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LAW FIRM MANAGEMENT

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Why this year could mark an inflection point

It's safe to say that the legal industry has never seen a year like 2020. But a recent study of the legal market suggests that disruptions to law firm operations could end up being the impetus the industry needs to finally adapt to the market's competitive realities.

The Center on Ethics and the Legal Profession at the Georgetown University Law Center and Thomson Reuters Institute's *2021 Report on the State of the Legal Market* looks at key issues likely to influence the market in 2021 — and beyond. One of its conclusions is that the industry may be reaching a critical inflection point when it comes to the delivery of legal services.

EVOLVING MARKET

Since the Great Recession, the legal services market has been slowly but inevitably moving toward a new delivery model. The report finds evidence of this shift in:

- Changes in the roles and expectations of clients,
- Pricing and technology, and
- The growth of competition (including from nontraditional providers).

All of these have pushed the market toward a more efficient, predictable and cost-effective delivery model.

One thing hasn't changed, though — resistance from law firm partners. While senior management often embraces the need to evolve, the report says, partners largely continue to turn a blind eye. This finding jibes with those in Altman Weil's *2020 Law Firms in Transition* survey. More than half of law firm leader respondents gave firms poor grades on how serious they had been about changing delivery models to provide greater value to clients (as opposed to just reducing rates). Asked why firms aren't doing more, about 70% said because "partners resist most change efforts."

SEIZING OPPORTUNITY

The tantalizing possibility that the report proposes is that "the combined effects of the pandemic may have softened partner resistance to fundamental change enough to create a tipping point" toward a major overhaul of the legal delivery system. Indeed, current conditions could present a ripe and unprecedented opportunity to get past previous hurdles.

> *Research shows that the vast majority of lawyers, including partners, now favor the remote work option.*

The report cites numerous reasons that 2020 and 2021 could mark the time that "serious change finally accelerated," including:

Acceptance of remote work. Law firms have long resisted remote working arrangements, even as they became more common in other industries and boasted obvious advantages. COVID-19 forced firms to allow work from home, though. Lo and behold, it turned out that law firm leaders' fears were largely misplaced. And Thomson Reuters research (independent of the report) shows that the vast majority of lawyers, including partners, now favor remote working options.

Recognition of technology's role in the delivery of legal services. Similarly, in the wake of involuntary changes to operations, partners probably have a broader acceptance of the role technology plays in effectively delivering legal services. This could create greater openness to experimentation in other forms of delivery.

HOW THE PANDEMIC PLAYED OUT

In addition to providing insight into service delivery, the *2021 Report on the State of the Legal Market* (see main article) also reviewed how COVID-19 affected law firms in 2020. Not surprisingly, the pandemic prompted some dramatic measures.

Beginning in March 2020, demand (as reflected in total billable hours) dropped in virtually all law firm practices except for bankruptcy and reorganization work. Nonetheless, according to the report, many firms were able to raise their rates last year. The increases were possible in part due to the fact that most were implemented prior to the end of 2019.

What about attorney growth? In 2019 and the first quarter of 2020, average lawyer growth jumped to 2.7%. As the pandemic took hold, though, many firms took immediate steps to reduce headcount growth.

Firms also reduced partner draws, cut salaries, furloughed support staff, and terminated both support staff and fee earners. One of the unexpected results was substantial improvement in profits per equity partner over 2019.

Persistent client pressures. The desire among clients for greater value from their attorneys hasn't waned during the pandemic; if anything, it has intensified. The report says this sentiment could undercut the belief of some partners that clients aren't asking for change.

Wave of operational adjustments. Many firms, the report says, have had to consider significant other changes to operations for the first time. Those include modifications to space planning; new training programs; revised technology strategies and investments; revamped marketing and business development strategies; and a new focus on staff safety and well-being. This type of momentum could facilitate new delivery models, too.

In other words, the pandemic has produced an opportunity for savvy law firms to seize the lessons they've learned to achieve competitive advantages for the long run.

POSITIONING FOR THE FUTURE

The report cautions that some long-standing economic problems remain for many firms, including issues of productivity and underperforming attorneys, recruitment and retention, and billings and collections. (See "Charting the future: How key performance indicators can help your firm succeed" on page 4 for more about using data to uncover and correct some of these problem areas.)

We can help you navigate these challenges. We can also help develop and implement plans that enable your firm to provide the alternative delivery models your clients and the market demand. •

Charting the future

HOW KEY PERFORMANCE INDICATORS CAN HELP YOUR FIRM SUCCEED

After a tumultuous 2020, many law firms are looking towards a calmer future. But the waning COVID-19 pandemic isn't the only factor affecting firms' futures. Each firm needs to review some key performance indicators (KPIs) to make informed decisions on the road to success.

RESEARCH FINANCIAL KPIs

For many firms, the biggest consideration is financial performance. Four KPIs that will help shed light on your firm's financial health include:

1. Realization. How much revenue does your firm collect compared with its billings (net realization), and how long does it take to collect that revenue? Determine how the amount billed compares with the amount of time worked (billing realization).

2. Profitability per attorney and client. You need to know how individual attorneys and clients are affecting your profits when making decisions about compensation and client relationships. Also look at profitability for each type of matter when considering which types of work to pursue.

3. Unbilled days. How long does it take to bill clients for work? Compare the fee portion of unbilled work-in-progress with the average fee billings.

4. Uncollected days. This is the ratio of the fee portion of accounts receivable to average fee billings.

SET STRATEGIC GOALS

It's admittedly hard to shift your focus away from billing-related metrics, but you also need to consider other KPIs that are specifically aligned with your firm's strategic plans and goals. After all, strong profits per partner are no guarantee of continued success.

For example, you can't afford to overlook client development. To measure your firm's performance in this area, look to the number of new clients per month compared with the total number of active clients, matters per client and practice areas per client. Evaluate your firm's marketing and client initiatives to determine which are working and which should be refined or discarded. This might involve measuring, among other things, the cost of client acquisition.

And don't overlook client satisfaction. Satisfied clients are returning clients and referring clients. Firms are increasingly turning to the net promoter score (NPS) to measure satisfaction. They ask their clients a single question: "On a scale from 1 to 10, with 1 being not at all likely and 10 being extremely likely, how likely are you to recommend the firm to family, friends

or colleagues?" Clients who reply 1 to 6 are "detractors," and those who say 9 or 10 are "promoters." Calculate your NPS score by subtracting the percentage of detractors from the percentage of promoters.

IMPLEMENT SOLUTIONS

Once you've decided to implement a KPI program, what's next? An effective KPI program includes:

Selecting KPIs. Select quantifiable KPIs linked to your goals. For example, if your goal is client growth, you might look at your rate of converting consultations into clients.

Setting targets. Establish targets for your KPIs that tie into the goals, perhaps based on comparable peer benchmarks. Using the example above, you might target a conversion rate of 50% to 60%.

Monitoring KPIs. Track relevant data and measure the results against your targets. Bear in mind that you generally need several months' data to detect trends.

Acting on KPIs. Use the information to make solid decisions.

Be sure to cycle through the steps regularly as your focus may shift. By doing so, you might find that some KPIs are no longer relevant and could be replaced with more suitable metrics.

HARNESS DATA FOR THE LONG HAUL

The amount of data available to you likely is enormous. Contact your financial advisor for help evaluating and selecting the most appropriate KPIs given your firm's circumstances. Doing so can set you up for long-term success. •

Automation brings savings and efficiency

You can't run a law firm without racking up nonbillable hours. Those hours — spent on anything from client intake to collections — can eat up a lot of time more profitably spent elsewhere. Fortunately, automated solutions are continuing to proliferate in ways that can help firms of all sizes make better use of their time and reap cost savings along the way.

POTENTIAL BENEFITS

The benefits of introducing automation into your law practice extend beyond simply freeing up time from mundane tasks. Properly implemented, automation can:

- Reduce human error — for example, in data entry during client intake or billing,
- Boost attorney satisfaction, as more time is spent on billable work that uses their expertise and knowledge,
- Significantly cut overhead,
- Improve and streamline the client experience, and
- Make smaller firms more competitive with their larger peers.

These and other advantages usually more than offset the upfront (and tax-deductible) investment in the long run.

POTENTIAL CANDIDATES FOR AUTOMATION

In the typical law firm, several areas jump out as ripe for automation, for example:

Client intake. This is generally a party's first contact with your firm, so you need to make it count. Attorneys need to collect a standard set of initial information for each type of case they handle. With automation, your firm can build different online forms for each type of matter, allowing clients to

easily enter the information themselves. They don't have to waste time entering anything that's unnecessary, and there's less chance of something being mistranslated when the client relays it over the phone to someone in the office. It's worth noting, too, that today's consumers have grown to expect such on-demand interfaces; firms risk seeming behind the times if they don't provide the option for clients to do it themselves.

> *Automated billing reduces the odds of the kinds of errors that can come from paper-based time tracking and invoicing systems.*

Document drafting. With robotic process automation (RPA) tools, a user can complete a questionnaire with the vital information for, say, a lease, letter of engagement or similar contract. The tool proceeds to add that information to a template to produce a document ready for human review. Machine learning (ML) can be applied to create more sophisticated documents. With either RPA or ML, your attorneys can draft documents more quickly, with little risk of error and at lower cost to the client. And ML also can help with contract review by checking for essential provisions and comparing subsequent drafts to ensure nothing has fallen between the cracks.

Billing and collections. This process often is subject to delays, which can lead to cash flow issues, especially for solo practitioners and smaller firms. Clients have been known to return invoices for repeated rounds of corrections. Automated billing reduces the odds of the kinds of errors that can come from paper-based time tracking and invoicing systems. It also provides an audit trail, should questions arise down the road. And automated time tracking can send out alerts when attorneys are spending too much time on certain tasks, making it less likely that clients will object to billed amounts.

THE FUTURE IS NOW

In today's economic environment, clients increasingly are demanding their attorneys do more with less, as well as demonstrate how their firms add value. Automation offers an affordable avenue to do just that, empowering firms to lower overhead while raising productivity, accuracy and efficiency. •

What's the latest on business meal and entertainment expenses?

The deductibility of business meals and entertainment for federal income tax purposes has received renewed attention in recent months. The IRS's final regulations on the deductibility of such expenses under the Tax Cuts and Jobs Act (TCJA) and a provision in December 2020's Consolidated Appropriations Act (CAA) change the rules of the game. Here's what you need to know.

TCJA AND CAA DEVELOPMENTS

The TCJA generally prohibits all deductions for expenses related to entertainment. But taxpayers originally were confused over whether it also banned the 50% deduction for qualified food and beverage expenses.

Under the final regulations, though, the term "entertainment" doesn't include food or beverages unless the items are provided at or during an entertainment activity. Even those costs are deductible if separately purchased or separately stated from the entertainment costs on one or more bill, invoice or receipt. The amount charged must reflect 1) the venue's usual selling cost for such expenses if purchased separately from the entertainment, or 2) the approximate reasonable value of the items.

The final regulations also specify that food or beverages must be provided to someone who the "taxpayer could reasonably expect to engage or deal in the active conduct of the taxpayer's trade or business such as the taxpayer's customer, client, supplier, employee, agent, partner, or professional adviser, whether established or prospective." As a result, the deduction is available for employer-provided meals.

FULLY DEDUCTIBLE MEAL EXPENSES

Notably, the CAA permits a full 100% deduction for business meals in 2021 and 2022 as long as the expense is for food or beverages provided by a restaurant. Food and beverage expenses must not be lavish or extravagant, and the taxpayer or an employee must be present.

The final regulations specify that, among other things, the 50% business meal deduction generally doesn't apply to expenses treated as compensation, reimbursed food and beverage expenses, and expenses related to recreational, social or similar activities for employees that don't favor highly compensated employees. One example is holiday parties. These expenses are fully deductible. However, this doesn't include free food and beverages left out in break rooms or provided for the convenience of the employer — such as that offered to employees who must stay on call for emergencies.

STAY TUNED

The long-term fate of many of the TCJA's tax breaks remains unclear with the White House and Congress under Democratic leadership. The rules are complicated; contact us to learn more about developments that could affect your federal tax liability. •

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