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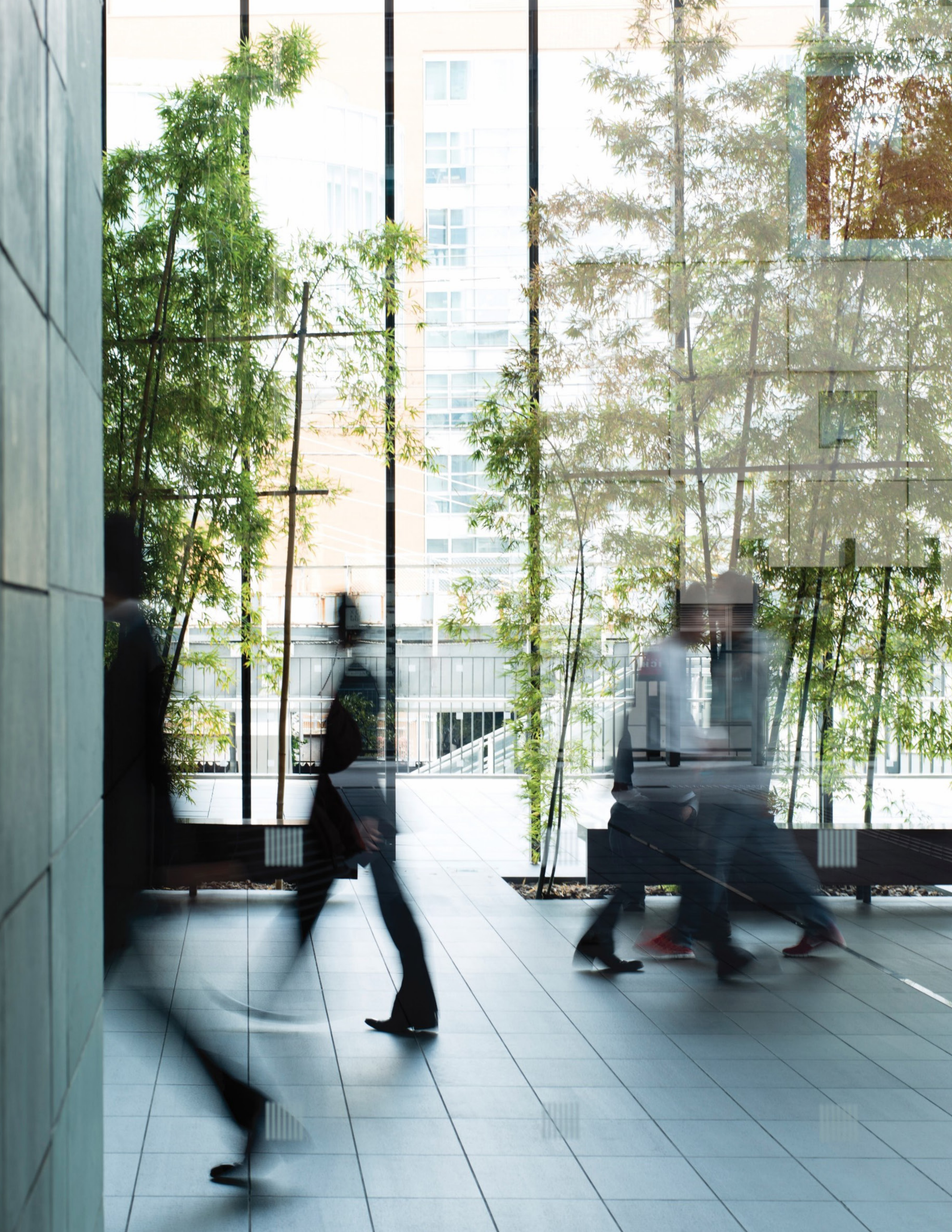
# Understanding and Counteracting the Challenges Facing Firm Profitability

With the pandemic finally in the rearview mirror, law firms must face the hard new realities of a business and work environment that has changed forever and continues to evolve. Inside this ebook, you will find helpful insights and solutions to help navigate this new landscape.



# Index

Ongoing inflation, the continual rise in borrowing rates, a slowdown in capital markets, global economic and political disruptions, and a challenging labor market all contribute to the general uncertainty within the legal industry. While there are no broad-brush strokes or magic wands that will resolve these fundamental issues, law firms that tackle individual aspects of their business well can pave the way to greater profitability. Throughout this ebook, we will address some of the major elements that can and should be addressed.

# Succession

*Who will lead the firm in the years ahead?*

The struggle to find leaders of the future has never been stronger. In today's environment, many younger professionals do not aspire to be managing partners. To change this growing trend, firms should consider creating leadership opportunities for their younger professionals to give them a taste of the diverse benefits that come with becoming a leader within their firms.

Since this takes time, perhaps decades, it is imperative to make moves now rather than waiting until a transition becomes imminent. Otherwise, survival may require considering merger opportunities.

# Stemming Profit Margin Erosion

The cost of keeping younger professionals in the fold — salaries, benefits, perks — continues to rise, and many law firms have struggled to fully pass these costs on to their clients. Here are some considerations to address the financial erosion:

**Travel and entertainment:** Now that in-person interactions are back post-pandemic, firms should consider the value each specific travel and entertainment expense can bring to the firm and fully monitor all activities and track the return on investment.

**Laterals:** This tried-and-true way of expanding business must now be weighed against the fact that a lateral will not immediately be profitable. Profits may be temporarily hindered due to the delay in the collection of billings compared to the increase in expense of the added labor force. The firm needs to determine if it can afford these sunk costs in the short-term and weigh the overall costs against the potential long-term benefits.

**Capital acquisitions and technology:** Carefully assess any potential capital acquisitions to determine the cost/benefit and consider leveraging technology. Has the firm taken every advantage of technology to create a paperless office environment or considered software upgrades and robotic process automation (RPA) to help enhance efficiency and save money?

**Outsourcing:** Outsourcing finance and accounting functions allows a firm to leverage a team of highly qualified industry experts that are able to handle the increased complexity associated with growth. Partners receive increased visibility into the company's key financial metrics and overall performance through timely and accurate month-end closes. This allows them the time to focus on forward-looking and strategic initiatives.

**Administration costs:** With many professionals more adept at technology and able to handle rote tasks they once passed off to assistants, there is potential to reduce the administrative assistant model and move toward a shared administrative model to support the firm and its partners.

# Budgeting, Forecasting, and Benchmarking

What may have been consistent over the pandemic years might now need revisions based on how people work and interact with clients today. Law firms should examine historical information to help forecast future spending by office, department, and industry/practice group. A benchmarking exercise can also produce value. Data from similarly sized firms in comparable markets can be used as informative benchmarks to determine where the firm may be spending too much or too little. This may present opportunities to renegotiate leases, insurance, and office equipment, among other areas.

# Office Space

*How big of a footprint do firms need?*

Nearly all law firms have been open to some form of flexible/hybrid work environment. This creates an opportunity for firms to reduce their physical space. Many firms are reconfiguring individual offices to a standardized size to allow for greater flexibility and a more efficient use of the office. If a firm has a hybrid work model, certain professionals may be able to work out a schedule to share desk space, creating further space efficiencies. Consider the elimination of the law library or other physical resources that are used infrequently. The firm may be in the position to eliminate entire floors when the lease matures or if they can find a sublease tenant.

# Finding Value in Fee Structures

A thorough review of billable rates can reveal what areas of the practice and specialized projects are the most profitable for the organization. Not only can this reveal where to concentrate efforts but also where the firm may have the greatest potential success in raising rates to meet increased costs. Many firms do not use fixed fees and/or alternative fee arrangements, however, it may be time to consider progress billing as a way to inform clients of where they are incrementally across the span of the engagement. This reduces surprises for clients when the engagement is concluded and can cut down on their demand for billing discounts.

# Improving the Health of Accounts Receivables

As law firms often look to cut costs as a way to enhance profitability, it is also just as impactful to implement methods to improve the firm's receivables. Here are some ideas to consider:

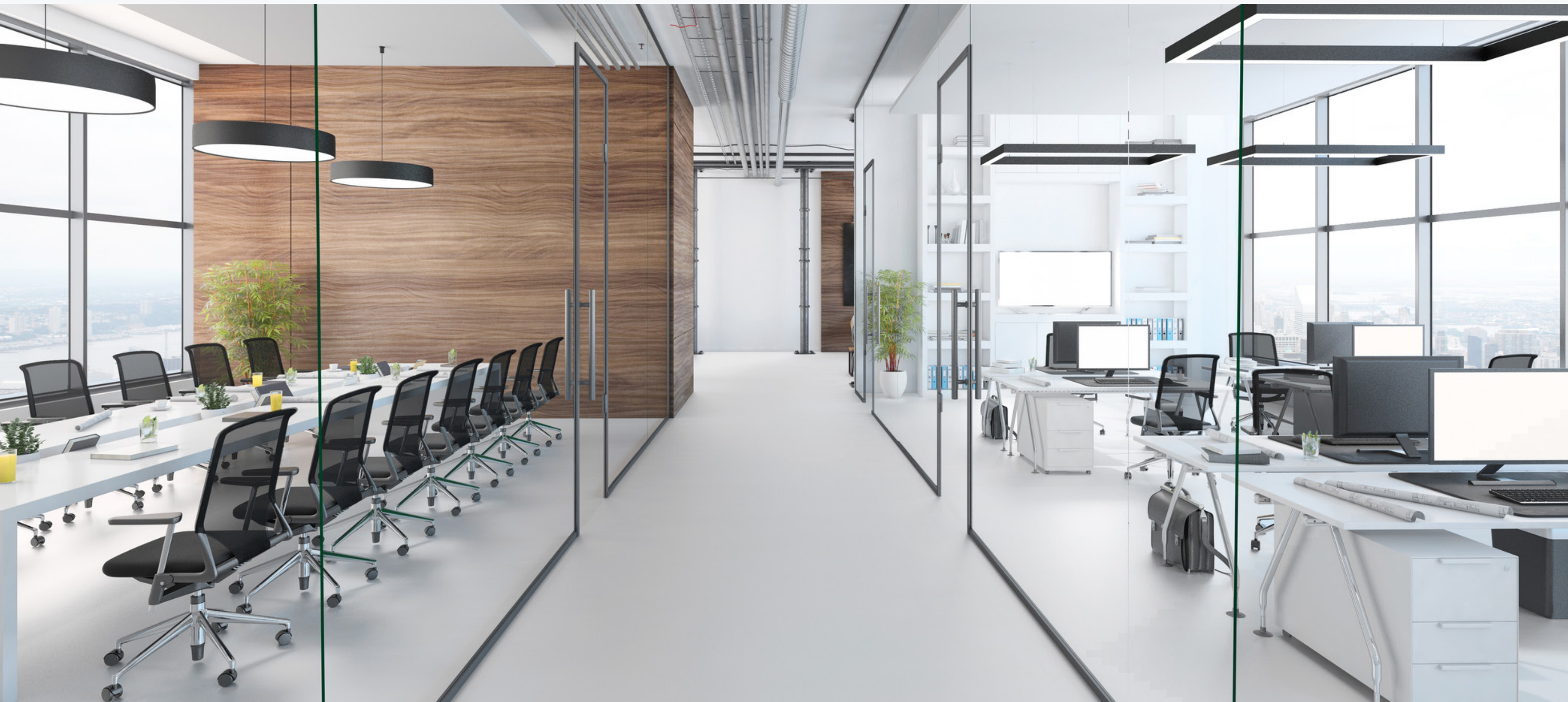
**Credit card payment programs:** There are clients that find this an agreeable method due to the convenience it provides, resulting in the firm receiving payments quicker than traditional methods.

**Aging accounts receivable:** Partners need to be held accountable if they have considerable aging receivables and are not attending to the problem.

**Managing of work-in-progress:**

- Allocate time to the items that are of the highest value
- Make sure that staff are being utilized efficiently

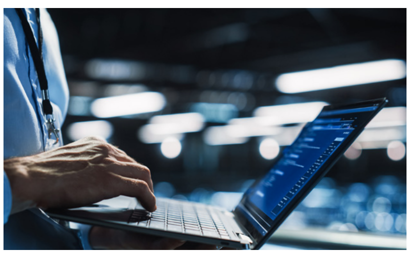
**Review unprofitable clients:** With potential resource limitations firms should look to cull clients that are not profitable to focus on profitable clients or new clients.



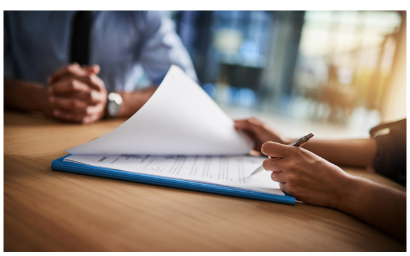
# Invest in Insurance and Cybersecurity

Law firms must expect to pay more for coverage for high-risk practice areas such as securities, banking, and real estate. For all firms, running the risk of losing confidential client data and suffering reputation damage is too great to go with anything less than a strong, regularly updated cyber protection program.

Ensuring the protection of your organization and client's data from potential cyber threats is critical. Taking the precautionary steps to prevent cyber intrusions will save firms from losing profits. Consider:



Conducting routine cybersecurity risk assessments



Having a plan and response for when a cybersecurity attack does occur

Educating employees on the importance of cybersecurity awareness and the array of threats they may face

Maintain comprehensive data privacy practices, including guardrails around the accessibility and storage of sensitive information

# Maximize Business Development and Marketing Programs

Customer relationship management (CRM) and marketing automation systems work for other business sectors and can work for the legal industry as well. These tools help manage and analyze client data and interactions throughout the working relationship. Integrated marketing systems assemble client data across different channels, or points of contact, between the client and the firm which could include the firm's website, emails, marketing materials, and various social networks.

## To create an effective and efficient marketing effort, leverage the following:

**Start a pipeline:**
Create a pipeline that includes all prospects in the business development cycle and host meetings to review, discuss, and strategize the firm's pursuit efforts with current prospects.

**Target the ripest fruit:**
Concentrate efforts on the prospects the data reveals to be the most likely to engage the firm.

**Review lost opportunities:**
Discuss why opportunities were lost and what could have been done differently.

**Gauge success:**
Determine where the organization has been most effective and highlight star performers.

**Cross-sell:**
Challenge the partners who believe they have proprietary clients. Encourage the development of a collaborative growth mindset and let it be known that the firm is a team. Cross-selling is required where it applies. This approach will also help foster a positive team culture.

# Potential Tax Exposure

With many firm employees working from home, either full- or part-time, in different states, there is the potential for state and local tax exposure due to the requirement for firms to report where their employees' work is being performed. Aggressive states seeking revenue may be particularly active in this area.

# Revisit Partner Compensation

The initiatives discussed in the article all point to partners becoming more actively involved in activities that generate business, which might require changes in behavior. Consider tailoring a partner compensation system that mirrors firm initiatives and rewards those who develop business.

# Acknowledge the Value of DEI

Diversity, equity, and inclusion (DEI) is extremely important to the workforce, especially for the younger generation, who are becoming the backbone of organizations. Studies have shown that those firms that embrace (with deeds and not words) DEI perform better than those that do not have such a platform.

# Conclusion

Profitability will always be a challenge, no matter the social, economic, or business environment but there are a variety of ways to take on the challenge. It is up to each firm to choose the paths it determines will yield the most beneficial results.

If you have questions or would like to learn more about your options to increase profitability, contact Citrin Cooperman at info@citrincooperman.com.

Learn more about Citrin Cooperman's Professional Services Practice, here.

# About the Author

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John Fitzgerald is an audit partner with more than 30 years of experience. John advises law practices and also works with closely held businesses in the real estate, hospitality, distribution, and manufacturing sectors. He consults on maximizing opportunities in purchases, sales, and acquisitions — obtaining financing and refinancing, preserving and transferring wealth, and improving operations.

For closely held businesses, John plans for the purchase and sale of assets, develops models to evaluate potential transactions, and structures and arranges financing and refinancing. He provides cash flow analysis and tax projections and advises on like-kind exchanges.

John is skilled in building strong succession plans for the transition of control and ownership of family enterprises to preserve and transfer wealth.

He has extensive experience working with law firms. John examines the financial and economic impact of partnership agreements, assists in reviewing candidates for mergers or lateral partner additions, and performs due diligence. He is experienced in evaluating internal controls — identifying weaknesses and suggesting approaches to his clients to increase efficiency.

John prepares, analyzes, and audits various special purpose financial statements relating to mortgages and other financing agreements, certiorari filings, and rent escalation clauses.

He has been active in training younger professionals and staff in essential audit and professional development skills. Prior to joining Citrin Cooperman, John was an audit partner at Berdon, LLP, which joined the firm in 2023.

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