OF COUNSEL

The Legal Practice and Management Report

ASPEN PUBLISHERS

Vol. 28 • No. 11 • November 2009

In This Issue

Of Counsel 700 Survey . . .

Several Firms Take Advantage of the Weak Economy and Expand to New Markets

When times are tight you batten down the proverbial hatches, right? You hold steady. Hunker down. Tighten your belt. Wait it out.

Or not.

Despite the layoffs of thousands of attorneys, partnership dissolutions, and the decline

Continued on page 2

Wolters Kluwer
Law & Business

Between a Rock and a Hard Place? . . .

Clients Demand Greater Value, Partners Want More Income

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 stakeholder 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 that we have witnessed over the past decade. As talented lawyers become more mobile, the need to deliver sustainable profitability 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 improved profitability over time *and* high value to clients, it is doomed to lose either its best (and most mobile) people or critically important clients or both.

This apparent conflict between the interests of shareholders and customers is not new. In the late 1980s, 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 what we believe to be a highly effective management tool to close the apparent gap. They called it *The Balanced Scorecard*, which explicitly recognizes the need to strike a strategic equilibrium between the needs of shareholders and customers. The balanced scorecard is a management tool that enables organizations to consistently improve on both fronts.

We firmly believe that the balanced scorecard will be a key tool for successful law firms as the traditional business model evolves in the coming years. This article provides an overview of how the balanced scorecard can be used in a law firm setting.

Basic Principles

The balanced scorecard was initially developed in the early 1990s in response to the widespread acceptance of shareholder value as the primary, and sometimes the only, metric of business performance. It reflected a growing perception that that metric was one-sided and that shareholders' needs had to be balanced with customers' expectations of value.

At its core, the balanced scorecard is designed to drive strategy implementation. It assumes that effective vision and strategy already exist. Balanced scorecards connect long-range strategy to day-to-day implementation. The management approach is deceptively simple, involving four fundamental dimensions:

1. 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 incorrectly seen as a backlash against shareholders. Actually, the paradigm simply recognizes that management needs to balance financial goals with other elements of strategy in order to deliver superior financial results.
2. Client measures: those measures that capture how well the organization is meeting client expectations. Simply put, 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 perceptions of that service.

3. Learning and growth (human development) measures: measures that capture how well an organization's people are able to change and improve. Ultimately, are the organization and its workforce getting smarter? At law firms, it means measuring whether people are more valuable to their clients and colleagues as marketplace needs evolve and change.
4. Internal business process measures: those measures that track improvement in the business processes most important to strategic success. At law firms, that means measuring and improving processes that directly affect client service delivery.

These fundamentals are not carved in stone for companies or law firms. Organizations can and do add new or different dimensions to their scorecards that better fit their businesses and primary strategies. However, as a management system, the balanced scorecard as originally designed has proven to be remarkably robust and durable.

A Law Firm Strategy

Research has demonstrated two very important conclusions regarding the balanced scorecard.

First, organizations that adopt and use the balanced scorecard as an integrated system not only improve their own performance but also 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.

However, 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.

Second, the balanced scorecard was primarily designed with the business units of larger companies (or single-focused middle-market businesses) in mind. The concept presupposes a common set of products, customers, and business processes, all focused toward the achievement of a common vision and strategy.

At a law firm, the balanced scorecard is therefore most easily applied at the practice group level. That said, our discussion here will suggest that law firms can maximize the benefits of balanced scorecards by using the system at both firm-wide and practice group levels in a coordinated manner.

Law firms are late to this table, but there are very solid potential benefits for them in taking an integrated approach to balanced scorecard implementation. In particular:

- Linkages between the work of the firm as a whole and its practices, directed toward improved profits 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, not just in terms of client service and internal capabilities but also in the use and application of technology, for example, and in improved business processes; and
- 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.

However, because partners are also a substantial portion of the workforce and of the management team, the dynamics of their top-down system present very specific obstacles. Law firm leadership is often held in check by factors that relate as much to interpersonal relations and 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, as management generally cannot or does not want to dictate to successful rainmakers.

Among other specific barriers:

- There is resistance to any business process focus that smacks of an MBA orientation. We need only point to the rapid demise of the "TQM for Law Firms" movement of the 1990s.
- Potentially conflicting incentives are an issue. For instance, to the extent that billable hours remain a fundamental driver of how law firms are paid for their services, there's obvious potential for conflicting incentives between clients' desire for greater predictability and/or efficiency and shareholders' desire for growing PPEP.
- Partner compensation systems are entrenched at many firms, but the balanced scorecard pushes firms to align compensation with the strategy. That push inevitably meets with resistance.
- 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 firm's qualitative goals.
- Some firm cultures actively resist the type of accountability associated with the balanced scorecard. Partners and attorneys are often accustomed to not following through on action plans, but as long as they continue to bring in clients and bill sufficient hours, there are no sanctions.

Implementing Strategy

Let's assume that your firm has a meaningful strategy capable of implementation. Using the balanced scorecard requires the firm to translate that vision and strategy into meaningful and measurable goals relative to profitability and client relationships.

While we abhor PPEP as a stand-alone performance measure, we do believe that your firm should set a clear, unambiguous profitability target as part of its overall strategic plan. As suggested earlier, the balanced scorecard also requires a limited set of measurable objectives related to client relationships. Those client goals can range from 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 that the firm has (*e.g.*, how many $1 million relationships); or to measures of client diversification.

The strongest firms tend to have goals that dovetail both financial performance and client relationships. For instance, over the past 15 years, most general service firms (midsized and larger) have exited the insurance defense business because, economically, it became increasingly incompatible with the shared financial goals of the partners, even as those client relationships became less compatible with the values and culture of full-service practices.

With the firm-level strategy in hand, along with clear profitability and client relationship goals, the firm can then directly engage its practice groups in implementation. This process requires the practice groups and their leaders to:

- Articulate their role; that is, how does the practice relate to the firm's overall business strategy, its PPEP targets, and its client relationship goals?
- Draw action plans, clearly delineating responsibility/and accountability, related to at least three aspects of strategy implementation:
  1. What the practice will be doing to grow and strengthen client relationships in ways consistent with firm-wide goals;
  2. How the practice will be delivering legal services to improve client relationships and financial performance; and
  3. How the practice will develop its people (and the tools/technology they use) to ensure they're increasingly valuable to clients.
- Set measures related to the action plans; in other words, meaningful quantitative and qualitative measures to monitor progress and hold individuals accountable.

Once the balanced scorecards and its action plans are operational, the effort turns to dialog and feedback based on the balanced scorecards at the practice group level. Depending on the group and its role in the overall firm strategy, firm leaders should evaluate progress anywhere from two to four times over the course of the year. Those review sessions provide opportunities for two-way dialog, keeping the practices on track and in sync with evolving firm priorities and providing firm management with early warning systems to assess its own core assumptions and strategy.

Firm management can then make necessary adjustments to the overall strategy and how it guides the practices. In turn, the practices can incorporate those adjustments into their annual planning by updating action plans, priorities, and related scorecards.

Real World Scenarios

A few case studies can illustrate the power of the balanced scorecard as an implementation/ management tool.

US-Based Global Law Firm

This firm began linking its strategy to practice-level initiatives several years ago. Upon 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 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 client matters so that the right people were doing the right work at the right time (across a global firm with more than 1,100 lawyers);
- Manage fundamental business practices to ensure that time was recorded accurately; invoices reflected client expectations as to value; and receivables were collected in a timely manner; and
- Make well-informed decisions on pricing, both for responses to requests for proposals as well as for more innovative pricing approaches at the client- and matter-specific level.

As a result, the firm, through its most recently completed fiscal year, has made measurable improvement in overall growth, client relationships, legal expertise, quality people, and financial strength. At the day-to-day level, it is meeting or exceeding the short-term targets set by its practice groups (*e.g.*, bill speed, staffing efficiency, etc.).

At the macro level, the firm has experienced significant levels of growth on three continents.

Leading Asia-Pacific Law Firm

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

In 2005-2006, the firm revisited its vision, strategy, and objectives. As a relationship-oriented firm, a key objective was to return to the top of the BRW Client Service Awards as well as perform well on other prominent third-party client-service and client-satisfaction rankings.

To that end, benchmarking data was developed to identify areas where the firm, its practice groups, and its individual lawyers could improve. This data pointed to a number of such areas, one of which was better client telephone access to lawyers. So the firm adjusted phone protocols and developed telephone technology for enhanced responsiveness.

This 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 gather data in real time from the firm's phone system (*i.e.*, who is physically on the phone); Outlook calendars (who is scheduled as committed); the human resource database (who is scheduled for vacation); and messenger status (who is logged on at their desk).

The firm also had a robust Client Relationship Management (CRM) tool in operation. Connecting that tool to the telephone technology solution enabled receptionists to immediately identify the logical candidates to take client calls. Likewise, the CRM and practice management tools could quickly bring lawyers on the call up to speed on the particular matter.

Through the first quarter of 2009, the firm logged 10,000 fewer voice mail messages per month, a dramatic reduction. Meanwhile, the new telephone technology/tool logs more than 1 million uses per year on a continuing basis.

The firm also engaged a number of parallel action plans, all similarly integrated to improve business processes, enhance human capabilities, and provide helpful tools to improve effectiveness and productivity.

The net impact of all these initiatives was that the firm achieved its defining goal, returning to the top position in the BRW Client Service Awards for 2009.

Regional Southeast-Based Firm

A successful regional firm based in the Southeast has used systematic client feedback as a source of ongoing measurement to ensure that the firm and its practice groups are on track to meet its client relationship goals. The firm most recently revisited its strategic plan in 2005. As a result, a number of primary goals and strategies were refined, building on the firm's strengths and opportunities. These included: building and strengthening multidisciplinary client teams (to help clients achieve their broader goals); fostering a culture of teamwork and innovation; and becoming a driving force for economic growth in the region.

At a time when most firms in this market are struggling, this firm enjoys financial strength and unparalleled client loyalty. Partner profits have dramatically increased and the firm continues to both act on and test its strategy, using client feedback every step of the way.

Closing Advice

There is real risk that the balanced scorecard will become an end in itself, as well as the latest winner of Buzzword Bingo. In truth, it should be an extremely pragmatic tool, enabling practice groups to clearly and simply articulate how they fit into the overall strategy of their firms.

By so doing, they can engage everyone in the practice to improve those processes that have the biggest impact on profitability and client satisfaction. It also enables practice leadership to identify where it needs to invest in human capital 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 its tools. The balanced scorecard is proven, effective, easy to use, and, importantly, it connects everyone to the overall guiding strategy in a way that is genuine and meaningful.

Law firms have no need to consider themselves "between a rock and a hard place." On the contrary, the best firms can and will balance improving financial performance with growing superior client relationships. ■

—John Sterling, John Smock, and Peter Giuliani

John Sterling, John Smock, and Peter Giuliani are the principals of SmockSterling Strategic Management Consultants, which works with law firms of all sizes on strategy development and implementation. Reach them at, respectively, JSterling@Smocksterling.com; JSmock@Smocksterling.com; and PGiuliani@Smocksterling.com.