

**Timothy B. Corcoran¹**

Corcoran Consulting Group
Principal

Law Firm Management Science: Ignore at Your Peril

Imagine this business school case study: A global business is managed by part-time leaders with minimal business training. The business offers different products to different customers depending on the varying skills and interests of the local service providers, who also serve as the salespeople, project managers and product managers. Pricing is customized to each transaction and rarely follows a cohesive strategy, save for the fiat that prices must increase each year. Marketing consists of promoting the business's capabilities, which are presented as vast and unparalleled. Customer demand has been a constant for as long as anyone can remember. The challenge: Customer demand shifts overnight from a constant to a variable, with immense competition for declining customer budgets. What should the leaders do first to ensure the survival of the business?

Clients Exert Their Will

Forgive the mild hyperbole, but such is the plight of the modern large law firm in recent years. The global economic meltdown reduced demand for legal services across the board, and it may take years for available budgets for legal services to return to pre-recession levels. What is here to stay, however, is increased rigor by chief legal officers in managing legal budgets, if only because of the increased scrutiny in turn placed on them. Corporate chieftains simply refuse to accept that legal budgets are any more

¹ **Timothy B. Corcoran** is the principal of Corcoran Consulting Group, LLC and served as the 2014 president of the international Legal Marketing Association. A former CEO, he specializes in helping law firm and law department leaders adapt and profit during a time of great change. He authors Corcoran's Business of Law blog and can be reached at +1.609.557.7311 and tim@corcoranconsultinggroup.com.

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unpredictable than, say, interest rates, currency prices, or critical supply chain costs such as fuel, raw materials and labor. And thus legal budgets have declined and the mandate to CLOs is to improve accountability, predictability and productivity. You've heard the old saw: You want it done right, on time and on budget? Pick two. Well, CLOs require all three, thank you very much.

Short Term Answers to Long Term Challenges

Law firm leaders reacted predictably to the recession, lowering costs in the first phase to maintain profit margins. However, it should come as no surprise that eliminating free coffee and soda, forbidding staff travel and laying off associates had little impact on increasing customer demand. In the next phase, law firm leaders increased the magnitude of cost reductions by putting capital investments on hold, de-equitizing partners and shuttering practices and offices, but also investing in business development training to turn everyone into a rainmaker. These efforts, contemporaneous with modest improvements in the global economy, provided some breathing room.

In the current phase, law firm leaders are exploring business process outsourcing in an effort to provide similar back office functions at a much lower cost, and some are dipping their toes into legal process outsourcing and legal project management, which strike at the heart of legal service delivery. There is a reluctance to go too far down this path, as everyone knows that profitability is directly correlated with the production of hours, and it's unclear how a law firm can make money by embracing efficiency. This uncertainty is usually wrapped in a concern for quality, as pushing work to young associates or to unskilled offshore lawyers is surely a recipe for shoddy legal work.

Trends That Will Have a Lasting Impact

However, there are very progressive law firm leaders who understand the three root causes of law firm dysfunction and are taking bold steps to gain a competitive edge while others waver. The first challenge is financial, and it's critical to understand the new math of law firm profitability. The second is process, and involves exploring differential ways of delivering legal services depending on the type of legal work. The third is organizational and consists of finding new ways to get things done amidst a culture of individuality and inertia.

Show Me the Money

Many U.S. homeowners learned a valuable lesson during the economic meltdown, namely that home values don't always go up, which is a reversal of a trend dating back to the post-WWII boom. Similarly, today's law firm partners have come of age in an extended period of near-unlimited demand for legal services, which is a pretty close approximation of a mathematical constant. When demand plummeted, lawyers were at a loss because the efforts they had put forth to win business during the boom times turned out to be correlated with high demand, and the causal relationship to winning work was marginal. Looking back, does anyone honestly believe that sophisticated buyers with multi-million dollar legal budgets were persuaded by glossy

brochures and pitch books filled with lawyer accolades, customized with the client's logo on the front cover? So the first financial lesson is that law practice is a business subject to the same market forces acting in other segments.

The second financial lesson embraced by progressive law firm leaders is that the R.U.L.E.S. have changed. Anyone familiar with traditional law firm finance knows this acronym representing the pillars of law firm profits: realization, utilization, leverage, expenses and speed (of collections). By manipulating these factors, large law firms have achieved impressive profit levels. What's missing from the equation is a fundamental component of every other business segment – the learning curve. In short, as businesses become more experienced at manufacturing a product, the delivery costs decline. This improves profitability even when (not if!) the product moves inevitably and inexorably from leading edge to commodity and the price drops.

Imagine a law firm that is able to capitalize on a wealth of experience in its practices, continually reducing the time needed to deliver legal services while simultaneously improving quality and reducing costs. Maximizing profitability becomes as much a function of delivery as of price. Law firms embracing these concepts understand that alternative fee arrangements (essentially all non-hourly billing) become profitable only when paired with business process improvement programs. Achieving better profitability while meeting client demand for improved predictability and accountability is a substantial differentiator in a competitive market for talent and clients.

Process Improvement Doesn't Reduce a Law Practice to Making Widgets

How, then, to incorporate process improvement into legal service delivery when each matter is different, each deal has unique characteristics, all complex litigation has unpredictable litigants, and so on? Taking a page from the legal process outsourcing providers themselves, law firm leaders are embarking upon campaigns to better understand how the firm's lawyers deliver legal services today. What they've discovered, to little surprise, is that a good portion of even "bet the company" matters is comprised of routine tasks that can be performed adequately in a number of ways. Some leaders look to third party off-shore and on-shore providers, and others, recognizing a hidden strength of a global law firm, migrate work to other offices with lower overhead and slack capacity.

By breaking down matters in this fashion, infinite variability gives way to flow charts and process maps of routine tasks that can be reused and improved over time, while the components requiring thought leadership remain a premium service in which partners with unique and market-leading capabilities really can stand apart. Not surprisingly, clients gravitate quite readily to law firm service providers who speak their language of continuous process improvement and quality control. And simple math demonstrates that repeat clients purchasing profitable engagements is more lucrative than chasing one-off engagements delivered at a loss in the hope of winning future work at premium (and competitively over-priced) rates.

If You Make Money, They Will Come Around

To say that driving such change in a modern law firm is quite challenging is like saying that the ocean is a bit damp. Indeed, businesses from which these concepts

have been adapted often fail to execute properly, with constant earnings restatements and corporate restructuring evidence that change is a painful and never-ending process. However, progressive law firm leaders have found it helpful to tackle head-on some of the peculiarities of modern large law firms, to give them a slight competitive edge. For example, the era of the honorary practice group leader whose primary asset is rainmaking or, in some cases, a startling lack of rainmaking ability that leaves plenty of time for administrative chores, is over. Practice group chairs are measured on business acumen, and they're hiring lieutenants with business experience to help manage the affairs of practices that, in some cases, exceed the revenues of publicly traded corporations. While law firm chairmen typically suspend their legal practice during their tenure, practice group leaders aren't yet allowed that luxury... but that day is coming.

With a savvier business mindset comes a shift away from the consensus atmosphere assumed in a partnership. It's an amusing notion that a flat governance model in which every partner is an equal owner with equal authority is somehow a rational business choice, when in fact it's an inefficient, extraordinarily dilutive and disruptive structure that persists due to inertia. Even the most progressive law firm leaders must still achieve consensus, but they do so by piloting the above concepts, measuring and promoting the results, relying on facts to earn buy-in. They also have a strong weapon unavailable to their predecessors: the cost of doing nothing has never been demonstrably greater.