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Recession Management

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Will Australia experience a recession? If it does, how long will it last and how severe will it be? This is the short but hotly debated agenda for every economist's discussion forum throughout the land. Few economists successfully predict booms or busts. Economists seem to me to be specialised historians, interpreting and explaining economic history.

We do, however, know that economic activity has been cyclical since the commencement of reordered economic history. We also know that governments of any persuasion, no matter how valiant and well intentioned, cannot prevent the inevitability of the cycle. The length of the cycle and the nature of cycles within cycles largely elude us but the existence of the cycle is accepted as given.

Relying solely on common sense and a passable undergraduate degree, it seems to me unlikely that the greatest ever boom in western economies would be back ended by a soft landing. On the contrary, the unprecedented boom of the nineties may well be followed by a severe bust few could imagine. The enormity of government stimuli world

wide gives me no comfort. Thinking men and women wouldn't plunge their nations into deep debt "to prevent unemployment reaching 7%", I suspect that they are genuinely fearful of severe unemployment, plunging property and commodity prices and, in due course, great hardship. I hope that I am wrong, mainstream economists doubt a deep, prolonged recession but some fringe dwellers are predicting that the next boom market in equities, commodities and property won't occur until the 2020's. It gives me no comfort

that recessions and booms have been hitherto accurately predicted by fringe dwellers, not mainstream economists.

I suggest that firms have some contingency plans in the bottom drawer that will enable them to enjoy success during a long and deep recession. If it does not occur there's no harm done, if it does you will be prepared.

Strategy

The business of law has a degree of counter cyclicity about it, the advantages of which are all intuitively obvious. Insolvency litigation booms, commercial litigation remains strong (subject to affordability), family law work and criminal work tend to increase in volume. Transactional activity remains at sustainable levels, particularly



as the bargain hunters become active in the market.

Firms should remain focussed on their core business activity and on their core talent. Ideally leverage structures should be preserved but many firms will have the opportunity to do more with less. It is unlikely that high staff attrition, low fee earner productivity and “work life balance” will continue as priority issues. For better or for worse I suspect that most employees will become unfashionably work focused.

Any person with a professional qualification and a pulse can make money during a boom. Recessions tend to differentiate the good from the rest; I imagine depressions even more so. Maintaining business development investment, talent through ongoing learning, systems development and, if appropriate, marketing and media, will maintain organisational health.

Thrift as ever will remain important. Strategic planning and the enhancement of organisational culture should continue albeit in-house or at affordable venues. Continue training and learning but ensure that you get good value from seminars, conferences and in-house training by disseminating knowledge throughout the firm.

Key performance indicators

All of the traditional anecdotal indicators of business health like full meeting rooms, smiling staff and volume of new matters

remain relevant. Here are some empirical measures to watch:

Hours leverage

Most practices consider leverage in terms of the number of fee earners per equity principal. For many years this was the primary measure of leverage used by FMRC in our benchmark surveys. Whilst managers and partners of law firms know that leverage is only successful when each of the fee earners are fully utilised, the historical measure of leverage using head count distorted this.

In tight times firms should measure leverage as a ratio of employee chargeable hours to partner chargeable hours.

The following table illustrates two practice groups with the same headcount leverage of 3 fee earners per principal. Each practice group is generating a total of 4,600 hours per annum.

	Realised Chargeable Hours	
	Prac Group A	Prac Group B
Partner	1,450	1,000
Senior Associate	1,130	1,200
Solicitor	1,010	1,200
Solicitor	1,010	1,200
Total hours	4,600	4,600
Hours leverage	2.17	3.60

The difference between the two practice groups is best illustrated in the hours leverage: 2.17 compared to 3.60. All things being equal, the benefits flowing to Practice Group B will include:

- Partner time being freed up to invest in client development and mentoring staff; and
- Better utilisation of solicitors – leads to improved retention.

Our experience has been that, by using this approach to leverage, firms are able to identify and improve key components of performance such as:

- whether or not practice groups are appropriately staffed
- the effectiveness of delegation within practice groups
- where time is being written off

This measure of leverage is appropriate for firms of all size. Among other things it will encourage partners to focus on the performance of their team as a whole, rather than their personal billings. Well managed firms have a greater hours leverage than they do headcount leverage.

Chargeable hours

For more than 10 years our survey data has reported that the average recorded chargeable hours generated by solicitors is 1,200 hours per year (or 5.2 per day).

Regardless of pricing strategy, in the crudest analysis law firms

sell time. This time may be packaged a number of ways, but the primary input is the time spent by the lawyers on client matters. In successful, commercial practices all employed lawyers are recording a minimum of 1,380 hours (6.0 per day) of which 1,265 hours (5.5 per day) are billed to clients and collected. Partners and practice group leaders have some budgetary relief to ensure each of the lawyers is utilising their time in the most effective way.

Approaches used in high performing firms to ensure lawyers achieve their hourly budgets are:

- meeting daily with junior lawyers to help them plan their day - the open door policy is not an effective substitute for structured daily meetings
- reviewing the file load of all lawyers to ensure they have properly prioritised their time and that no critical dates slip through the net
- a one-on-one meeting each week with each fee earner to discuss objective and subjective performance issues
- 6 monthly file closing days where all lawyers bring their difficult files. The group as a whole work through each file with the aim of closing or advancing as many as possible. In addition to the obvious financial benefits there is a positive impact on lawyer stress levels as their

difficult files have been turned into fees.

It is likely that leverage models will change. Partners are more likely to retain two or three highly productive employed fee earners not four or five average ones.



Price

For the past couple of years price has been the primary driver of increased profitability for many firms. Stagnation in leverage and chargeable hours has been offset by increased hourly rates. This increase has been a function of both an annual review of rates and bracket creep. Bracket creep occurs when an individual solicitor's charge rate increases in line with their skill and experience.

There has been little uniformity in the Australian legal profession when determining and setting hourly rates. In most instances it is driven by the ability of the partners to sell value irrespective of an hourly rate. This introduces a personal nature to hourly rate

pricing. As a result we have seen principals in country towns realising \$400 per hour without discounting whilst some of their peers in smaller CBD practices are agonising over their capacity to get close to this.

The successful firms we have worked with have calculated the cost of production of each fee earner in the practice. This cost of production underpins all pricing decisions be they hourly rate or fixed fee. These firms know that each practice will have a different cost of production based on how the practice is structured, the salaries paid, the overheads consumed and the level of utilisation of fee earners. In this environment, a broad brush price setting approach where the firm pegs its rates to a narrowly sampled market rate means that some firms will win and some will lose.

Pricing methodology and quantum attracts significant media attention. It is likely that many firms will continue the fixed fee trend. Partners should develop strategies that ensure fixed fee pricing does not lead to loss making or commoditization.



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Fee: \$880 each for the first person. Additional people from the same firm are \$660 each.

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- Melbourne: Tuesday, 17 March 2009
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TAX INVOICE

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