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LAW FIRM CONSULTANTS

BETWEEN A ROCK AND A HARD PLACE – CLIENTS DEMAND GREATER VALUE, PARTNERS WANT MORE INCOME

By John Sterling, John Smock and Peter Giuliani

As law firms look toward the emerging recovery, they face a potentially significant dilemma. The traditional structure of the legal industry sets-up a seemingly intractable conflict between two key stakeholders' claims on the economic fortunes of a law firm.

- On the one hand, partners' expectations for solid and growing profitability are at the heart of the battle for talent we have witnessed over the past decade. As talented lawyers become more and more mobile, the need to deliver sustainable profitability in order to retain the best people is critical to continuing firm success.
- At the same time, clients (particularly general counsel) see the run-up in costs – from starting salaries for associates to seven figure PPEP – as the primary culprit behind the rapid escalation of their own legal bills over the past few years.

To achieve enduring success, both sets of stakeholders need to be satisfied. Firms need to effectively balance their own financial objectives with the needs and expectations of their clients. In our view, delivering exceptional value to clients **is not** at odds with earning a healthy profit for shareholders. If a firm cannot deliver both improving profitability over time **and** a high level of value to clients, it is doomed to lose either its best (and most mobile) people and/or critically important clients.

Frankly, this apparent conflict between shareholders' and customers' interests is not new. In the late 1980's, the strategic imperative of maximizing shareholder value became widely accepted in business management circles. That led to a genuine concern – particularly among corporate management – that strategies designed to merely maximize shareholder value could easily damage long term relationships with customers, erode the value of brands, and lead to short-sighted operational responses.

Harvard professor Robert Kaplan and his partner David Norton developed a highly effective management tool to close the apparent gap between the interests of shareholders and the interests of customers. They called it **The Balanced Scorecard**, which explicitly recognizes the need to strike a strategic balance between the needs of shareholders and customers. The balanced scorecard is a management tool that enables organizations to improve consistently on both fronts. It is not an either/or question for a well-managed company – rather, it is a case of creating a balanced approach to improving both shareholder value and the value customers and clients derive from the firms' products and/or services.

Smock Law Firm Consultants firmly believes that the balanced scorecard will be a key tool for successful law firms as the traditional business model evolves in the coming years. In fact, John Sterling recently authored a book on this important topic – Balanced Scorecards for Law Firms.

This monograph provides an overview of on how the balanced scorecard concept can be used in a law firm setting. Included are:

- A brief overview of the original balanced scorecard concept
- A translation of that balanced scorecard concept to the law firm environment
- An introduction to how to use balanced scorecards at the firm and practice group levels
- A few examples of how scorecards have helped real law firms.

It should be noted that the balanced scorecard is a big topic. This monograph is intended to only provide an overview – we refer you to our book for a more detailed explanation.

OVERVIEW – BALANCED SCORECARD PRINCIPLES

The balanced scorecard was initially developed in the early 1990's in response to the widespread acceptance of shareholder value as the primary (and sometimes the only) metric of business performance. It reflected a realization that shareholders' needs had to be balanced with the customers' expectations of value. In addition, the balanced scorecard emerged at a time when an alphabet soup of operational management and new technology platforms were competing for management's attention (e.g., TQM, ERP, etc.) as potential unachievable *"silver bullets"* for improved performance. The authors knew that those tools and technologies needed to be directed toward activities that genuinely drove improved shareholder value and/or an improved ability to meet customers' expectations.

At its core, the balanced scorecard is designed to drive strategy implementation – it presumes that an effective vision and strategy already exists. Balanced scorecards connect long range strategy to the day-to-day implementation of that strategy.

The management approach to do this is deceptively simple. The balanced scorecard involves four fundamental dimensions:

- **Financial measures** – those measures that define what shareholders (in law firms, the partners) need and expect from the firm financially. In some circles, the balanced scorecard was seen as a backlash against a focus on shareholder value – not true, the system simply recognizes that management needs to balance financial goals with other elements of strategy in order to deliver superior financial results.

- **Client measures** – those measures that capture how well the organization is meeting client expectations. Simply, how does the organization appear to its clients (e.g., flexible, responsive, intelligent, innovative, providing value, etc.)? Law firms have historically focused intently on client service, yet do relatively little to measure client's perceptions of their firm's performance.

- **Learning and growth (human development) measures** – measures that capture how well the firms' people are able to change and improve. Ultimately, is the organization and its workforce getting smarter? In a law firm environment, this involves measuring whether people are more valuable to their clients and colleagues as the market and client needs evolve and change.

- **Internal business process measures** – those measures that track improvement in the business processes most important to strategic success. In a law firm environment, that translates to measuring and improving processes that directly impact client service delivery (i.e., tracking improvements that make processes more efficient, more effective, or both).

These four dimensions are not carved in stone – either for companies or law firms. Organizations can and do add new or different dimensions to their scorecards that better fit their business and their primary strategy. However, as a management system, the balanced scorecard as originally designed has proven to be remarkably robust and durable. And, the evidence has overwhelmingly demonstrated – in industry – that those organizations that use a balanced scorecard clearly out-perform those that do not.

TRANSLATING THE BALANCED SCORECARD TO LAW FIRMS

There are inherent challenges associated with applying the balanced scorecard to a law firm environment.

- First and foremost, shareholders in a law firm are not simply looking for a return on their investment – they are personally involved in the delivery of legal services, they develop and maintain client relationships, and they manage and train less experienced lawyers. In other words, shareholders in a law firm are active, not passive, investors.

- Further, the balanced scorecard was primarily designed with business units in a larger company (or single focused middle market businesses) in mind. The concept presumes a common set of products, customers, and business processes – all focused toward the achievement of a common vision and strategy. Thus, in a law firm the balanced scorecard can be most easily applied at the practice group level.

- That said, we believe law firms can maximize the benefits of balanced scorecards by using the system at **both the firm and practice group level** in a coordinated manner.

The following sections highlight the considerable **benefits** firms can capture via use of the balanced scorecard, as well as the primary **barriers** law firms can expect to face in adopting the concept.

The Benefits to Law Firm Use of the Balanced Scorecard

Business research has demonstrated two very important conclusions regarding the balanced scorecard.

- First, organizations that adopt and utilize the balanced scorecard as an integrated system improve their own performance and out-perform organizations that do not use an integrated scorecard.

- Second, organizations that have adopted the balanced scorecard experience much higher levels of buy-in and understanding vis-à-vis the organization's vision and strategy – people understand what the strategy means to them on a day-to-day basis.

Law firms are late to the table with regard to adoption of the balanced scorecard. But there are very solid potential benefits to taking an integrated approach to balanced scorecard implementation. These include:

- Development of clear linkages between the work of the firm and its practices, directed toward **improved profit per partner**

- Dramatically **improved implementation** of firm-level and practice-level strategic plans

- Pointed **improvement in performance** associated with each dimension of the balanced scorecard:

  - Especially **on behalf of clients** and in the development of the **capabilities of a firm's people**

  - But, also in the development of other important capabilities (e.g., the use and application of technology) and in improved business processes

- **Substantial improvement in practice group performance** – where the integrated nature of the balanced scorecard can be best leveraged given the common clientele, service offerings, skill base, and work processes that often exist at the practice group level.

Challenges and Barriers

- Because the shareholders/partners are also a substantial portion of the workforce and of the management team, the dynamics of any *"top down"* management system present obstacles.

  - Law firm leadership is often held in check by factors that relate as much to interpersonal relations and firm politics as they do to financial returns.

  - That dynamic is further complicated by the high value placed on business development. Successful business originators usually enjoy a substantial degree of autonomy (i.e., management generally cannot or does not want to dictate to successful rainmakers).

- There is resistance to any business process focus and anything that smacks of an MBA orientation. We need only point to the rapid demise of the *"TQM for Law Firms"* movement of the 1990's to make that case.

- Potentially conflicting incentives are also an issue. For instance, to the extent billable hours remain a fundamental driver of how law firms are paid for their services, there is a potential for conflicting incentives between clients' desire for greater predictability and/or efficiency and shareholders' desire for growing PPEP.

- Partner compensation systems are entrenched in many firms – yet, the balanced scorecard will push firms to align compensation with the strategy. That change will inevitably be resisted by some partners.

- Quite simply, some things are very hard to measure – at both a macro (firm or practice) level and/or at a micro (action plan) level. People oriented goals are the most difficult to measure quantitatively in ways that actually relate to the qualitative goals the firm is pursuing.

- Finally, some firm cultures actively resist the type of accountability associated with the balanced scorecard. That is, balanced scorecards tend to focus accountability on doing what you said you were going to do. Partners and attorneys are often accustomed to not following through on action plans – so long as they continue to bring in clients and bill sufficient hours, there are no sanctions.

USING BALANCED SCORECARDS AT THE FIRM AND PRACTICE LEVELS – AN INTRODUCTION

We strongly believe the balance scorecard is most useful in settings where firms have a clear vision and strategy at the firm level. We are reminded of the old Steve Martin stand-up comedy routine – *"How to become a MILLIONAIRE and never pay taxes…"* In that bit, Martin would quickly say, *"first, get a million dollars, then…"* So, we acknowledge that putting together a logical, compelling strategy for the firm is not an easy task. In fact we have written about it on numerous occasions including here. However, for purposes of this monograph, we will begin with the assumption that your firm has a meaningful and implementable strategy.

Using the balanced scorecard requires the firm to translate that vision and strategy into meaningful and measurable goals relative to **profitability** and to **client relationships**.

- While we abhor PPEP as a stand-alone measure of performance, we do believe your firm should set a clear, unambiguous profitability target as part of its overall strategic plan.

- In addition to setting a PPEP target, using the balanced scorecard effectively requires that the firm adopt a limited set of measurable objectives related to client relationships. Those client relationship goals can range from client satisfaction scores to third party rankings/ratings; to the depth and breadth of relationships (e.g., how many partners touch key relationships); to the number of large relationships the firm has (e.g., how many $1 million relationships); to measures of client diversification.

We have found the strongest firms tend to have common goals relative to both financial performance and client relationships. For instance, over the past fifteen years, most general service firms (both mid-size and larger firms) have exited the insurance defense business – why? Because economically, those practices became increasingly incompatible with the shared financial goals of the partners – and, the nature of those client relationships became less compatible with the values and culture of full service practices. Thus, this aspect of balanced scorecard implementation should be straight forward for most law firms.

With firm level strategy in hand and clear goals articulated relative to profitability and client relationships, the firm needs to engage its practice groups directly in implementation planning. That process will require the practice groups (and their leadership teams) to articulate:

- Their role within the firm and its overall strategy (i.e., how does the practice relate to the firm's overall business strategy, its PPEP targets, and its client relationship goals?)

- Action plans (including clear delineation of responsibility/accountability) related to at least three aspects of strategy implementation at the practice group level:

  - What the practice will be doing relative to growing and strengthening client relationships – in ways consistent with the firm level goals?

  - What the practice will be doing relative to the delivery of legal services – both to improve client relationships and to improve financial performance?

  - What the practice will be doing relative to the development of its people (and the tools/technology they will be using) to ensure they are increasingly valuable to clients?

- Practice level measures related to the action plans – in other words, meaningful quantitative and qualitative measures that can be used to monitor progress and hold individuals accountable.

Once the strategy is in place at the firm and practice levels and the balanced scorecards and related action plans are operational, the effort turns to dialog and feedback. The practice groups' balanced scorecards provide the basis for that dialog and feedback. The practices will be pursuing action plans with clear milestones and expectations for particular outcomes relative to financial performance, client relationships, and professional capabilities.

Depending upon the practice group and its role in the firm's strategy, firm leadership should plan to evaluate progress anywhere from two to four times over the course of the year. Those review sessions provide an opportunity for two-way dialog – keeping the practices on track and in sync with evolving firm priorities and providing firm management with an early warning system relative to the validity (or invalidity) of its core assumptions and strategy.

On an annual basis, the firm can assess progress against firm level objectives – financial, client relationship, and people related. In addition, firm management can make necessary adjustments in the overall strategy and its guidance to practices. In turn, the practices can incorporate those adjustments into their annual planning – a process that should involve a straightforward updating of the action plans, priorities and related scorecards.

We recognize this description only scratches the surface of *"how to"* implement balanced scorecards at the firm and practice levels. Smock Law Firm Consultants will follow-up this monograph with a more extensive *"how to"* discussion in the coming weeks. Meanwhile, we hope this introductory monograph provided a foundation for thinking about how balanced scorecards might work in your own firm.

A FEW EXAMPLES FROM THE REAL WORLD

Our balanced scorecard book includes a number of case studies exploring real world examples of implementation against one or more of the four balanced scorecard dimensions. A brief summary of some of those cases – which follow – can help to illustrate the power of the balanced scorecard as an implementation management tool.

A United States Based Global Law Firm

This firm began linking its firm strategy to practice level measures several years ago. With the adoption of its most recent strategic plan in 2007, the firm took an integrated approach to implementation – one that explicitly focused both on strengthening client relationships and on improving financial performance. At the desktop level, individual firm lawyers were given real time information and tools that enabled them to:

- Manage day-to-day staffing decisions on clients' matters so that the right people were doing the right work at the right time (across a global firm with over 1,100 lawyers)
- Manage fundamental business practices to ensure time was recorded accurately, invoices reflected clients' expectations vis-à-vis value, and receivables were collected in a timely manner
- Make well-informed decisions relative to pricing – both on traditional responses to requests for proposals, as well as on more innovative pricing approaches (including cost control and cost estimating tools at the client and matter level).

The net results of those integrated implementation efforts – balancing client and financial needs included the following.

- Through its most recently completed fiscal year, the firm has made measurable improvement in overall growth, client relationships, legal expertise, quality people, and financial strength.
- At the day-to-day level, the firm is meeting or exceeding the short term targets practice groups and partners are setting (e.g., bill speed, staffing efficiency, etc.).
- Finally, the firm has experienced significant levels of growth on three continents.

A Leading Asia-Pacific Law Firm

This firm focuses on advising major corporations and financial institutions in Australia and Asia. The firm's 1,000+ lawyers are spread across offices in Australia's main business centers, as well as Hong Kong, Beijing, Shanghai and London.

In 2005/06, the firm revisited its vision, strategy and objectives. As a relationship oriented firm, a key objective the firm adopted was to return the firm to the top of the BRW Client Service Awards – as well as other prominent third party rankings of client service and client satisfaction. To do that, the firm used benchmarking data to identify areas where the firm, its practice groups and its individual lawyers could improve. This data pointed to a number of areas for potential improvement, one of which focused on improving client telephone access to lawyers. In response, the firm adjusted phone protocols and developed telephone technology to support that process change.

- The technology enabled the firm to draw together a diverse range of data sources to identify who was available and who was not when a client was on the phone. For instance, the tool can – in real time – gather data from the firm's phone system (i.e., who is physically on the phone), Outlook calendars (who is scheduled as committed), human resource database (who is scheduled for vacation), messenger status (who is logged on at their desk), among other sources.

- The firm also had a robust Client Relationship Management (CRM) tool in operation. Connecting that tool to the telephone technology solution enabled receptionists to see immediately who the logical candidates were to take clients' calls. Likewise, the CRM and practice management tools could quickly bring the lawyer taking the call up to speed on what was happening on a particular matter.

Through the first quarter of 2009, the firm is now logging 10,000 fewer voice mail messages in the system per month – a dramatic reduction. A parallel measure – use of the new telephone technology/tool – logs more than 1 million uses per year on a continuing basis.

The firm also engaged in a number of parallel action plans – all integrated in a similar fashion to improve business processes, enhance people's capabilities, and provide helpful tools to improve people's effectiveness and productivity. The net impact of all of these initiatives – the firm has returned to the top position in the BRW Client Service Awards for 2009.

A Regional Firm Based in the Southeast

A successful regional firm based in the Southeast has used systematic client feedback as a source of ongoing measurement to ensure the firm and its practice groups are on track relative to its client relationship goals. Those client relationship goals are held in clear balance with financial objectives – and are supported by action and implementation at the practice group level.

They most recently revisited their strategic plan in 2005. The result of that process led to a number of primary goals and strategies that built on the firm's strengths and opportunities including: building and strengthening multidisciplinary client teams (to help clients achieve their goals); fostering a culture of teamwork and innovation and; becoming a driving force for economic growth in their region.

The result – at a time when most firms in its markets are struggling, they enjoy a position of financial strength and unparalleled client loyalty. Partner profits have dramatically increased and the firm continues to both execute on and test its strategy using client feedback every step of the way.

CLOSING ADVICE

There is a real risk of the balanced scorecard becoming an end in itself (as well as for creating new winners in *"buzzword bingo"*). In truth, this should be an extremely pragmatic tool. It enables the practices to articulate clearly and simply how they fit into the overall strategy of the firm. In so doing, they are well positioned to engage everyone in the practice in improving those processes that have the biggest impact on profitability and client satisfaction. It also enables practice leadership to identify where it needs to invest vis-à-vis people and organizational capabilities.

Having done this type of work on both the commercial and law firm sides of our practice, we are comfortable with the simplicity of the balanced scorecard process and the tools. The balanced scorecard is proven, effective, easy to use and, importantly, it connects everyone to the strategy in a way that is genuine and meaningful.

So, firms should not consider themselves to be *"between a rock and a hard place."* On the contrary, the best firms will balance improving financial performance with superior client relationships. The balanced scorecard will be a key tool in making that balanced approach possible and successful.

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Smock Law Firm Consultants works with law firms of all sizes on strategy development and implementation. Our track record and references highlight our success in helping firms with strategic planning; firm and practice organization; mergers and combinations; profitability and financial analyses; and strategic issue resolution. We recognize the unique differences among firms and as such do not preach a standard *"dogma."* We welcome your input, feedback and questions.