50-Cent Dollars Are in Vogue Again

By Stephen Mabey

NOW, I KNOW I am speaking to a certain demographic when I recall the heady days when law firm expenses were equal to only 50 cents of every dollar of revenue. Since then, firms have been struggling with escalating operating ratios—that is, all expenses before any payments to partners divided by revenue—that are now in the 60-cent to 70-cent range.

This erosion has often been blamed on escalating rents, increased salaries for attorneys and staff, and the burgeoning cost of marketing and technological investments. Yet it would seem that under the tutelage of the national certified public accounting firms' consulting arms, law firms are being advised that a return to the past glory days is indeed possible and worth doing.

RECONCEIVING EXPENDITURES

Given the perceived fixed nature of some of the costs associated with running a law firm, a firm will not achieve this return by a simple mathematical cost-cutting exercise. Rather, it will require a real philosophical change in how expenditures are viewed by the partners. I would anticipate that over the coming months you will hear about a lot of cutbacks and outright elimination of expenditures that may previously have been treated as a birthright by the owners of law firms. The reasons for taking steps to pursue a 50 percent operating ratio include:

- An increased ability to handle client rate pressures without sacrificing the desired levels of profitability. Client rate pressures are not abating, as evidenced by a recent Altman Weil survey that indicated nearly 30 percent of the respondents felt that between 21 and 40 percent of their billings were now based upon discounted rates.
- It enables partners to not only draw more money without working harder, but also to do so in a more timely fashion as a result of the lower operating ratio.
- Enhanced resiliency allows firms to take advantage of any entrepreneurial opportunities arising from the constantly shifting legal landscape.

THE MEANS TO AN END

Firms that have embarked and are embarking on this quest are using a variety of measures to pursue the goal, including:

- **Zero-based budgeting.** On a line-item-by-line-item basis, firms are not starting with how much they can cut an expense but rather, before determining the appropriate total amount (if any), they ask, Why do I need to spend this money at all?
- **Rethinking the space they really need.** In more prosperous times, space was taken to meet immediate needs rather than determining what usage would be required in the future. Many firms have come to realize the serious amount of wasted or ineffective space they currently pay for, and are migrating toward smaller footprints. They are negotiating with landlords to return space by extending the term of their leases and, depending on

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the local market, by pursuing base rent decreases as part of the trade-off package and building in future put-back clauses.

- **Establishing new metrics for complement planning,** of both staff and lawyers, and then actually sticking to them. Instead of some arbitrary ratio of lawyers to legal assistants, law firms are tying the complement ratio to their revenue unit, the billable hour. Firms are setting targeted ratios of a certain level of billable hours per legal assistant and, if below that, are not hiring and, in fact, are using it to justify terminating underperforming legal assistants. (Targeted ratios have ranged from below 3,000 to above 5,000 billable hours per full-time equivalent legal assistant.) Firm management is setting similar types of ratios for lawyer complements and adhering to them when annually reviewing existing and new associates. It isn't a stretch to see partners agreeing to a similar ratio in the future when considering candidates to become partners.
- **Process mapping.** Firms are removing layers of administration (and complexity) between partners and the task at hand: client service. Process mapping provides a visual representation of every step, touch, task, person and resource used to complete a legal transaction or a business process. Mapping is an interactive process that reveals rework loops, steps that don't add value from the client's perspective, bottlenecks, misallocation of resources and other forms of waste that impede the flow of quality work. The map serves as a baseline from which to identify and target improvement opportunities. The goal of firms using this tool is to implement sustainable solutions that optimize processes by reducing errors and waste, and increasing quality and productivity.

MOVING AHEAD

Some firms have opted to proceed on their own, while others have sought assistance from their external accountants and other cost-focused advisers. The right approach is the one that works for your firm and enables a successful quest.

Since there should now be little doubt where I stand on these cost-cutting issues, I generally laud this change in philosophy, and any reservations I hold exist because of the legal industry's track record of failure to execute.

The stress and strife caused by talking about, but not making, tough expense decisions is very real, so firms should not undertake these measures on a whim. Rather, firm leaders need to discuss such measures seriously with the partners to gauge ultimate success. Remember, culture trumps strategy in most firms!

Until our next "meeting," let's seriously consider a phrase attributed to Meister Eckhart: "The price of inaction is far greater than the cost of making a mistake." **LP**

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