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Plenary Session

Move Your Clients Up or Out?

Presenter:
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About the Presenter...

Jeff Krause is part of Affinity's document management team. He specializes in corporate legal department deployments and workflow design and efficiency. Jeff practiced law for two years after finishing law school in 1996, but decided technology was a better path for him. He began working for a pioneering legal technology consultancy called MicroLaw in 1998. In 2003, Jeff started his own legal technology consultancy, which he ran until 2016, when he joined Affinity. Jeff's superpower is patience, and his favorite part of his job is the satisfaction of helping someone solve one of their business problems.

Clients Up or Out

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Introduction

We all have "those" clients. The clients that call constantly even though they never seem to be available when you need to call them. The clients who harass your staff as well as you, no matter how much you try to "kill them with kindness." The clients whose main reason for calling is to complain about the other side or to share their new idea about how you can win their case. The clients who complain about the bill they received for the twenty-seven times they called you last month. The clients who don't pay the bill on time even after you reduced it.

You ask yourself, "Why are they calling you this time?" when you should be asking "Why do I put myself and my staff through this?" Some of us have altruistic reasons for putting up with these clients. We became lawyers to help people. That includes people who are rude and obnoxious. While this may be true, you still need to consider your staff. They are dealing with these clients too.

Most of us deal with clients like this out of fear. For some this fear is professional. We don't want to be "that" lawyer who fires clients. However, for most of us, the fear is financial. Clients can be hard to find. If you start firing clients, how will you replace them? While the client might be abusive to your staff, the part of their bill they do pay keeps the lights on, right?

In this presentation, we will discuss how to identify these problem clients (although you should not need a lot of help with that). We'll also explain how these clients hurt more than your feelings. They hurt your bottom line. Finally, we'll offer strategies to help you move these clients up the ladder of satisfaction or out of your life.

Law Firm Profitability

Understanding how your law firm generates profits is the first step to understanding the impact these clients have on your business. To help us understand profitability, let's go back to some of the lessons from Moneyball for Lawyers, my presentation on using data to drive your law firm.

Like sports, business has winners and losers. During a sporting event, you can tell who is winning and how each team is doing by looking at the scoreboard. After the game, the compiled box score or stats sheet provides the details. Looking at the statistics in depth almost always explains the final score. Sometimes, a single statistic tells the story. In football, for example, the team that has the fewest turnovers usually wins even if they trail in other statistics. Improving key stats from game to game increases the odds of achieving the goal – winning the game.

Ultimately, the goal of every business is profit. While many lawyers have other personal and professional goals such as pro bono service, we all realize that it is difficult to help anyone if we cannot stay in business. Even a non-profit organization needs to produce revenue or obtain funding sufficient to continue operating. However, recognizing that profitability is critical does not answer the question of how we measure or achieve profitability.

Ask almost any business owner how profitable their business is and ninety percent of them will refer to the last item in their Profit and Loss Statement. That's the proverbial bottom line or final score. If you check that number every so often, you're doing more than many other business owners. Is that enough? While it is better than not looking at all, the final score happens for a reason. If you want to improve the final score, you need to dig into the details.

Changing the Score

When faced with a Profit and Loss Statement that does not meet the desired bottom line, what do most business owners instinctively do? They look to cut expenses. Obviously, a Profit and Loss Statement reflects income minus expenses and almost every business can find an expense or two that can be lowered or eliminated. Cutting an expense will dollar for dollar impact the bottom line. It's like finding money – instant profit! Now, if we could only reduce our expenses to $0, think how profitable we would be!

The truth is that reducing expenses is often a temporary solution. Eventually, they will creep back up. Cutting expenses also has hidden costs, especially if you reduce or eliminate the wrong ones. Cutting marketing will improve your bottom line in the short term. The problem is that it will soon start reducing your revenue. You end up in the same place or even further behind. There is a limit to how much you can cut without impacting services.

No business should throw money away in the form of unnecessary expenses. However, if you want to improve profitability, look at the top of the Profit and Loss Statement. Unlike expenses, there is no set limit to the amount of revenue you can generate or the ways you can generate it. Focusing on revenue is not quite as easy but it creates bigger and longer lasting results.

The Profit Formula

The simplest method for calculating, tracking, and increasing profitability is a formula that I learned from my friend and former business coach, Chris Carmen of ActionCOACH.

ActionCOACH teaches its clients a formula they refer to as the Business Chassis or the Five Ways. For our purposes, I will refer to it as the Profit Formula.

The premise of the Profit Formula is very simple. There are five ways to increase profitability in any business – Leads, Conversion Rate, Number of Transactions, Dollars per Transaction and Margin. Everything you can do to increase the profitability of your law firm falls into one of these categories.

Leads is the number of prospective clients you attract to your firm. Don't confuse Leads with possible clients or ideal clients. To qualify as a Lead, a prospective client must "raise their hand" or otherwise express interest in working with your firm. Leads are the result of marketing or lead generation activity. There are many ways to generate Leads. Most forms of marketing, including everything from traditional networking to social media networking, generate Leads.

Conversion Rate is the percentage of Leads that become clients. For lack of a better word, Conversion Rate is about sales. Many lawyers will insist that they are not involved in sales, but we all are. It might be as simple as establishing rapport with the client over the phone or at an initial consult but we all sell clients on the benefits of working with us as opposed to the many other attorneys out there who could help them. Even if you consider yourself terrible at sales, you may have an acceptable Conversion Rate. The quality or messaging of your marketing may go a long way to convince a Lead to become a client before you ever speak to them. Your demeanor, the friendliness of your support staff, or even the artwork in your office may influence or place a Lead at ease and convince them they should work with you.

The bad news about Conversion Rate is that, unless you are already measuring it, your rate is much lower than you think. We all tend to remember the wins and forget the losses. We also tend to disregard lower quality Leads or window shoppers as if they don't really count. When a law firm or other business that does not measure Conversion Rate begins to do so, they are often shocked to find it is as low as 25% - when they assumed it was 75%. The good news is that there is often a lot of room for improvement and there are many simple ways to improve Conversion Rate.

Leads times Conversion Rate equals the number of new clients your firm added over the tracking period. If you want more clients, you need to generate more Leads, convert more of the Leads you generate, or both. I often hear lawyers express a desire for more clients. New clients don't appear out of thin air. They are the result of Lead generation and Conversion.

The first part of our Profit Formula is:

Leads x Conversion Rate = Clients

The second part of the Profit Formula is about what we do once a Lead is a Client. Specifically, now that we have a new client, how do we maximize the revenue generated from that client over their lifetime relationship with your firm? There are two ways to do this, and the word lifetime is a hint. The first way to maximize client revenue is to get them to come back again. I refer to this as **Number of Transactions**. Not every practice area lends itself to returning clients, but many do. If your area does lend itself to repeat business, focus on providing excellent service with personal touches and on keeping in touch with clients after their initial engagement concludes.

The second way to maximize client revenue is getting them to spend more. I refer to this as **Dollars per Transaction**. A Lead or Client may come into your office with a specific goal in mind but may be completely unaware of something else they need. Are you watching for these types of opportunities? Good retailers have this down to a science. Think about the last time you purchased paint. The store likely placed a sticker on the top of the paint can. The sticker identifies the color along with the formula and a “don’t forget” list. This is a list of things you might forget about unless reminded – rollers, brushes, tape, drop cloth, etc. How many times have you added to your order when asked, “Do you want fries with that?”

Multiply the number of clients by the number of times they come back, then by the amount they spend each time. The result is your revenue.

The second part of our formula is:

Clients x Number of Transactions x Dollars per Transaction = Revenue

We’ve already touched on the final piece of the formula when we discussed cutting expenses. **Margin** (or Profit Margin) is how much of every dollar in Revenue a business gets to keep. If for example, you generate $100,000 in revenue but your cost of goods sold and expenses are $80,000, you are left with $20,000 or 20% of your revenue. Decreasing your expenses increases your Margin. However, it is not always as simple as cutting something. Leveraging people, process or technology may allow you to get more done without increasing expenses. Efficiency increases margin because you can do more work without an associated cost.

Multiply your Revenue by your Margin (the percentage of your Revenue you get to keep).

The third piece of our formula is:

Revenue x Margin = Profit

Your Firm's Box Score

The entire Profit Formula is the like a box score for your firm. It looks like this:

Leads
x Conversion Rate (%)
Clients
x Number of Transactions
x Dollars per Transaction
Revenue
x Margin (%)
Profit

The items in red are the things you can change. The items in blue are the results.

Let's throw some simple numbers into the Profit Formula.

Leads	100
x Conversion Rate (%)	.25
Clients	25.00
x Number of Transactions	2
x Dollars per Transaction	$5,000.00
Revenue	$250,000.00
x Margin (%)	.40
Profit	$100,000.00

Now, for some magic. What happens if we increase each of the items in red by 10%?

Leads	110
x Conversion Rate (%)	.275
Clients	30.25
x Number of Transactions	2.2
x Dollars per Transaction	$5,500.00
Revenue	$366,025.00
x Margin (%)	.44
Profit	$161,051.00

Increasing each of our formula numbers by only 10% created a 61% increase in profit.

Increasing two numbers by only 5% each yields more than a 10% increase.

Leads	105
x Conversion Rate (%)	.2625
Clients	27.56
x Number of Transactions	2
x Dollars per Transaction	$5,000.00
Revenue	$275,600.00
x Margin (%)	.40
Profit	$110,240.00

Finally, what if we increase each of our original numbers by 50%?

Leads	150
x Conversion Rate (%)	.375
Clients	56.25
x Number of Transactions	3
x Dollars per Transaction	$7,500.00
Revenue	$1,265,625.00
x Margin (%)	.60
Profit	$759,375.00

The first time I saw the Profit Formula, I thought it was too simple and could not possibly be right. I felt that way until I tracked each of the five numbers for one year. In the end, my Profit Formula was remarkably close to my Profit and Loss Statement.

If you are still skeptical, at least take a few things away from this exercise.

1. Clients, Revenue and Profit are RESULTS. You can change them but only by changing the numbers that drive the result.
2. We tend to focus on increasing the results, when we should focus on the numbers that drive the results.
3. Small improvements multiply, especially over time.

For more on what I call the Profit Formula, please see:

Instant Cashflow, by Bradley J. Sugars

Profit Rocket: The Five Key Focus Areas to Skyrocket Your Profit by Kelly Clifford

Measuring Profitability

Profitability Numbers to Know

The Profit Formula helps you get a handle on the overall profitability of your firm. If you are like most firms, you will track it in a tool like Microsoft Excel. To make data driven decisions, add just a little more information to your tracking. When you start tracking information such as the source of Leads, who handles which matters and revenue generated by specific clients, you begin to see the true power of data. Use it alongside the data in your billing and accounting systems and you begin to understand how well your players are performing.

Each of your players makes specific contributions to your team. Attorneys and staff contribute to Lead generation and Conversion Rate. Do you know how much? If you know where your Leads are coming from and who handles the inquiry, it’s relatively easy to know who is contributing. They also contribute to Number of Transactions and Dollars per Transaction because clients tend to come back and pay their bill when they received great service and like the people they are dealing with. Attorney and staff salaries effect Margin in a negative way. However, more efficient attorneys and staff get more done in the same amount of time, which has a positive effect.

Clients don’t generate Leads or help with Conversion Rate. Or do they? A client that sends another client your way is generating a Lead and has likely made a convincing argument that the Lead should work with your firm. It goes without saying that the best clients refer others, spend more and come back more often.

If this information is part of what you are gathering in your Profit Formula spreadsheet, it is easy to find these numbers. You can back this up with hard numbers from your billing and accounting system. Receipt allocation reports, for example, can shed light on which attorneys, staff and clients are producing the most revenue.

Of course, team averages don’t only consider the best players. There are others who bring the average down. To spot the underperformers, watch for Problem Clients and Profitability Killers.

Problem Clients

Problem clients impact almost every aspect of the Profit Formula.

Think about the first contact you had with one of your problem clients. Did you ask them how they heard about your firm? If you did, it is highly likely that another problem client referred them. People tend to spend their time with other people like them. They also know that you have tolerated them, so they are happy to send people just like them to your firm. Even if the problem client was not referred, ask yourself how you generated the Lead. By any chance, have multiple problem clients came from the same type of Lead generation?

Problem Leads are also more difficult to convert to clients. They ask for more discounts, don’t return engagement letters on time, and don’t provide you with the information you need to properly analyze their case. Too bad they aren’t just a little more difficult to the point where you don’t take them!

Dollars Per Transaction is where problem clients really start to show up on your bottom line. They are more likely to demand discounts, you are more likely to write them down and you are more likely to write them off. Later, we will show you exactly how much of an impact this is.

Problem clients are also a huge drain on Margins. If efficiency is about doing more with less or creating processes to do things better, problem clients have the opposite effect. They use a disproportionate share of resources, and they could care less about your process.

The only part of the Profit Formula that problem clients seem to increase is Number of Transactions. Once they find someone who puts up with them, they keep coming back. Isn’t that an encouraging thought?

All of these directly contribute to Profitability Killers.

Profitability Killers

Profitability Killers are things that crush your bottom line. Many firms don't realize it is happening or the impact these things have on their bottom line. However, armed with the Profit Formula, you start to see the impact.

Some Profitability Killers decrease revenue, most often by reducing your Dollars per Transaction. These Profitability Killers include discounts, write downs, and write offs. A discount is a promise to work for less money than you are worth. In effect, before you start working for a client, you agree to reduce the amount they are going to spend on your services. A write-down occurs at the time of billing when you look at the amount of work you have done for a client and decide to reduce how much you will charge for it. Both discounts and write downs tend to be gut reactions where you convince yourself that your normal fee is too much or that the client will never pay the full amount. Finally, a write-off occurs after billing when a client refuses to pay their bill, and you agree to cancel some or all of it.

That sounds harsh because I am pointing out something that none of us like to think about. The truth is that you always have a choice with these three Profitability Killers. In addition, when you look at real numbers, you will inevitably find that some of your players – whether they be attorneys, staff, clients, or practice areas – force you to make one of these choices far more than others.

Problem clients have a disproportionate negative impact on Dollars per Transaction. They demand discounts, to which we acquiesce. When we look at their pre-bill, we know they are going to complain, so we write the bill down before we send it. When they receive their bill, they still complain, and we write more of it off. That is, after we wait 90 days or more for them to pay the smaller amount.

Some Profitability Killers reduce your Margin. While poorly designed flat fee structures also reduce revenue, I view them as a Margin killer. The worst flat fees are those where you base the price on a gut feeling that it should take you about (fill in the blank) hours. Not much better are those where you run a report and price your flat fee based on how many hours it normally takes you to do a certain type of work. In this case, the number of times it takes you more than the normal number of hours will almost always exceed the number of times it takes you fewer hours. Flat fees based on an assumed number of hours are basically another form of discount. Now that you know what your Margin is, think about setting your flat fee based on how much profit you would like to make on the matter. When you set a carefully priced flat fee, it is within your power to determine not only how much revenue you will generate but also how much profit you will make on the matter.

Think about the last time you said to yourself, “I can’t believe I agreed to do this for only $x” Was it for a problem client?

The final Profitability Killer is harder to quantify but, nevertheless, impacts your Margin. This is Inefficiency or its distant cousin Ineffectiveness. Inefficiency is doing things the wrong way so that they take longer, require more resources, and/or cost more money. Any task that takes longer or costs more than it should, is not being done in an efficient way. If another firm can complete two matters in the time it takes you to complete one, they are more efficient. If they require only one staff member to handle the same number of matters that require two staff members at your firm, they are more efficient. Such a firm is beating you at the Margin game. Very often, it is because they have better people, better processes, better technology and/or better clients.

Ineffectiveness is doing the wrong thing with your time. If you are a lawyer dealing with office administration instead of helping clients, you are not spending your time in an effective way.

Problem clients always seem to make you less efficient. They disproportionately use resources such as staff and, more importantly, time. They also make you ineffective by calling to interrupt your process, they make you less efficient for other clients.

The Cost of Discounting

Most businesses do not appreciate the true cost of discounting. Law firms are no exception and may, in fact, discount more than other businesses, especially for problem clients. Discounting should always be on your radar because it destroys profits. Here is a simple example using the baseline numbers from our earlier Profit Formula exercise. We assume your firm routinely offers 10% discounts.

> Baseline Pricing. 25 Clients x 2 Transactions x $5,000 = $250,000 Revenue
>
> 10% Discount: 25 Clients x 2 Transactions x $4,500 = $225,000 Revenue

Those numbers make sense. A 10% discount reduces revenue by 10%. While the effect on profit is not shown in my example, rest assured that it reduces it by 10% as well. That’s the obvious cost. Here is the less obvious cost:

> 10% Discount: 28 Clients x 2 Transactions x $4,500 = $252,000 Revenue

In other words, you must bring in 10.8% additional clients to make up for a 10% discount. That's 10 additional Leads, at a Conversion Rate of about 30% or some combination that will increase your number of Clients by 10.8%. Once you find additional clients to make up the difference, you have work to do – about 12% more work, since you will probably apply your generous 10% discount to these new clients.

The Value of Raising Rates

If discounting kills profits and makes you work harder, raising rates has the opposite effect.

> Baseline Pricing. 25 Clients x 2 Transactions x $5,000 = $250,000 Revenue
>
> 10% Rate Increase: 25 Clients x 2 Transactions x $5,500 = $275,000 Revenue

Once again, a 10% increase is the obvious result. Here is the less obvious result.

> 10% Rate Increase: 23 Clients x 2 Transactions x $5,500 = $253,000 Revenue

Isn't that interesting? You can raise rates by 10%, lose 9.2% of your clients and still generate more revenue. In the meantime, you don't have to work quite as hard.

What about the 9.2% of your clients you lost? Anyone want to take a guess as to which clients are likely to run as soon as you raise rates? They are almost always your problem clients.

Grading Your Clients

Which of Your Clients Make the Cut?

Major league baseball teams evaluate players to field the best possible team. They do this before the draft, when considering free agents and before making trades. Similarly, building a major-league practice requires regular evaluation of your clients.

You should review your clients at least annually, although more frequent reviews can help you make decisions faster. Grade your clients on a scale of A, B, C, and D. If you are like most firms, you will find some that don't even earn a grade of D. Throw those into a fifth bucket called F.

Your D clients are those that always take up a lot of attorney and staff time, make unreasonable demands, complain about bills, demand discounts and pay late. Except for what constitutes an unreasonable demand, each of these items is quantifiable using time records, case notes, billing and payment history. Admittedly, there is a certain gut reaction that most of us have regarding these clients. We cringe when their number pops up on caller id.

As I mentioned, you will likely find some extreme examples that grade an F. If you do, start the process of disengaging with them immediately. I fully understand that it is not easy to fire a client and that there are ethical implications if done the wrong way. On the other hand, you can at least stop taking new work from them.

C clients are those that sometimes act like D clients but usually don't. Overall, they are easy to work with. B clients rarely or never act like D clients and are a pleasure to work with. When a B client complains, you may want to consider it a learning experience and make appropriate adjustments.

There are several good reasons to grade your clients. You can choose to stop working with the worst offending D clients. However, firing clients should not be your goal. Rather, your goal should be to move them up the scale. Is there a way to discourage the behavior that defines a D client to the point that they qualify as a C from now on? What about those prized B clients? What will it take to make them an A client?

Second, grading clients allows you to identify patterns. Where did your best clients come from? What about the worst clients? The answers tell you something about where you should invest your time and money in marketing. One thing is almost always true about each group of clients. They tend to refer other similar clients.

That brings us to the definition of an A client. A clients act much like B clients; except they refer other great clients to your firm.

Up or Out

Once again, firing clients is not the goal of this exercise. Not all problem clients are irredeemable. The goal is to move clients up the scale. Only those clients that cannot be moved up the scale to at least a C should be moved out.

Most F clients cannot be moved up the scale. They are already worse than D clients. They are making your life miserable and demoralizing your staff. The strategies that work with other clients most likely won't work with them. If you cannot fire them immediately, you can at least stop taking new work from them. This way, there is at least some light at the end of the tunnel.

For other clients, your first step is to understand that you get what you tolerate. If there are client behaviors you want to change, you need to stop tolerating those behaviors. It's time to let your clients know the ground rules. Are there clients that call too often and then don't want to pay for your time? Make it clear what is billable and by how much. Put it in your engagement agreement. Tired of clients who don't pay on time? Once again, make it clear that invoices are due on receipt or in 30 days, put it in your engagement agreement and follow-up when someone does not follow the rules.

Making the rules clear provides a way for your D and C clients to move themselves up the scale. If your D clients begin to follow the rules, they have probably earned C status. If a D client does not want to follow the rules, they may move out on their own. If they don't, perhaps raising your rates will give them that extra nudge. Your B clients are already great clients. Treat them well and they may become A clients by refering other great clients.

Trust the process. If you are worried about losing a few clients along the way, you probably will. However, consider which clients you will lose. Also consider whether they can be replaced by higher quality clients. In the "worst" case, you will have more time to spend satisfying your best clients. Eventually, your best clients will refer more great clients just like them.

About the Author

Jeffrey S. Krause is a Wisconsin attorney and senior consultant with Affinity Consulting Group and a law firm coach with Lawyerist. He has spent the last twenty-five years helping other attorneys understand and properly use technology in their practices. He also uses his passion for business to help other attorneys run their law firms like a business using systems and sound decision making.

Mr. Krause is a frequent author and speaker on a variety of legal technology and law office management topics. He has served as the chair of the Wisconsin Solo and Small Firm Conference, the Milwaukee Bar Association Law and Technology Conference and helped develop programs such as the State Bar of Wisconsin's Business School for Lawyers. He is a graduate of Marquette University Law School and the proud parent of another Marquette Law graduate.

In 2024, Mr. Krause was honored by the State Bar of Wisconsin Solo & Small Firm Section with the John Lederer Service Award. The Lederer Award recognizes those focused on improving the lives and practices of solo and small-firm attorneys in Wisconsin. The award is given annually to an individual, group, or organization that exhibits the leadership, spirit, and dedication of the late John Lederer of Oregon, Wisconsin.