

How important is practice management?

By Vincent Faris

There can be no doubt that the global economic meltdown impacted everyone in one way or another. Law firms too have not escaped the impact. My experience tells me that the impact has been particularly harsh on the smaller firms and/or those firms that were and may still be dependent on one service activity. Statistics of the composition of South African professional law firms indicate that 90% of firms comprise four partners/directors or less. The larger firms are managed in a typical style as one would expect of a corporate entity with a multi-million rand turnover and an appropriate staff structure to support the size. This means that such firms have been able to absorb the economic decline and direct their activities accordingly. The smaller firms have not been able to do so because they have not had the foresight and/or the leadership structures to not only address the economic decline but continue to grow. The whole profession has experienced, and in many instances are still experiencing, what I refer to as 'the profit squeeze'.

What is the profit squeeze?

The answer is very easy. Revenue (fee income), has not kept pace with the increase in overheads, which means that profitability has declined. The decline in revenue is due to a number of factors, *inter alia*:

- Increased competition within the profession from new entrants into the profession.
- External competition from the banks, accountants and other institutions rendering services that have traditionally been rendered by the legal profession.
- More pressure and demands from clients for service delivery and lower fees.

We have all experienced the effects of increased costs. The cost structure of law firms consists mainly of expenses that are fixed irrespective of the level of economic activity, such costs being rentals, employee salaries and benefit contributions. While these expenses can be controlled they are an essential part of the infrastructure and cannot easily be reduced. We are all aware of the pressure to increase employee emoluments, but at the same time we face many cost increases, which are beyond our control such as power and fuel.

How then, given the current economic climate, can a law firm grow, and what role, if any, can or should practice management play?

Components of practice management

Practitioners should realise that they are running a business and not a charitable organisation. It is acknowledged that attorneys are not trained as managers and prefer to do what they are trained to do and enjoy doing, namely to practice law. Given the economic climate mentioned above, however, practitioners need to spend more time on managing their practices. What then should practitioners do? Sustainability and profitability of the firm demands that fundamental business processes and principles are applied. These principles and processes are not new. As each practice will differ depending on its service activities, its geographical situation, its size and its human and financial capital resources, it is essential to understand and identify the components that are to be managed. The common and most important components that will apply to a greater or lesser extent to all firms are: Strategy, marketing, financial, human resources, administration, partnership matters and management structures. Information technology has become more important in the recent past and continues to require more attention and resources. These components are of course not the only ones and the components impact on one another. For purposes of this article, I briefly deal with some of these components.

Strategic management

Future strategy is vital to the sustainability of the firm. This will require a critical review of the firm and its activities that is usually done with a strengths, weaknesses, opportunities and threats (SWOT) analysis exercise. Such an exercise will address, *inter alia*, the clients' needs, the services rendered, the community being serviced, the strengths, weaknesses, opportunities and threats not only of the firm itself but also of the individuals making up the professional, support and administrative staff of the firm. The exercise will identify the future direction that the firm should take, and will require discipline and commitment from all staff. Of course, for such an exercise to be meaningful it will be necessary to review the firm's past performance, recognising that the past cannot be changed but the future can be planned. In this regard it may well be advisable and necessary to prepare cost centre analyses of departmental service activities and/or fee earners. However sensitive such an exercise may be, it will identify the profitability of each cost centre, which will be a meaningful tool in determining the future services to be rendered.

Marketing

There can be no doubt that the face of business has changed, not only due to the advances in technology but more specifically as a result of the transformation that has taken place since 1994, and is still taking place today and will continue to take place in the future. This being the case, firms should be more conscious of the need to not only expand their client base and the services that are rendered, but also ensure that management communicates regularly with the ever-changing decision makers of its existing clients. Marketing is about creating an aura of professionalism at all levels within the firm and externally in the business and social community; it is about client service and service delivery. The marketing function is accordingly one in which all staff, irrespective of their positions in the firm, should be involved. The goodwill and word of mouth referrals that are generated should result in existing clients, as well as potential new clients, queuing at the front door for professional advice and services.

Financial management

If profitability is to be, not only, sustained but also to grow then the management of the financial resources of the firm is an imperative. This can only be achieved if an intelligent assessment of the future financial path of the firm is prepared in a budget. The budget will of course depend on the future strategy of the firm and will detail the financial performance expected of fee earners and departmental service activities. Detailed analysis of the past performance will form the basis for the future projections not only of the fee revenues but also of the anticipated expenditure. Abnormal and non-recurring income and expenses of the past will be ignored when preparing the future levels of such items and it may well be necessary to perform zero-based budgeting principles for service departments where the past performance is not appropriate. Once the income and expense budgets have been prepared it will be possible to prepare cash flow projections and following on there from statements of the financial position (balance sheet). The ultimate goal must be the comparison of the budgets and projections with actual performance, the identification of variances, both positive and negative, and the management decision-making that should take place thereafter.

Other management components

As mentioned above there are numerous other components of the practice that will need management. It is not possible in a short article of this nature to deal with all of the components. It needs to be mentioned, however, that the total remuneration paid to all employees, irrespective of their classification as professional, support or administrative staff, (excluding partners' profit share/directors' emoluments), usually comprises between 45% to 55% of the total expenses of a firm. This being the case, the management of staff and the productivity thereof is an essential management function involving not only their remuneration but also their hopes, needs, aspirations and desires.

Summary, recommendations and conclusions

It should be patently clear that in order to survive and grow (no real growth is a recipe for decline and possibly disaster), practitioners operating in large or small firms including sole practitioners will have to devote more time to managing their firms' affairs. Management is important and it is suggested that the management team consider the following actions:

- Review the firm's terms of business in accepting mandates so that cash flow can be maximised and improved and the level of book debt reduced from current levels, which are likely to be in excess of 90 days. The terms of business should in any event be included in an engagement letter detailing, *inter alia*, what the hourly rates are for the various levels of staff engaged on the mandate, the disbursements that will necessarily be incurred in executing the mandate and how payment of the fees and disbursements is to be made.
- Review the operational, administrative and financial systems and procedures of each department and/or fee earner to identify excess or idle capacity so that overall rationalisation can be implemented. In this way capacity can be created and tasks assigned to free senior staff to devote more attention at higher hourly rates to more lucrative mandates.
- Prepare detailed budget and cash flow projections with regular comparisons between actual and budgeted performance.
- Ensure regular communication with senior executives and decision makers of existing and potential clients.
- Break away from the office environment for a properly structured strategic planning exercise, if necessary by engaging an external facilitator.
- Review the time recording and fee debiting systems and procedures, all of which will impact on the fixed and working capital funding requirements of the firm.
- Review the structure of the firm, the compensation, salaries and other benefit arrangements between partners/directors and senior professional staff.
- Ensure that the firm is not dependent on one major service activity or on one major client.

All of the above assumes that the trust and business accounting records are kept up-to-date without which most of the management functions will fail.

The secret of success for a modern-day law firm, be it a multi-disciplinary incorporated practice, a partnership, a smaller structure or a sole practitioner is: Work smarter and quicker by creating capacity.

- Practitioners will be well advised to attend a two-day practice management conference, hosted by the Law Society of South Africa, on 19 and 20 August 2015 at the Bytes Conference Centre, Midrand, Johannesburg, where a number of international and national speakers will present on a variety of practice management topics.

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