

OPERATIONAL EFFICIENCY - THE ROUTE TO OPTIMIZING PROFIT MARGINS

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Now that much, if not all, of the low hanging fruit has been plucked, the opportunities for cost reduction and cost containment at law firms have become much more challenging to identify and implement. However, in the present market environment, where overall demand is slightly down, or at best flat, there are more lawyers chasing the same or less work. And, the need to take existing market share from competition has made the challenge of returning operating margins to levels that can sustain firm growth and profitability even more daunting than before.

This monograph opens the discussion on the need for and ways to lower the cost of legal operations. While we recognize that firms' processes are different – and, sometimes, very unique – we believe our suggestions hold for most firms.

The Opportunities May Not Be Obvious

My partners and I strongly believe that significant opportunities still exist to further improve operational efficiencies (i.e. – doing what you do at a lesser cost) while not negatively impacting operational effectiveness (i.e. – doing what you do at least as well as you do it today). The practice of law has been evolving for decades. But, the natural resistance to change demonstrated by most lawyers has impeded the progress towards increased efficiencies and optimal profit margins.

- Many of the changes experienced over the past several years have been driven by technological enhancements and the introduction of new applications to ensure lawyer efficiency.
- But, we are far from done. Clients are pushing for greater efficiencies all the time. They want to see lower cost components in their legal representation at every stage of a matter.
- The potential efficiency enhancements we see in the future address (1) the actual practice of law or matter management, where legal work product is created by the lawyers; (2) the production of the legal work product that is ultimately paid for by the client; and (3) the operational support for the business of the law firm (accounting, recruiting, etc.). All three areas have potential efficiency enhancements that must be pursued.

Efficiencies in the Creation of Legal Work Product

Tens of thousands of lawyers at hundreds of law firms create legal work product every day. But apart from some obvious enhancements to efficiency, most of the process has remained unchanged for decades.

We all recognize that lawyers today can research legal precedent, case studies, and the law in a matter of minutes when compared to the hours that it used to take to conduct research in the library, thanks to the automated services such as WestLaw, Lexis/Nexis, Google, and others.

- And while these services, along with document assembly applications and knowledge management data bases, have enhanced efficiency, we believe that the assignment of these tasks are too frequently given to or taken by higher cost resources than is necessary.
- Moreover, inadequate case management practices frequently result in work being handled by higher cost resources (due to compensation systems that reward billable hours worked), rather than by lower cost resources who can be trained in these tasks.

- Similarly, senior lawyers may not be as adept at using these automated research tools as their younger colleagues, frequently resulting in inefficient data searches that increase the out-of-pocket costs to clients.

Thus, inadequate training in these research techniques, or failure to utilize specially trained resources for such research all too frequently makes the cost higher than it needs to be.

Lawyers work habits and the hierarchical systems employed by most firms that assign work to associates do not adequately assign tasks on a short-interval schedule basis. As a result, the hoarding of some work by more senior lawyers and the convenience of allowing more experienced lawyers to perform simpler tasks that could be done just as effectively, and in many instances considerably more efficiently, by junior lawyers continues to increase the cost content of the work produced.

Re-engineering the Legal Process

We believe that law firms must aggressively reengineer the process by which legal work product is created. While it is quite true that many legal matters possess characteristics that make them unique, there are a myriad of tasks that are repeated in every like matter or case. And, the time and billing systems used by most firms contain a plethora of historic data that can be mined to isolate tasks, segregate those that can be done by lower cost resources, and identify those that are not value added.

One common complaint we hear from clients' partners – when we bring up the need to lower firms' costs of legal services – is that lowering the cost of matters results in a reduction in profitability. But by reengineering the cost components and resources used, the margins produced by these lesser cost resources can be just as great, on a percentage basis, as the margins produced in the traditional fashion. All it takes is a willingness to study the data and a commitment to change and manage the processes.

Producing and Delivering a High Quality Legal Work Product and Getting Paid for the Effort

Most law firms employ approximately one non-lawyer for every lawyer employed. While these support and business department personnel represent a lower cost component on the income statement than a like-number of lawyers, their salary and benefit costs are nevertheless quite significant. Moreover, many of these costs vary with the number of lawyers at a particular firm – for example, the number of receptionists may vary with the *number of offices* your firm has, but the number of secretaries clearly varies with the *number of lawyers*.

Over the past few years, many firms have challenged their non-lawyer headcounts and have reduced them considerably. And yet, the one-to-one ratio of non-lawyer personnel to lawyers still holds fairly consistently across the country and type of firm.

- Some firms have looked to reduce the costs of these non-lawyer employees by moving the functions they perform to markets with lower real estate and labor costs.
- Others have even chosen to outsource these functions to specialty firms that provide lower cost resources with dedicated and skilled management of the various functions performed.

But many firms that have considered such moves have been taken aback by the high up-front costs of implementation. And many other firms are loathe to cede control to others for these integral and critical resources to the firm. Indeed outsourcing can have a near term impact on your cost structure, especially if you are willing to terminate your long-term employees and replace them through an outsourcing vendor with lower cost talent in a less expensive market. But most of the outsourcing (and insourcing) programs that have been implemented have only moved the existing function to lower cost markets (for people and real estate) without making any changes to the processes being performed by these people.

Again, the failure to reengineer the tasks performed by these people, and the processes they use to produce and deliver legal work product is preventing firms from achieving the maximum amount of potential cost reductions that ordinarily accompany such an effort.

- Every task performed by your non-lawyer support or business department personnel is (or should be) part of an established procedure or process to produce a specific work product or service. But just as technology has made inroads in enhancing the efficiency and effectiveness of lawyers, so too has technology impacted these support functions.
- Additionally, practice teams, secretarial pools, workflow applications, and enhanced skills among support personnel have created a vast, untapped opportunity to improve the efficiency and enhance the effectiveness of many support functions at most firms.

Periodic reviews of the operational work flows including the systems and applications that support them, as well as ensuring that employees skills are being adequately upgraded, is an important first step. It always represents a warning sign to us when we hear that something is being done in a particular fashion "*because that is the way we have always done*" that particular task. Also, the successful law firms in the future will be those that embrace operational change routinely and periodically. Enhancing efficiencies can produce the margins that are needed to sustain the firm as opposed to selective or indiscriminate cost cutting which all too frequently erodes service levels and only produces short term improvements in profitability.

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