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Stick to the fundamentals and your firm can become – and remain – viable

Many legal practices become unviable because the principals to do not adequately understand the need for genuine profitability and liquidity, but they can turn it around by focusing on some simple fundamentals, writes Rob Knowsley.

The viability of legal practice is again the flavour of the month.

Lawyers are often counselled to look hard at how technology can assist them with the future viability of their practice, no doubt because suitable technology, properly used, is perceived to have the ability to reduce labour inputs while getting various tasks performed well. In turn, this should free up time to handle more matters, and thus generate additional revenues. It should also reduce errors that need to be rectified, which costs the practice time and money that cannot be recovered, reducing potential revenues.

However, in most practices that I examine which have poor profitability (and which, therefore, have very suspect viability) the people who should be considering important changes to the operation of the practice, including smart use of good technology, are too busy being busy as they try to keep the practice afloat. That means they cannot properly address the fundamentals of existing problems, let alone prioritise steps to take and organise their effective implementation.

Furthermore, in such practices cash is all too often under great pressure. Put simply, principals juggling cash to keep the practice afloat, while not even drawing a proper salary for themselves, are often not quick to seek external assistance to put them on the right track.

Profitability *and* liquidity the key
Viability is tied up with genuine profitability and liquidity. Both these elements have many aspects that need to be attacked consistently at a fundamental level, and both are very dynamic and can get out of control quickly when even well-designed practice processes are insufficiently adhered to, and when that lack of adherence is not addressed.

Readers of earlier articles (see list below) will know that I stress the importance of genuine profitability simply because too many lawyers do not yet act as if they fully 'get' that their practice is not actually profitable if it can't produce a real profit return *after* providing a proper salary for their work. Profit is not a return for your work; it is a return over and above your salary (actual or notional) for running a very sound business.

As I did research for this article, I came across articles that compound this misconception, with one legal practice management consultant writing a recent article setting out his understanding that a good legal practice will have profitability in the range of 40 per cent to 45 per cent of revenues … and sometimes 50 per cent! After making allowance for a proper salary for principals, I would more often expect to see profit in a range between 12 per cent and 22 per cent of revenues. Note that even practices with margins at the low end of this range can generate exceptionally good returns per principal – it is certainly 'all in the particular numbers'.

In practices with suspect viability, genuine profits are very often non-existent, and all sorts of consequent issues are obvious as soon as some basic investigation is carried out. In looking into definitions of 'viability' as my starting point for another article a short while back, I came across this from the Australian Taxation Office:

"Viability is defined as the ability to survive. In a business sense, that ability to survive is ultimately linked to financial performance and position. A business is viable where either:

- it is returning a profit that is sufficient to provide a return to the business owner while also meeting its commitments to business creditors
- it has sufficient cash resources to sustain itself through a period when it is not returning a profit."

Readers will immediately note that the definition assumes a return to the business owner, and the need for sufficient cash resources for unprofitable periods.

My advice to the big majority of firms that are generating poor profits, with all the natural consequences that brings the longer it goes, is to immediately focus on a few key fundamentals that will make a great difference to profitability and cash (liquidity) in the short term.

More difficult, time-consuming and potentially stressful decisions can usually wait until there is ample cash available and the Gordian Knot is untied (or simply sliced clean through).

The fundamentals…

Any firm needs enough of the right sorts of matters to keep the resources it intends to keep investing in fully occupied. That enables the firm to generate the revenues needed to create a healthy profit margin. As principals, you need to identify exactly what would be needed, and how to get the volume coming in.

Everyone involved needs training so they can properly conduct all communication with each prospective client from the outset. This involves attentive listening, and asking permission to ask questions, so that the prospect's need for assistance can be properly elicited.

It also involves explaining what you will, and will not, be able to do to assist, how you will do it, and what the potential benefits will be for the prospect. You need to professionally help the client to arrive at an agreement with you on the likely cost to them, so they can work out in their own mind, in their own time, a personal cost-benefit analysis on their potential investment.

Disclosure requirements are mandatory and commercially sensible, so you should also establish credit terms and ensure they are implemented, including, everywhere relevant, retainer funds in trust.

Process the work promptly and efficiently while communicating well with the client at all times.

Bill as promised, and ensure very prompt collection.

Doing all the above in enough volume to generate revenues that will create a healthy profit margin will go a long way to ensuring viability.

Finally, when there is temporarily not enough client file work to keep your resources busy, use their spare time to do a greater volume of pragmatic business development so as to increase enquiries for the kind of instructions you consider most desirable. There is no silver bullet for practice viability. There is in any event no need for such a miracle because running the practice soundly, and according to the fundamentals, will always do the trick.

Rob Knowsley is the principal of Knowsley Management Services. He is a high-performance coach and facilitator with four decades of experience that has been dedicated to assisting law firms and their individual lawyers and managers as they seek to maximise their return on investment from reasonable inputs of time, money and other resources.

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Rob's previous articles in this series have dealt with:

The critical interplay between people management, productivity and profitability
The relationship between profits and fair, reasonable and proportionate fees
A message to all small law firms – as principals, you need to make a profit
Staff turnover hurts, but beware of keeping people at all costs
How to become, and remain, a small law firm employer of choice
How cash-flow and liquidity problems can cruel even profitable firms