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Improving Law Firm Profitability and Performance Amidst Reduced Demand and Tighter Budgets

- Mark Masson, Esq. - Lotis Blue Consulting
- Ed Estrada, Esq. - Estrada Legal Consulting

Celesq® AttorneysEd Center
www.celesq.com

5301 North Federal Highway, Suite 150, Boca Raton, FL 33487
Phone 561-241-1919

Improving Law Firm Profitability and Performance Amidst Reduced Demand and Tighter Budgets

Presenter contact information
Mark J. Masson
Managing Partner and Head of Professional Advisory |
Lotis Blue Consulting, LLC
www.lbconsulting.com
mmasson@lbconsulting.com
814-880-2040

Edward J. Estrada
Estrada Legal Consulting
58 Park Avenue, Bronxville, NY 10708
ed@estradaconsult.com
917-406-0560

Challenges in the Current Environment

- The modern American law firm adhering to an aligned strategic plan can trim the fat without sacrificing talent simply by pulling a number of levers, smart business practices that will drive significant efficiency in cost savings, and shorten and make more predictable several parts of the revenue cycle.

- The 10 year long bull market has come to a close, and the ominous word “layoffs” is reverberating in the heads of employers and employees across industries.

- Mass layoffs have come to several sectors of the American economy as employers scramble to rebalance their costs due to losses in revenue. Law firms are not immune, [cite law firms].

- Even amidst these challenging conditions, the cost and demand for talent, in certain practices, has only increased. As a result, lateral hires dramatically increased at both the partner and associate levels during the post-pandemic period. Compensation also rose dramatically—growing 16.3% in 2021 (2), and 22% when accounting solely for senior roles (3). Compensation doesn’t just mean raising base salaries, the structures of annual, retention, and signing bonuses all have to be dramatically altered to lure top-tier talent as well.

Challenges in the Current Environment

- Compounding this softening of demand are soaring operating costs, which grew 13.5% in 2022 alone (4).

- One such aggressive move has been the incorporation of new, innovative technologies into firms' outdated infrastructures. While technology costs have skyrocketed by 13.5% in 2022 (4), these costs are justified—law firms should view these expenditures as investments that position their organizations for long term growth.

Examining Collections

- In the first half of 2022 there was a 4.2% lengthening of the collections cycle. In 2022 as a whole, firms have also seen an increase of receivables outstanding by nearly 10% (4). Megafirms especially are leaking revenue—AmLaw 100 firms miss out on 12% of billable invoices they send to clients, which lags behind AmLaw Second Hundred and mid-sized firms in this area (5). Unfortunately, as many firms expand, their collections departments are the last to catch up with other upgraded, sophisticated sectors.
- A lever available to law firms is optimizing their collections processes. By eliminating collections inefficiencies, organizations can better survive the bear market—positioning themselves for new growth when the economy once again turns bullish.
- The first step to revolutionizing collections practices is breaking down the systems into its four key components:
  - matter and client acceptance
  - matter intake and setup
  - delivery,
  - invoicing and collections.
- By connecting and streamlining these four links in the revenue chain, law firms can save an enormous amount of time while still driving profitability.

Examining Collections

Collections dashboards

Process mapping

- Rates applied, proposed team profitability, prompt time capture, decreased pre-billing write-offs, timely billing to clients, accounts receivable procedures, clear A/R accountability, coordinated A/R status, avoiding post-billing write-downs, write off and collections decisions.

Change management

- Accountability
- Focusing on client experience
- Detailed metrics - Modern metrics should go above and beyond percentage collected—they should measure the percent of revenue collected vs. written off, the percent of clients with outstanding invoices, the number of clients past X days outstanding, and the margin impact on the firm from improved collections.

Building towards predictive analytics

Practice Group Organization

Firms of any size, but particularly larger firms, are a collection of lawyers with specialty areas of practice, organized, whether formally or informally, into groups (by clients, practices, sub-practices, offices, industry groups, etc.). While having many practices, geographies, and types of clients in a firm is healthy for diversification, it can be difficult to organize and manage dozens of these groups.

While the practice leaders, Partners, and lawyers in the practice know their clients best, they focus most of their time and energy on being legal experts. This is where practice, operations, and firm-level leadership need to provide focus, process, and resources to help their legal experts deliver their unique value to clients.

Practice Group Organization

Client focus

- ***Assess the firm and practice/geo's client list***
- ***Categorize clients into: sunset, maintain, grow***
  - Using firm data, analytics, and aligning to target client profiles can help firms focus their efforts. The most advanced firms leverage core firm data and predictive algorithms – like www.orgaimi.com - to identify undiscovered potential and how to best serve target clients sets.
- ***Look across the firm for collaboration opportunities***

Talent focus

Talent focus tactics:

- ***Catalogue existing talent (capabilities, demographics, experience, etc.)***
- ***Defining client needs and expectations for firm talent***
- **Identify gaps (or excess) in workforce capabilities or other characteristics**
- **Minimize unwanted attrition**

Where to invest

- ***Identifying key client accounts***
- ***Aligning resources for key client accounts (dedicated team, customized approaches, introductions across the firm, additional time/energy/research to serve)***
- ***Clarifying the talent capabilities needed to serve key accounts and aligning workforce strategy to reinforce those capabilities (recruiting, training, etc.)***
- ***Develop processes to identify and export best practices from client teams throughout the firm***

Leveraging Internal Support Teams

KNOWLEDGE MANAGEMENT

MARKETING

BUSINESS DEVELOPMENT

Leveraging Internal Support Teams

Knowledge Management

- Leveraging the collective knowledge of your law firm's lawyers and staff.
- Forms, templates, and work product.
- Client, industry, practice and market knowledge.
- Basis for providing efficient solutions.

Marketing

- Creating brand awareness and attracting new clients to your law firm.
- During a recession, competition for clients may be higher, so having a strong marketing strategy can set you apart from other firms.
- Target specific industries and practice areas that may be more active during the recession.
- Do not ignore current strengths
- What is your value proposition?

Business Development

- Identifying new business opportunities, nurturing existing relationships, and creating strategic partnerships.
- Identifying regional and industry strengths that could inform broader business strategy
- Must by in sync with management and partners

Essential for Success: Data and Technology

Create a data strategy and/or append existing firm-strategy with data strategy that outlines:

- Security and risk management approach to protecting firm and client data
- Data inventory
- Data governance
- Most valuable use cases (internal and client-facing/revenue generating) and opportunities where data analytics are critical to inform the approach and outcomes

Conduct a technology service stack assessment – which technologies are most critical?

- Which are performing poorly/out of date/performing well?
- Where can you re-negotiate technology contracts?
- Which technology solutions/platforms should be more integrated?
- How could your technology solutions be more client-focused/friendly?

Essential for Success: Data and Technology

Where to invest?

- Prioritize critical needs followed by revenue generating investments and then operational efficiency solutions
- Continue on your IT roadmap – this may require some re-prioritization in the short term, but should not alter the 3-5 year vision you have for your firm's technology solutions
- Move towards the cloud (if you are not already) – especially in larger firms, but also for mid-sized/growing firms the move to the cloud represents and easier, more consistent way for your professionals to work with enhanced security. These aspects will continue to be critical to how the firm operates and protects itself/its clients

Conclusions

Demand for legal services has shifted dramatically and quickly from two years of unprecedented growth and profitability to deep uncertainty and threats of recession

Firms have responded with tightening budgets, direct or indirect reductions in talent, and delays in large firm-wide transformations and initiatives

All the while, firm leadership and Partners expect improved performance and even in times of recession, clients will demand certain types of legal services

Layoffs are a common headline from technology companies, law firms, and others, an unfortunate reversion to the mean of talent norms after rapid recent hiring

Law firm leadership teams are being forced to review all potential options to deliver high quality service to clients, grow revenue, and do so in an efficient manner

No/low-cost solutions – To help firms focus and remain competitive, there are a handful of places where firms can implement no/low-cost solutions that will set them up for immediate success

Where to invest – Beyond the (hopefully) short term economic headwinds, firms should keep their eye on the areas where continued investment is necessary for long term relevancy and growth. Yes, budgets are tight, but they are not completely gone

TECH

Here’s a rundown of tech companies that have announced layoffs in 2022

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@SOFIA_PITT

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KEY POINTS

- Meta cut 11,000 jobs Wednesday in the biggest tech layoff of 2022.
- The tech industry has seen a string of layoffs this year in the face of uncertain economic conditions.
- Layoffs come as digital advertisers are cutting back on spending and rising inflation curbs consumer spending.

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Meta Platforms CEO Mark Zuckerberg speaks at Georgetown University in Washington on Oct. 17, 2019.
Andrew Caballero-Reynolds | AFP | Getty Images

The job cuts in tech land are piling up, as companies that led the 10-year stock bull market adapt to a new reality.

Days after Twitter’s new boss Elon Musk slashed half his company’s workforce, Facebook parent Meta announced its most significant round of layoffs ever. Meta said on Wednesday that it’s eliminating 13% of its staff, which amounts to more than 11,000 employees.

Last month, Meta announced a second straight quarter of declining revenue and forecast another drop in the fourth quarter. Digital advertisers are cutting back on spending as rising inflation curbs consumer spending, and apps like Facebook are suffering from Apple’s iOS privacy update, which limited ad targeting.

VIDEO 09:05
Meta and other Big Tech companies announce layoffs

The tech industry broadly has seen a string of layoffs in 2022 in the face of uncertain economic conditions. Here are the big ones that have been announced recently.

Meta: about 11,000 jobs cut

Meta’s disappointing guidance for the fourth quarter wiped out one-fourth of the company’s market cap and pushed the stock to its lowest since 2016.

The company’s Reality Labs division has lost $9.4 billion so far in this year due to CEO Mark Zuckerberg’s commitment to the metaverse.

Meta is rightsizing after expanding headcount by about 60% during the pandemic. The business has been hurt by competition from rivals such as TikTok, a broad slowdown in online ad spending and challenges from Apple’s iOS changes.

In a letter to employees, Zuckerberg said those losing their jobs will receive 16 weeks of pay plus two additional weeks for every year of service. Meta will cover health insurance for six months.

Twitter: about 3,700 jobs cut

Shortly after closing his $44 billion purchase of Twitter late last month, Musk cut around 3,700 Twitter employees, according to internal communications viewed by CNBC. That’s about half the staff.

In a post on Nov. 4, Musk said there was “no choice” but to lay off employees, adding that they were offered three months of severance.

Musk said the layoffs come as Twitter is losing over $4 million per day. In the second quarter, the last time Twitter reported earnings, revenue fell 1% from a year earlier.

Lyft: around 700 jobs cut

Lyft announced last week that it cut 13% of its staff, or about 700 jobs. In a letter to employees, CEO Logan Green and President John Zimmer pointed to “a probable recession sometime in the next year” and rising rideshare insurance costs.

For laid-off workers, the ride-hailing company promised 10 weeks of pay, healthcare coverage through the end of April, accelerated equity vesting for the Nov. 20 vesting date and recruiting assistance. Workers who had been there for more than four years will get an extra four weeks of pay, they added.

Stripe: around 1,100 jobs cut

Online payments giant Stripe laid off roughly 14% of its staff, which amounts to about 1,100 employees last week.

CEO Patrick Collison wrote in a memo to staff that the cuts were necessary amid rising inflation, fears of a looming recession, higher interest rates, energy shocks, tighter investment budgets and sparser startup funding. Taken together, these factors signal “that 2022 represents the beginning of a different economic climate,” he said.

Stripe said it will pay 14 weeks of severance for all departing employees, and more for those with longer tenure. It will also pay the cash equivalent of six months of existing healthcare premiums or healthcare continuation.

Stripe was valued at $95 billion last year, and reportedly lowered its internal valuation to $74 billion in July.

Coinbase: around 1,100 jobs cut

In June, Coinbase announced it cut 18% of full-time jobs, translating to a reduction of around 1,100 people.

Coinbase CEO Brian Armstrong pointed to a possible recession, a need to manage costs and growing “too quickly” during a bull market.

Coinbase, which held its stock market debut, has lost over 80% of its value this year, cratering alongside cryptocurrencies.

Those laid off received a minimum of 14 weeks of severance plus an additional 2 weeks for every year of employment beyond one year. They also were offered four months of COBRA health insurance in the U.S., and four months of mental health support globally, according to the company’s announcement.

Shopify: around 1,000 jobs cut

In July, Shopify announced it laid off 1,000 workers, which equals 10% of its global employees.

In a memo to staff, CEO Tobi Lutke acknowledged he had misjudged how long the pandemic-driven e-commerce boom would last, and said the company is being hit by a broader pullback in online spending. The company’s stock price is down 78% in 2022.

Shopify said employees who are laid off will receive 16 weeks of severance pay, plus one week for every year of tenure at the company.

Netflix: around 450 jobs cut

Netflix announced two rounds of layoffs. In May the streaming service eliminated 150 jobs after Netflix reported its first subscriber loss in a decade. In late June Netflix announced another 300 layoffs.

In a statement to employees the company said, “While we continue to invest significantly in the business, we made these adjustments so that our costs are growing in line with our slower revenue growth.”

Netflix’s stock is down 58% this year.

Microsoft: less than 1,000 job cuts reportedly

In October, Microsoft confirmed that it let go of less than 1% of employees. The cuts impacted fewer than 1,000 people, according to an Axios report which cited an unnamed person.

The announcement came after Microsoft called for the slowest revenue growth in more than five years in the quarter that ended Sept. 30.

Snap: more than 1,000 jobs cut

In late August, Snap announced it laid off 20% of its workforce, which equates to over 1,000 employees.

Snap CEO Evan Spiegel told employees in a memo that the company needs to restructure its business to deal with its financial challenges. He said the company’s current year-over-year revenue growth rate for the quarter of 8% “is well below what we were expecting earlier this year.”

Snap has lost 80% of its value this year.

Robinhood: 31% of its staff

Retail brokerage firm Robinhood cut 23% of its staff in August, after slashing 9% of its workforce in April.

Robinhood CEO Vlad Tenev blamed “deterioration of the macro environment, with inflation at 40-year highs accompanied by a broad crypto market crash.”

The stock is down by more than half in 2022.

Chime: about 160 jobs cut

Earlier this month, Fintech company Chime laid off 12% of its workforce, or about 160 employees.

A Chime spokesperson told CNBC that the so-called challenger bank – a fintech firm that exclusively offers banking services through websites and smartphone apps – is cutting 12% of its 1,300-person workforce. The company said that while it’s eliminating approximately 160 employees, it’s still hiring for select positions and remains “very well capitalized.”

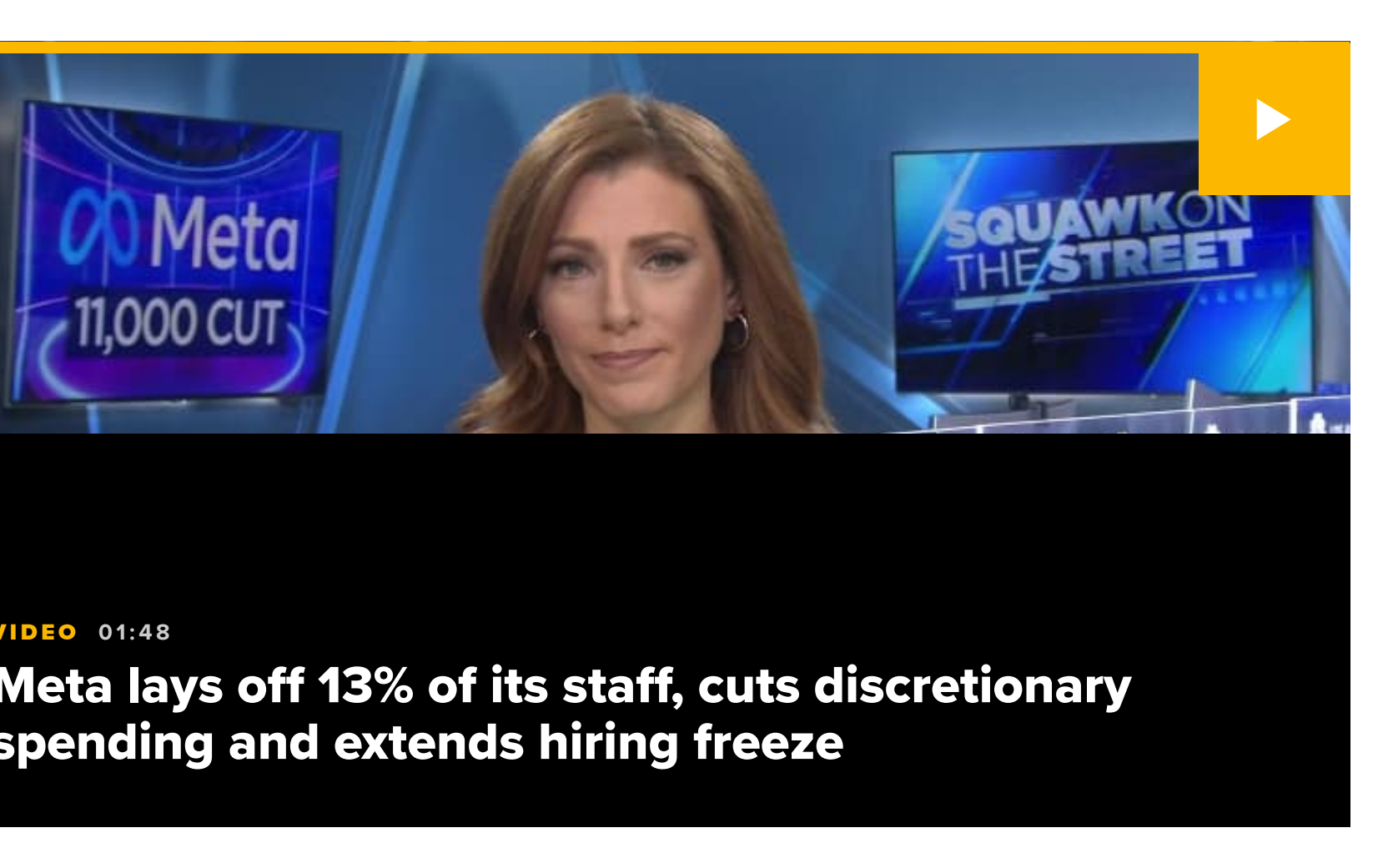
Private investors valued Chime at $25 billion just over a year ago.

Tesla: cutting 10% of salaried employees

In June, Tesla CEO Elon Musk wrote in an email to all employees that the company is cutting 10% of salaried workers.

“Tesla will be reducing salaried headcount by 10% as we have become overstaffed in many areas,” Musk wrote. “Note this does not apply to anyone actually building cars, battery packs or installing solar. Hourly headcount will increase.”

WATCH: Meta lays off 13% of staff, cuts discretionary spending



VIDEO 01:48
Meta lays off 13% of its staff, cuts discretionary spending and extends hiring freeze

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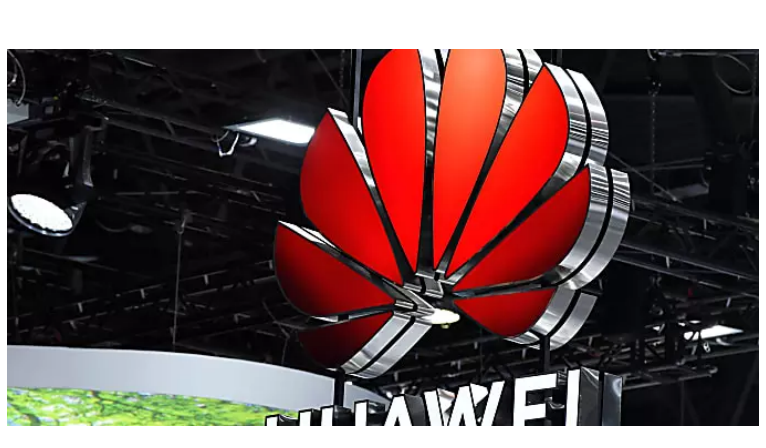

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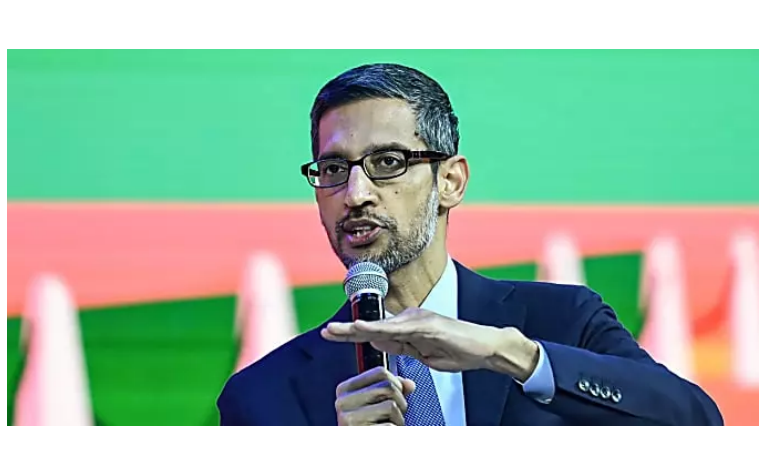

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COMMENTARY

Before Layoffs, Look to Collections

Advisers at Lotis Blue Consulting and Estrada Consulting share a series of tips on how firms can get more out of their collections process—possi
avoiding layoffs as a result.

January 26, 2023 at 02:18 PM

Law Firm Client Relationships

By Mark Masson, Jay Russell and Ed Estrada | January 26, 2023 at 02:18 PM

Editor's note: This is the first in a series of articles on practical, low-cost options to improve performance and profits amid tight budgets and layoffs.

With the end of 2022, a 10-year-long bull market has come to a close, and the ominous word "layoffs" is reverberating across industries. Mass layoffs have come to several sectors of the American economy as employers scramble to rebalance their costs due to losses in revenue. In October alone, Meta slashed its workforce by 13% (11,000 employees) and Twitter fired half its staff.

The question becomes: should law firms take a page out of big tech's playbook and rapidly downsize their staff? Our answer is a resounding No!—fire-drill mass layoffs leave firms both unsustainable and stunted when it comes to potential growth. The modern American law firm can trim the fat without sacrificing talent by pulling a variety of other levers—smart business practices that will drive significant efficiency cost savings and shorten and make more predictable several parts of the revenue cycle. One of these levers is optimizing their collections processes. By eliminating collections inefficiencies, organizations can better survive the bear market—positioning themselves for new growth when the economy once again turns bullish.

The current anxiety in law firms isn't just the result of slight present losses in revenue, it's from the threat of significant losses to come. While unprofitability plagued large swaths of the pandemic-era market, counterintuitively, law firms were spared. After enjoying 13% growth in revenue in 2020, law firms grew again by 14.8% in 2021. Profit per equity partner rose 19.4% last year as well. However, many worry that this sudden rise in demand isn't sustainable. Those in the legal profession see the tech sector's plight as a foreboding omen—an exuberant rise can produce an equally devastating crash.

What Goes Up Must Come Down

The rapid expansionist moves taken by law firms during the period of surging demand make the projected fall of revenues all the more challenging if demand starts to slip drastically. An Increase in demand equals an increase in demand for talent. However, a sector-wide increase in demand for talent equals an increase in competition for said talent. As a result, lateral hires dramatically increased at both the partner and associate levels during the post-pandemic period. Compensation also rose dramatically—growing 16.3% in 2021, and 22% when accounting solely for senior roles. Compensation doesn't just mean raising base salaries—the structures of annual, retention, and signing bonuses all need to be altered dramatically to lure top-tier talent as well.

The first dominos are already starting to fall—after revenue grew a modest 5% during the first half of 2022, these figures slumped 3.6% in the second half of the year. Compounding this softening of demand have been soaring operating costs, which grew 13.5% in 2022 alone. A return from the virtual-work nature of the pandemic has been devastating for the balance sheets of law firms, as renting offices and funding business trips once again eat into profits. While this may be one of many expenses out of law firms' control—factors such as inflation, instability in Eastern Europe, and supply chain issues—a significant portion of operating costs can be blamed on overly optimistic moves made during the period of rising bullishness.

One such aggressive move has been the incorporation of new, innovative technologies into firms' outdated infrastructures. While technology costs have skyrocketed by 13.5% in 2022, these costs are justified—law firms should view these expenditures as investments that position their organizations for long-term growth. Because these investments in cybersecurity, cloud computing, and other digitization efforts will attract a more diverse client base and streamline data collection, it would be shortsighted for organizations to backpedal on these investments, sacrificing their future for better short-term profitability. While spending aggressively on tech and talent may have been overzealous, reflexively reversing these expenses risks more in the long term than simply eating the costs or cutting corners in over-bloated departments.

Collections: A Long-Overlooked Target for Increasing Efficiency

One area that has the potential for massive return is collections, especially considering that the current state of law firm collections is a mess, marred by inefficiency and outdated technology. The problem here is only getting worse—in the first half of 2022, there was a 4.2% lengthening of the collections cycle. In 2022 as a whole, firms have also seen an increase of receivables outstanding by nearly 10%. Megafirms especially are leaking revenue—Am Law 100 firms miss out on 12% of billable invoices they send to clients, which lags behind Am Law Second Hundred and midsized firms in this area. Unfortunately, as many firms expand, their collections departments are the last to catch up with other upgraded, sophisticated sectors. Bull market-induced complacency can be blamed for the decay of collections practices—indeed, when law firms have a lot of work coming in, the last thing they'll worry about is operational hygiene.

The first step to revolutionizing collections practices is breaking down the system into its four key components: matter and client acceptance, matter intake and setup, delivery, and invoicing and collections. By connecting and streamlining these four links in the revenue chain, law firms can save an enormous amount of time while still driving profitability.

By taking on a new approach, helped by introducing data analysis and cutting-edge technology into the collections sector, law firms can both expedite the collections process and eliminate human error. For example, organizations that invest in collections dashboards that automatically score each invoice based on the client relationship, number of days the bill is outstanding, size of the bill, and concentration of outstanding accounts receivable the overseeing partner has, will have much better visibility into their collections problem. This approach will help the CFO and progressive layers of leadership prioritize profits in an efficient manner. There is immense value in integrating a toolkit that can locate holes in the company's infrastructure rather than blaming poor margins on individual clients. A client's outstanding payment is symptomatic of a firm's poor collections practice—they aren't the root cause of the problem.

Collections can't be overhauled without firms looking within and auditing their collections process to pinpoint inefficiencies. Process mapping is key in identifying flaws in the revenue cycle. Rates applied, proposed team profitability, prompt time capture, decreased pre-billing write-offs, timely billing to clients, accounts receivable (A/R) procedures, clear A/R accountability, coordinated A/R status, avoiding post-billing write-downs, write off and collections decisions—all these facets must be analyzed to locate where firms are leaking revenue. Many lawyers describe from anecdotal experience that what starts the vicious cycle of delays, debts, and deteriorating attorney-client relationships isn't a late payment on the client's end, it's a late bill sent on the attorney's end. Sending prompt bills is a preventative measure—it sets a precedent, establishing that the company values professionalism while eliminating unpleasant surprises on the client end.

After identifying any holes in the collections infrastructure, senior management must be ready to hold members of the organization accountable for their oversights. Perhaps the associate didn't remind the client consistently enough about the payment. Maybe the associate didn't put enough effort into the client relationship. Leadership must also ask the following questions: does the collections team need additional members? If so, how many? What level of resourcing gets us to "good enough," and avoids diminishing returns? Is the tech worth the investment, or could we get to "good enough" without significant investment in digital?

Legal collections can be a delicate balancing act—in seeking payments, firms must be careful not to alienate valuable clients, yet still be clear about their intentions. As reported in an American Bar Association Journal article, Darlene Maronge, collections analyst at Galloway, Johnson, Tompkins, Burr & Smith, says: "When I have to contact a client for payment, I speak to them the way I would want someone to speak to me—especially when trying to collect payments. I always listen to the client. To me, it is important to be respectful and be responsive as soon as possible regarding issues with invoices." Empathy is usually a more effective approach than detachment or anger when dealing with outstanding payments.

Payments will be received far more smoothly when firms approach collections from the client's point of view. Organizations must make careful considerations when selecting who should reach out for collections. They must factor in whether the relationship is new, if it's long term, and/or if it extends across multiple practices in the firm. Firms must also use straightforward and deliberate language when establishing terms for payment. Maybe a specific client has the money to pay yet they were confused because the terms were set in ambiguous or jargony language. Personalization goes a long way when dealing with a diverse group of clientele. The difference in fiscal year cadence, a newness to the firm's invoicing system, distractions in a client's personal life—all these unique factors require an equally bespoke approach.

Striking the Right Balance

While setting bold revenue goals goes hand in hand with overhauling collections, firms need to remain realistic about expectations. Change can be incremental and nonlinear, and that's okay. This is where KPIs come in: advanced analytics can make sure that firms don't get too carried away cutting corners in an attempt to iron out their collections inefficiencies. There is a happy medium between cleaning the slate and stagnating, and advanced analytics can determine precisely how much needs to be overhauled to reach sensible revenue targets. Just to put in perspective how archaic the current state of collections metrics are, some firms don't even track their percent collected at the year's end. Modern metrics should go above and beyond percentage collected—they should measure the percent of revenue collected versus written off, the percent of clients with outstanding invoices, the number of clients past 30, 60 or 90 days outstanding, and the margin impact on the firm from improved collections.

The future of collections analytics involves data that is not only reactive, but predictive. In the not-so distant future, collections departments will be able to build a profile of a prospective client, and from there determine if they are more or less likely to pay on time—even going as far as to determine by how many cycles their bills would be late. These advancements in predictive analytics will not only help firms to make more lucrative client selections, but also more accurate revenue projections.

While creating an effective collections department may be the first step to sustained profitability, these changes must be part of a larger, overarching culture shift. Overhauling collections will impact the bottom line, but it won't impact sales, associate development, and delivery. Companies can make a roadmap from the remodeling of their collections practice—a first step in leading an organization toward profitability, sustainability and increased satisfaction for clients and associates alike.

Mark Masson *and* **Jay Russell** *are, respectively, lead partner and principal in the professional services practice of Lotis Blue Consulting.* **Ed Estrada** *is managing partner Estrada Consulting. They can be reached, respectively, at mmasson@lbconsulting.com, jrussell@lbconsulting.com and eestrada@gmail.com.*

Business & Practice

Cravath is the latest law firm to revise its lockstep pay system.
Daniel Acker/Bloomberg News

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Big Law's Pay War Is Dangerous Game for Firms Posing as 'Elite'

Meghan Tribe
Reporter

- Milbank, Davis Polk, Cravath have upped associate salaries
- Pay scale has ratcheted up three times this year amid talent war

An ongoing pay war is making lawyers at some of the top firms in the world more money than ever before. It's also exposing a growing fault line between the richest firms and everyone else.

In just a few weeks, Milbank LLP, Davis Polk & Wardwell and Cravath Swaine & Moore all announced a series of compensation increases that saw annual pay soar by 13% to $415,000 for their most senior associates.

As the salary scales reach new heights, many of the top performing law firms have quickly moved to match—seeing it as an imperative in the tightening battle for top associate talent. Now, a small group of the richest firms appears to be pulling away from the pack.

"The firms that can match the Cravath salaries are making a point of setting themselves apart," said Katherine Loanzon, managing director at legal headhunter Kinney Recruiting. "They're telling the market they're considering themselves part of the elite firms," she said.

Some firms can easily bump salaries to keep up. For others outside of a select tier, the barrage of raises is a risky proposition.

Many firms matched last year's associate salary increases and bonuses—whether because of competitive market forces or for the appearance of prestige—but the latest round of pay boosts poses a fresh threat to their finances. It

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To contact the reporter on this story: Meghan Tribe in New York at mtribe@bloomberglaw.com

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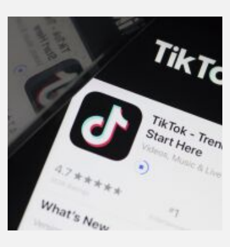

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March 17, 2022, 5:30 AM

Big Law's Soaring Profits May Be Next Pandemic Darling to Falter

COLUMN

Roy Strom
Reporter

Welcome back to the Big Law Business column on the changing legal marketplace written by me, Roy Strom. Today, we look at Big Law's chances of growing profits in 2022. Sign up to receive this column in your inbox on Thursday mornings.

What goes up must come down. It's a lesson seemingly every financial asset is reminding us lately. So many early "pandemic darlings"—Netflix, Peloton, Zoom—that surged as Covid-19 took hold and people stayed home aren't looking like they've won much of anything, two years later.

Big Law profits are next at risk of faltering from record highs. Large firms were always bound to be victims of their own success—and overwork. Now they are facing rising costs and growing economic uncertainty, too.

Big Law firms aren't publicly traded. The closest equivalent the industry has is the annual release of AmLaw's profits per equity partner.

That figure, set to be reported next month, will no doubt show the booming value of holding equity in the world's most prestigious law firms. Many of the numbers reported by AmLaw so far have been staggering. Cooley, for instance, told AmLaw the firm's profits per partner rose nearly $900,000 from last year—a 28% increase—to $4 million.

It's possible that average profits per partner across the AmLaw 100 could have grown as much as 20% last year. That's on top of 13% growth in 2020. It's a huge

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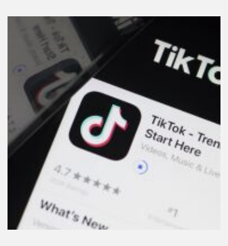

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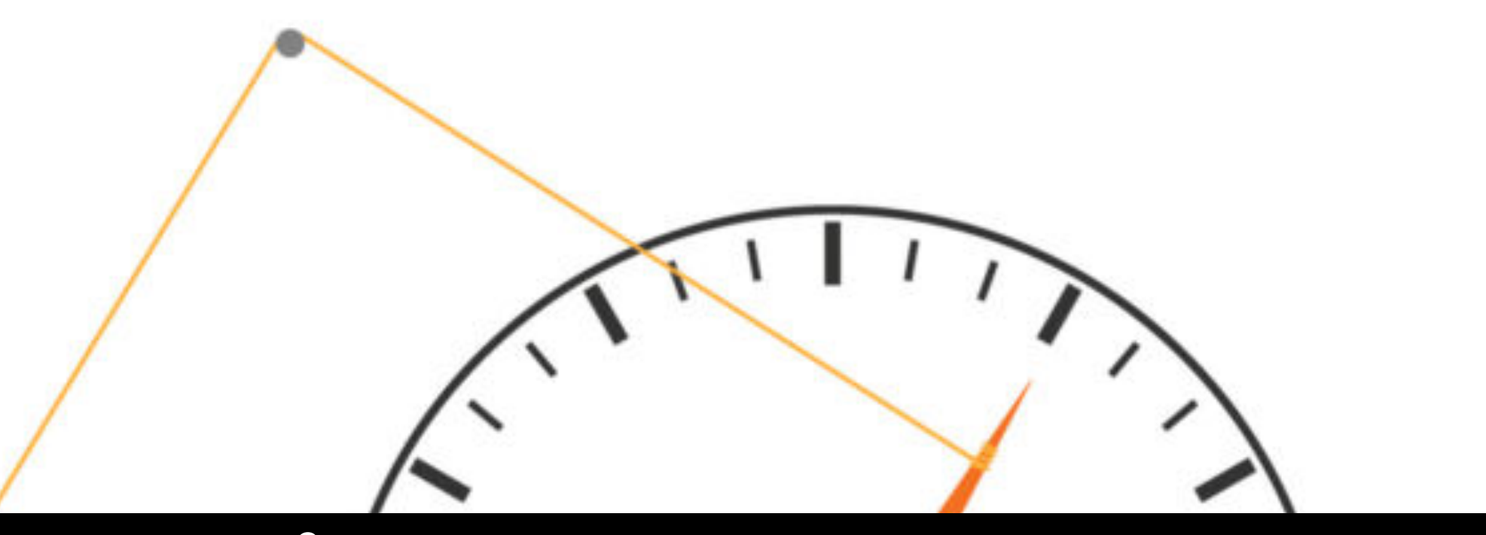

LEGAL MARKETPLACE

Forum: Law firms face key challenges as 2022 draws to a close

Marci Taylor Law Firm Strategy Consultant
John Cahill Senior Consultant / Law Firm Advisory / Withum

11 Nov 2022 · 5 minute read

Those tasked with law firm management currently find themselves in a more tenuous financial landscape than existed just one year ago

The high bar set by the law firm industry's extraordinary performance in 2021, together with several external factors, has made the first half of 2022 challenging for the industry. Recent reports indicate that overall demand for legal services continues to decline, while firm expenses have increased by double digits from the first to second quarters of 2022. The current setting has led to a 3.6% decline in profits per lawyer, quarter over quarter.

Inflation, the continued war for talent, return-to-office strategy implementation, as well as the declining demand for corporate and mergers & acquisitions (M&A) legal services, led to a second consecutive quarter of profit decline. Reduction in profit margin also comes while billing rates continue to climb industry wide. While firms had enjoyed nearly two years of continued quarterly profit increases, the declining trend identified in the first half of 2022 serves as an ominous warning of future liquidity issues if margins continue to decline.

The Thomson Reuters Institute reported that, in the second quarter of 2022, overall average industry demand fell by 0.5% in comparison to the second quarter of 2021. Corporate demand fell by 0.7% and M&A fell by 4.9% over the same period, although it should be stated the 2021 figures correlate to a period of unmatched demand after firms and clients adjusted to the pandemic-related legal atmosphere.

> ***While demand has receded through the first half of 2022, billing rates have increased approximately 5.8%. This may appear to be a sizable increase but is less than those in prior years of 5.9% in 2020 and 6.7% in 2021***

The war for talent continues to drive compensation expense upwards, as it increased 12.4% in the second quarter, year over year, according to the Thomson Reuters Institute. Lawyer head counts increased 4.5% during the first half of 2022, which correlates to the increase in hiring made in 2021. Operating expenses also increased by 13.5% year over year, fueled mostly by increases in technology spending, rising costs due to inflation and costs related to returning a workforce to the office, as many legal professionals were still operating mostly in a work-from-home environment in the first half of 2021. It should also be noted that many of these operating expenses were initially implemented in the second half of 2021, and as a result, one expects to see a more gradual increase in operating expenses in the second half of 2022.

Revenue growth of 5% during the first half of 2022 is more in line with historical first-half figures, and 2021's first-half growth of 14.6% is now seen as an outlier that's tied to the industry's resurgence after a period of pandemic-related dormancy. Another variable that appears to have curbed revenue growth in the first half of 2022 is a 4.2% lengthening of the collection cycle. Firms are servicing clients who are taking longer to pay their bills. Receivables continue to age, and the legal industry has seen an almost 10% increase in receivables outstanding since the beginning of 2022.

Inflation as a factor

US inflation roared to a four-decade high at the end of June, as the consumer price index rose approximately 9% from a year earlier. If inflation remains at current levels, law firm billing rates won't be able to keep pace. While demand has receded through the first half of 2022, billing rates have increased approximately 5.8%. This may appear to be a sizable increase but is less than those in prior years of 5.9% in 2020 and 6.7% in 2021. Firm leaders may have wanted to implement additional fee raises midyear, but many opted against adjusting fees in light of decreasing legal demand industry wide. Also, billing rates have historically been about two points higher than inflation for the past decade.

Firms that opted against midyear billing increases may be facing quite the uphill climb as they attempt to make up for their eroded gross profit margins during the first half of 2022. It is not guaranteed that inflation will continue its current torrid pace; in fact, multiple projections suggest inflation will decrease in the next 12 months. Either way, the industry can expect to deal with inflation-related fallout for the immediate future.

As the industry enters the third quarter, market conditions remain challenging. However, rising accounts receivable balances at the end of the first half should aid in increased revenue if firms can efficiently prioritize collections prior to year-end. It is also expected that expense growth should diminish in the second half of 2022 as the lawyer head-count boom spurred on by the rush of post-pandemic-related demand finds its market-driven equilibrium.

While technology expenses have increased drastically in 2022 (approximately 10.5%), this is one area where firms should be hesitant to reduce costs. Such expenses should instead be viewed as *infrastructure investments*, as new technology allowed firms to pivot to the remote-work environment during the pandemic, while also driving firm efficiency improvements through cybersecurity and cloud computing, among other processes. Firms that properly invested in new technology can expect to see improved realization efficiencies through the continued implementation of data analytics. Such investments will also give firms the ability to reach a new client base and explore emerging practice areas through streamlined data intake and initial analysis.

As firms continue to compete for new business in an increasingly competitive marketplace, technology will be at the center of improving the client-driven experience by increasing the perceived value of the clients' legal services. As more routine procedures are automated, professionals can spend more hands-on time with clients, working through more high-value processes.

For many firms, it is likely that 2022 profits will be lower than 2021. However, a reduction to the continued growth of expenses, and the potential for increased revenues if a concerted effort is made to increase collections on outstanding balances should result in the second half of 2022 being more profitable than the first half.

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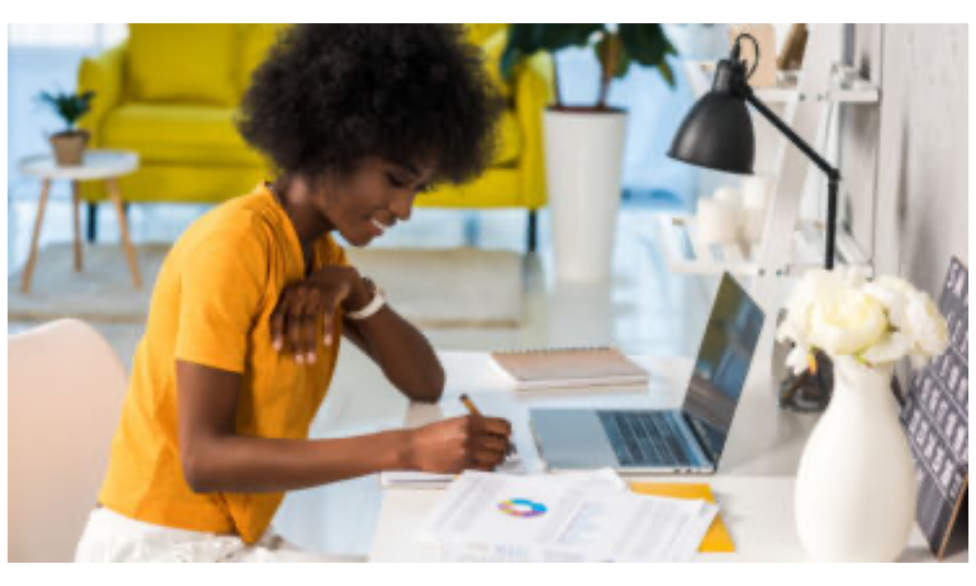

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EXPERT OPINION

How Improving Practice Management Can Protect Revenue

An investment in practice management can pay off in more loyal talent and clients, partners at Lotis Blue and Estrada consultancies outline.

February 28, 2023 at 10:00 AM

Legal Practice Management

By Mark Masson, Ed Estrada and Jay Russell | February 28, 2023 at 10:00 AM

This is the second in a series on practical, low-cost options to improve performance and profits amid tight budgets and layoffs. The first piece, on collections, can be found here.

The Backdrop

- Demand for legal services has shifted dramatically and quickly from two years of unprecedented growth and profitability to deep uncertainty and threats of recession.
- Firms have responded with tightening budgets, direct or indirect reductions in talent, and delays in large firmwide transformations and initiatives.
- All the while, firm leadership and partners expect improved performance and even in times of recession, clients will demand certain types of legal services.
- Layoffs are a common headline from technology companies, law firms, and others, an unfortunate reversion to the mean of talent norms after rapid recent hiring.
- Law firm leadership teams are being forced to review all potential options to deliver high-quality service to clients, grow revenue, and do so in an efficient manner.
- No/low-cost solutions: To help firms focus and remain competitive, there are a handful of places where firms can implement no/low-cost solutions that will set them up for immediate success.
- Where to invest: Beyond the (hopefully) short-term economic headwinds, firms should keep their eye on the areas where continued investment is necessary for long term relevancy and growth. Yes, budgets are tight, but they are not completely gone.

A Focus on Practice Management

Firms of any size, but particularly larger firms, are a collection of lawyers with specialty areas of practice, organized, whether formally or informally, into groups (by clients, practices, sub-practices, offices, industry groups, etc.). While having many practices, geographies, and types of clients in a firm is healthy for diversification, it can be difficult to organize and manage dozens of these groups.

While the practice leaders, partners and lawyers in the practice know their clients best, they focus most of their time and energy on being legal experts. This is where practice, operations, and firm-level leadership need to provide focus, process and resources to help their legal experts deliver their unique value to clients.

There are a number of low-investment solutions to common challenges that can make a firm more responsive to client needs, more profitable and more productive.

No/Low-Cost Solutions

Client focus: In a highly competitive, uncertain economic environment, client service should be the primary focus for any firm. Without a stable client base, there is no firm. Like law firms, clients are trying to navigate current uncertainty, so they need the best advice and guidance from their firms to grow and protect their businesses. Likewise, with finite resources, law firms need to make informed decisions as to how best to allocate those resources among client teams that vary in production, profitability and stage of development.

Client focus tactics:

- **Assess the firm and practice/geography's client list**: Understanding which clients are the best candidates to develop in line with firm strategic goals, and able to be best serviced by existing capabilities is crucial to developing a "target client profile." What makes for a good client/potential client at the firm level? What about at the practice/geographic level? What criteria are used to assess clients? Is the firm/practice investing too much into certain clients? Missing opportunities with others?
- **Categorize clients into sunset, maintain, grow**: Not all clients are the same, so a firm should know how much to invest to best align opportunities with a client. Some clients cost more to serve than they are worth. Some are likely not to grow but are still valuable to the firm. And some are poised to grow and need increased focus. Using firm data, analytics and aligning to target client profiles can help firms focus their efforts. The most advanced firms leverage core firm data and predictive algorithms—like www.orgaimi.com—to identify undiscovered potential and how to best serve target clients sets.
- **Look across the firm for collaboration opportunities**: The practice/geographic focus of many firms helps to organize, but often times creates silos, cutting off opportunities to collaborate for firm and client benefit. A coordinated, full-service/collaborative firm will likely retain more clients over longer periods of time. Leveraging similar analytics to understand client growth trends, firms can see likely next-matter types by client, industry and by practice. This helps to arm firms with information about additional/new resources and people to introduce to clients for additional matters and best practices behaviors that have led to this growth.

Talent focus: To deliver the best work to clients, firms must have and develop the best people. Both high- and low-performing people can get lost in big firms without processes to maximize the firm and individual's experience.

Talent focus tactics:

- **Catalogue existing talent (capabilities, demographics, experience, etc.)**:

Understanding the skillsets, characteristics and experiences of your talent will help to align work that fits the right people and gets better results. This improves the client and employee experience. Plus, the firm now has the information to properly plan future talent-related strategies and develop and retain its most valuable asset (talent).

- **Defining client needs and expectations for firm talent**: Conducting a similar audit as cataloguing existing talent, understanding client needs down to the skillset, characteristic and experience level will help firms align their talent to client needs. This will further enhance client and employee experiences and thus revenue, retention and productivity. Identify gaps (or excess) in workforce capabilities or other characteristics—conducting the gap analysis between the firm's existing talent and client needs/expectations will inform the firm's approach to recruitment, employee experience, training and development. This will also help firms organize the right combination of skillsets to staff on matters to align with client needs and also provides the data required for an informed cost-benefit analysis when determining whether an expansion into a new practice area or retreat from one is best advised.
- **Minimize unwanted attrition:** All of the above tactics are aimed at providing a better client and employee experience. Outcomes include higher employee retention and productivity, that translate into better client experiences, revenue, rates and retention. These benefits are built on a foundation of data, likely data the firms already have. Organizing and analyzing these data points will allow firms to see what works for client/employees, why, and what actions to take for a more consistently high-performance experience.

Where to Invest

- **Identifying key client accounts**: Key client accounts are those where there is high value for the firm, in terms of profitability, prestige or revenue, and/or potential future growth. They aren't necessarily the firm's largest client relationships, but collectively may also be of a size where losing the client would have a big impact on the firm. Thus, it is worth investing in the planning around how the firm can serve, retain and grow those key accounts that are part of the firm's long-term growth.
- **Aligning resources for key client accounts** (dedicated team, customized approaches, introductions across the firm, additional time/energy/research to serve): Beyond identifying key accounts, creating and investing in the right resources and capabilities for clients will help ensure retention and growth. This may mean new skillsets for existing people, new offerings, new ways of delivery, and more resources dedicated to serving and growing clients. All these "news" mean investment is required to get this right.
- **Clarifying the talent capabilities needed to serve key accounts and aligning workforce strategy to reinforce those capabilities** (recruiting, training, etc.): Similar to the talent inventory detailed above, identifying the skillsets, resources and talent clients need to remain with your firm is important. This may require dedicated training, outsourcing or bringing in new people.
- **Develop processes to identify and export best practices from client teams throughout the firm:** To realize long-term value from the ideas above, the firm will need a dedicated process to scale learnings from the highest performing teams and clients. The unique combinations of skills, situations, client, team members, etc. will always be somewhat different, but the more a firm can provide a high-value and high-return experience for clients and the firm, the better.

Mark Masson *and* **Jay Russell** *are, respectively, lead partner and principal in the professional services practice of Lotis Blue Consulting.* **Ed Estrada** *is managing partner Estrada Consulting. They can be reached, respectively, at mmasson@lbconsulting.com, jrussell@lbconsulting.com and eestrada@gmail.com.*

August 01, 2021 **MIND YOUR BUSINESS**

How law firms should approach collections for financial success

By Scott Brennan

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By many accounts, law firms got through the financial challenges of 2020 by making deep cuts to expenses. And while that strategy seems to have worked, firms have likely reduced spending as much as they can and will have to focus on other aspects of the revenue cycle to propel their recovery. As a result, collections will probably become an obsession for law firm managing partners and CFOs throughout 2021. This will be a challenge, as many law firms already struggle to maintain a healthy collections cycle even in the best of times.

According to the 2018 Clio Legal Trends Report, the utilization rate (i.e., the number of hours billed divided by the number of hours worked) for lawyers is only 30%, which means nearly two-thirds of attorneys' workdays are spent on nonbillable hours. Furthermore, the realization rate shows that only 81% of billable hours worked are invoiced, and the collection rate averages 85%.

That's a lot of money that should be flowing into a firm that is not. Firms are also well-known for focusing on collections in the fourth quarter rather than the whole year, which really isn't the best approach.

But ramping up collections when a firm's processes—and culture—have not evolved with that in mind may backfire. This is particularly the case if a firm does not already have a solid billing relationship with its clients that begins well before a letter of engagement is even signed.

Viewing collections as a gas pedal that can be pushed to pull more revenue out of clients could end up driving them away, particularly as the economic impact of 2020 continues.

Know your clients

Even though firms might justifiably want to maximize revenues right now, doing so at the expense of client relationships is not a sustainable approach. What's needed is flexibility and empathy with a client's financial situation. There's no use collecting a large invoice immediately if doing so helps push a client into insolvency. That is not how a client-focused firm is successful, and it also makes terrible long-term financial sense.

Instead, firms would be wise to use the events of 2020 as inspiration to solve the collections puzzle once and for all.

It also pays for firms to ask themselves some questions about each client, such as:

- What is this client relationship worth to the firm over the long term?
- Is this a client we can afford to lose?
- Do we want to be known as a firm that values money over client relationships?
- How can we partner with this client to help him or her ride out these financial difficulties and make us both stronger for the future?
- What alternate arrangements can we make for payment?
- What can we afford to do in this situation?

A healthy approach

The most important thing to realize is that a healthy collections process does not start after the client receives an invoice. Rather, law firms set the stage to maximize what they collect from the very start of a client relationship. There are some specific areas to focus on in order to get this right.

Fee agreements. Having a clear fee agreement that specifically lays out how much a client will be billed, what they are receiving and payment windows goes a long way in setting the stage for healthy collections. It's also important to customize fee agreements for each client.

Clear, unambiguous language that establishes deliverables and costs not only helps the overall client relationship but also minimizes confusion as to why a client owes the amount billed on an invoice.

Invoices. Just as important as fee agreements is providing clients with bills that are easily understood and thoroughly describe the work performed. Sending a bill with just an amount due and a vague one-sentence description of services provided is just asking for a client to query it. Likewise, billing for chunks of hours using nonspecific descriptions is only going to raise eyebrows and delay payment. A clear, concise and detailed invoice should solve that problem.

Timekeeping. As noted above, law firms repeatedly leave money on the table simply because it is not properly tracked and then billed.

In addition, sloppy timekeeping leads to inaccurate invoices, annoyed questions from clients and delayed payments—not to mention the fact that this could also create an ethics headache that no firm wants. For good collections to happen, firms should foster an internal culture that emphasizes accurate daily timekeeping and use solid, user-friendly (and preferably cloud-based) software.

Client communication. For unpaid invoices, firms often leave following up with clients to someone in accounts receivable. While that is fine for the first or second inquiry, it is mostly a reminder. It's not where things should be left if payment is not received quickly. Rather, firms should employ a staged communications approach where the main relationship attorney is looped in for follow-up after one or two attempts by accounting staff. The attorney can also maintain a more personal touch to communications and weigh alternative arrangements for the client. This is also a good way to maintain and even enhance the client relationship.

Software solutions. There are software products that can assist firms in making the collections process more efficient.

A list of "must-haves" includes:

- Built-in timers.
- Automatic prompts that remind users to enter time throughout the day.
- Help for users in accounting for all billed time, including how much of their time remains to be allocated.
- Flexibility that allows users to break time blocks into subcomponents.
- Capacity for multiple timekeepers to work on a matter and use robust, customizable rate tables for clients, practice areas, offices and roles.
- Electronic bill approval.
- Automatic write-down of charges that exceed a fixed fee while still tracking hours worked.

Firms that implement all of these strategies at key moments in their client relationships are far less likely to experience problems with collections, whether in good times or bad.

Above all, it's about focusing on clients and what they need, both in terms of legal work and facilitating payment. It's also not something a firm can just reach for when cash flow is threatened. Instead, collections should be a part of the fabric of a client's experiences with the firm at every touch point.

Scott Brennan is the former CEO of Lexicon, a provider of practice management software and legal support services. This column was written before he left the company.

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