey as well, and found that approximately 3% of law firm revenue is spent on marketing. I'll suggest to you that this is not a number that is conducive to growth, and that there is a correlation between a higher spend on marketing and greater growth and greater client acquisition.

What you actually spend, in cash, on marketing can vary greatly depending on what you're willing to spend in personal marketing efforts. Some marketing is nearly free, but requires more of your time, such as networking events, speaking engagements, and the like. Measuring expected results vs. actual is what is important. You must have a marketing plan designed to deliver the leads that the firm needs to meet its revenue goals.

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Why do many firms give marketing insufficient attention, time and money? When you boil it right down, they actually fear that more clients are going to come in the door and they're not going to know what do with them. When you focus on profitability, and then make sure that marketing is delivering the right number of leads, at the right time, your client service improves, and your business improves. You get to become more the lawyer that you want to be—get the luxury to practice the kind of the law that you want to practice.

4 Technology Spend as a Percentage of Total Revenue

IThis is actually a very good corollary to the marketing spend. ABA Technology Basic Trends Report shows that law firms have increased their technology budget about 5% year over year between 2011 and 2012. And that is a fantastic sign.

Technology, if properly implemented, can help your business serve clients better, and become more efficient at delivering services for less time and money invested. With appropriate technology, you can get more work done per unit times spent. Since every hour contains within it the direct compensation to the fee earners, as well as all the overhead costs, modest spending on technology can deliver big results to the bottom line.

Additionally, using the right technology to augment the talent and efforts of your team, allows you to deliver to your clients the kind of service that they've come to expect from every other sector of the economy. Deliver to them the information they want, when they want to get it, where they want to get it. Deliver information to them in a timely manner, and be more efficient in the way that you provide it.

On average, about a little bit less than 60% of law firms have a budget at all for technology spend. And the average is about 2% to 4% of the total revenues being spent on technology. So, without making a judgement as to whether that's good, knowing that number is really, really important. The average capital budget per lawyer, so getting away from percent of revenues, the average capital budget per lawyer sweet spot appears to be in the range of between $8,000 and $17,000 per lawyer, spent on technology.

It important to note that when we talk about technology, we're talking about all things. Not just computers and software, though that's a big part of it. It also includes all the things that help us deliver quality service to our clients, like spending on client portals, and the kind of things that we could use to share information more effectively with our clients, and do a better job of servicing them. It includes spending on the right policies and procedures for running your business. It includes systems for keeping your clients property and information safe. Every kind of system that makes your business more predictable, more repeatable, and more productive is technology that will help your business produce better results for you, your stakeholders, and your clients.

5 Realization

What exactly is realization? Basically, it's how much you work versus how much you bill.

And this, to me, is one of the great crimes of many small law practices, in that this number is far too low. The sad truth is that for the number of hours we work in our business, the number of hours that are actually billed and collected is pathetically small.

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This is due, in large part, to a lack of good technology; to a lack of systems to capture time. IF you think about a bucket, as the amount of work that we are capable of doing, this is the first big, giant hole that keeps us from bringing the water in that bucket into our bank as profit and as cash.

Ineffective recording then leads us to discount our work even before the bill goes out the door. Then, once do record our time, and do get an invoice out to our clients, we then are all too willing to write the bill down further when our clients request it. Instead of leveraging technology to capture the work we did, and producing invoices that help the client understand the value we provided, we communicate to our clients that we don't really value the work ourselves.

Then after we bill, we also have the epidemic of writing off amounts. You know, clients call back and say, "Hey, you charged too much for this." And remember, this is after we have gone through the bill and written down what we thought wasn't fair. Clients that receive bills that are delayed, that are incomplete in their descriptions necessarily, call back, push back, are reluctant to pay. Sometimes we'll write things off so that we can a bill paid that was sent 90 days after the work was done, whatever it is.

So, now that you've sent your bills late, discounted them, and then written them down again, and the clients agreed to pay, how much of that do you actually get?

You must know that number! It helps you evaluate your clients. I have been astounded working with attorneys, other attorneys, and asking what the general life cycle of AR is. Most businesses find 60 days to be completely unacceptable, and write stuff off after 90. Nevertheless, many law firms that I've worked with considered 90-120 days to be sort of expected. And I've seen ARs that are still being kept on the books as receivables that are a year and more old! I walked into one firm where two of the three partners in the firm had accounts receivable in excess of their annual income. So, people owed them enough so that they could take an entire year off without working a minute, and yet, they just let that float out there as receivables. Monitoring you're A/R and then taking steps to reduce that AR cycle are extremely important.

You are in absolute control of this. Understanding your clients, the ones that will and won't pay is the easy part. The harder part is the up-front work of getting those bills out on time, with accurate records, and descriptions that help clients know why they should pay them. Client are far more likely to pay timely invoices that convey value, plain and simple.

Another more difficult task is following up on those bills. You should have expectations clear and when you accepted the clients' cases, so that if you do have to follow up before the invoice becomes more than 30 days old, the clients will take your inquiry seriously. When you you're your commitment to your business seriously, your clients are more likely to do so as well.

It's amazing how much you can reduce your accounts receivable. And I assure you that a firm with large accounts receivable would really prefer to have the cash on hand.

The process of doing all those things is a form of technology. It isn't difficult; t just requires doing, and it is all in your control. The first step is knowing the numbers! It makes it much easier to do something about the problem. Reducing your accounts receivable, restricting the number of write-offs, and capturing more billable work will make the hours spent are far more productive and will result in far more profitability to you and your stakeholders than all the additional legal work that you can do. Taking steps to get bills out faster, more accurately and more completely, by accepting online bill payment, many firms can increase realized revenues by 30% or more; without doing any additional work! Legal work done and not realized doesn't get you very far.

6 Industry Benchmarks

It's hard to know how to measure yourself, particularly in a small law firm, because there are very few people to talk to that will tell you what those numbers should be. In order to ensure that your numbers are right, you have to measure them against benchmarks to understand how you're doing in the general market.

Law Firm Economics 101

Some things that we can help you with from a joint ALM Legal Intelligence and *National Law Journal* 2015 survey of law firm economics is that for law firms from one to 75 attorneys, the average total expense, as a percent of revenue, is 39%. The average income per lawyer, as a percent of revenue, is, therefore 61%. How do you measure up? The answer, unfortunately, across when I speak to attorneys about this, generally speaking, is, "I have no idea." And so, the first step, in order to be able to get towards that profitability, so in order to understand the numbers, is to get an idea. And the fact is that these numbers are at your fingertips. They are in your books, they are in your control, and you just simply have to have a way to get them out—bookkeeper, accountant, or a good program to do that.

79% of law firm expenses are from your salaried lawyers, paralegals, and staff. And this number is remarkably consistent across practices. Being able to manage expenses from this level is really critical because this is the biggest part of your overhead. Moving that number up and down will have a dramatic impact on your bottom line. About 6% is a good benchmark for occupancy cost, and 2% for equipment including technology and other things.

By knowing your numbers, you'll go a long way towards getting control and managing a law firm by the numbers.

Paying attention to your realization, to billing, accounts receivable, realization, marketing, etc., are all really important. It would be incomplete, however, to have this discussion without considering a major source of inefficiency in your law firm business. That is how you (and others spend your time that you're supposedly working "in the business." When you do, you will know that there are some things you could be doing that are really valuable, and other things that you are doing, that aren't nearly as valuable, to your stakeholders, to your clients, or ultimately, to you. Are you investing time wisely in your business?

Hierarchy of Tasks

Consider this. Whatever you are doing in your business, the most value you can bring your business at that moment, is the least amount you could pay somebody else to do that job competently. Above is a list of many of the activities that take place in a law firm. I've found in talking to a lot of lawyers that they spend a lot of time on the things on right-hand side of this ladder. I also call this list of things on the right-hand side of the ladder the list of things we shouldn't be doing.

At the end of the day, in a law firm, we have a choice—to spend time on activities of high value or low value. There is one abiding truth. Time is finite. We will spend only a certain number of hours in the office. We can spend as many as we want, but we can't expand it beyond 24 a day, and seven days a week. And so in that finite amount of time we can choose whether to do high-value or low-value things. The more bookkeeping, telephone answering, email reading, or office management that you do, the less you will be able to spend on marketing and client development, on maintaining good client relationships, on planning for your law firm, and on doing the highest level legal skills. The things that make you special, the things at which you are, or ought to be, becoming an expert in that people want to pay you a premium amount to do.

If you spend more time on the right, you have to spend less time on the left. It's simple math. When I discuss this with many lawyers, they describe themselves as being caught in a trap, saying, "You know, that's all well and good, but I don't have time to delegate." This is a trap of their own mind. It isn't real. What is real is that if you keep spending time on the right, you never will have enough time to do what needs to be done on the left.

To get started, you must simply decide, and pick just one thing to stop doing.

Sometimes, I say it's telephone answering, that's an easy one. Sometimes, I say it's bookkeeping. That's a little bit harder, but could also be done. Pick one, and peel that off of the things that you do, and pay someone else $10, $15, $25 an hour to do it, part-time if you have to. Promise yourself that you'll invest the time saved in doing only the things on the upper left-hand corner.

Doing the things on the upper left-hand corner will result in dollars that amount to more like $150, $250, $350 an hour for your efforts. And then, promise yourself that you would dedicate that money back into paying someone else to do more of the things on the right. It's really that simple. It's the way we would counsel our clients to get out of debt. There's no reason not to take that advice ourselves and use it to invest more wisely in our business.

Which one do you pick? Ask yourself what is your biggest pain point? Unfortunately, on the right-hand thing is also things that lawyers like to do sometimes. But pick one that you don't. Do you like answering the phone, really? Because, maybe, that's one that you can pick and just let's just use it as an example. But if that's your biggest pain point because it costs you both in energy and time, maybe that's the one that you select. Or, think about which one's going to be your biggest return on investment. Maybe getting a bookkeeper who can give you those numbers that I've been talking about in a way that you're having a hard time doing would give you the bigger return on investment, and you pick that one.

Or maybe pick one that's given your greatest effort—opening your email and reading your mail. And, believe me, if you don't think that's not one of your greatest time sucks, you're wrong. And that one could be a huge deliverer of time back to you, as well as efficiency in having someone else put the most important emails in front of you. Or pick one that is the one that you think you're more likely to achieve. The most important thing is that you pick one. Take that list on the right and rank them in order of the ones that—in whatever order of importance it is to you, and attack that one first.

Then, when this delegation results in more profits, repeat the exercise, and work your way up the ladder, picking off all the things on the right, and then most of the things on the left, too. This will allow you greater and greater focus on the things that you ought to be doing, until you are, truly, doing only the things in the upper left-hand corner—the things that are also known as the things that are most profitable to you, and your firm, and to the stake holders in your firm, and your life, to whom you owe all the efforts that you are giving.

Following the things that I've said, and particularly the arrangement of your time, to focus on the highest-valued tasks, on the numbers that we've been discussing, together, with the elimination of deadwood, both in performance in your firm and in the behavior of your clients, can and will result in greater profitability and greater results for you.

Paying attention to these numbers, paying attention to the cases, the good ones and the bad, paying attention to the way you spend your time will have results. Measuring these things is the first, most important step to improving performance.

Bottom Line:
Don’t Hold On to Old Ways of Thinking—or Doing Business

There are a lot of people who will hold on to the old way of practicing law, and believing that it’s not a business. And there are a lot of people who actually get angry at being told otherwise. What I recommend, is that you decide whether you’re going to be with them? Will your team be watching the World Series, or will you be playing? Are you going to be at Fenway, or are you going to be on the couch? Those are the two choices.

Every lawyer and every law firm out there has a choice. You can manage your firm like a business and stay in this game. But make no mistake, the game is changing, and you only have one decision to make.

What you know is comfortable, but is that truly what you’re working for? If it is, stick with it. If it’s not, learn about these numbers, get to know them and love them, and know about how you’re spending your time.

Make the changes that are necessary to achieve what’s important for you.

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