

Efficiency Is Not *The* Competitive Advantage

by Patrick J. McKenna and Edwin B. Reeser

Efficiency in any firm, in and of itself, is not the competitive advantage. There is a big difference between being efficient and being *effective*. It's not that becoming more efficient lacks importance, but far too many firms only seem to be investing significant time and resources about being more efficient – at the expense of being effective.

Management thinker Peter Drucker addressed this topic decades ago. Here's what Drucker wrote in his book entitled *People and Performance*

"Efficiency means focus on costs. But the optimizing approach should focus on effectiveness. Effectiveness focuses on opportunities to produce revenue, to create markets, and to change the economic characteristics of existing products and markets. It asks not, how do we do this or that better? It asks, which of the products really produce extraordinary economic results or are capable of producing them? Even the most efficient business cannot survive, let alone succeed, if it efficient in doing the wrong things, that is, if it lacks effectiveness. No amount of efficiency would have enabled the manufacturer of buggy whips to survive."

Law firms are all too often focused on being efficient at doing the wrong things.

• **Efficiency At Producing Commodity Work**

Every firm is dealing with clients striving to get more for less. As a leader you can easily get stuck in an efficiency mindset and become totally reactive. Today it is hard to find many firm leaders that aren't encouraging their attorneys to embrace cost-cutting, project management, process improvement and other such initiatives designed to make their individual practices and their groups more efficient. Indeed, all of these tactics are included in most firm's (supposed) formal strategic plans and can quickly evolve into being your firm's primary focus.

Thinking about efficiencies is easier than developing effectiveness. You simply focus on the way you do things now – like the kinds of matters and engagements you are already doing for clients – and make doing them a little bit better. It is relatively safe, measurable, and satisfying. Alternatively, effectiveness requires that we transition from an operational (internal) lens (are we doing things the right way, a managerial imperative) to the strategic (external) lens and requires that we consider the leadership imperative – are we even doing the right things in the first place?

This can be a stressful question to answer. It may mean questioning the kinds of work that we are accepting and doing for clients. It may mean questioning why we are discounting our fees, only to fill our shops with more low-margin (commodity) work.

Many of your partners don't want to deal with this issue. In a difficult environment where they are being called upon to improve their revenues, they simply want to put their heads down, keep moving (not necessarily forward) and continue with what they're already doing. For these partners, thinking about effectiveness is too long term.

However, real competitive advantage is built on effectiveness, not efficiency. Consider – have you invested so much time being efficient at doing commodity legal work that you've missed the opportunity to invest some of that time in building your skill-set to find and do the higher-value work? In your firm, have you focused so much attention on project management and incremental gains that you've failed to engage your partners in seeking opportunities to be entrepreneurial or constructively disruptive?

Take general litigation, for example. While the prospects for truly exceptional trial lawyers will continue to burn bright, there is no lack of advice on how your firm can improve its efficiencies in handling litigation matters. But is that all there is to it? At a time when in-house law departments will willingly pay bonuses to avoid litigation, where is your firm's investment in developing sophisticated tools and systematic techniques to rigorously help clients manage risk and avoid disputes? At a time when most lawyers are unfamiliar with online dispute resolution, in spite of the European Commission having already formulated a draft regulation on ODR, have you thought of investing to build your litigators skills in this emerging and potentially important market space?

Firm leaders should be beyond agonizing over *efficiency*, and aggressively pursuing *effectiveness*. Firm leaders should be constantly questioning: What needs are emerging in our particular markets? How can we get out ahead of the curve to anticipate clients' needs before clients even know those needs exist? Most importantly, how can we build our skills in new and emerging areas that may prove to be highly profitable market niches in the years to come and allow us to meaningfully differentiate ourselves from competitors?

Constant obsession around improving efficiency becomes contradictory to pursuing excellence, innovation, and dynamism.

• **Efficiency At Pricing Services**

As economic pressures increase, the debates over legal fees will intensify for many years to come.

Most firms have reacted to these pressures by attempting to adopt various alternative fee arrangements, usually in those practices where it suited the firm and where the firm could be assured of still making a good profit. But even if you were incredibly efficient at developing AFAs, it would still not provide you with much of a competitive lead, for within a short time other competitors will match or better your position. Cutting costs and reducing prices rarely provides a competitive advantage for long.

In this case, unfortunately, AFAs seem to be failing to deliver significant savings for clients. What we hear most often from in-house lawyers is that their requests for discounts are largely being driven by their not seeing much of an overall reduction in costs from employing AFAs. Law firms have not succeeded with their efforts to make price efficiency work. Indeed they have built AFA proposals on billable hour metrics, thus making them “a rose by any other name is still a rose”.

Alternatively, those who are more focused on effectiveness have gravitated from obsessing over how to price differently to exploring how to do the client’s work differently. These firms are examining both litigation and transactional work by breaking them into their different component pieces and then determining how each of those pieces, from legal research through to legal strategy might be effectively handled – which could mean utilizing the firm’s lawyers to even utilizing alternative providers outside of the firm to execute certain components of the client’s matter. Indeed it is even leading to finding ways to solve the problem in the most client advantageous manner as the foremost priority.

• **Efficiency in Generating Net Operating Income**

This may be one of the more powerful examples of efficiency destroying effectiveness.

In the panic to maintain reported profits, law firms have become supremely efficient in de-equitizing partners to maintain profits per partner, accounting gimmicks to overstate income, lateral hiring and mergers/combinations to buy books of business to show ‘growth’ in revenues, building a production caste of income partners, installing wide compensation spread systems for equity partners, coercing partners to make higher capital contributions, using debt to fund distributions, reducing promotions to partner from within and building the partnership with newcomers from sources outside the firm. Firm cultures are sacrificed, training and mentoring of young lawyers essentially abandoned, lawyers are flogged for higher billable hours quotas, billing rates raised, and compensation systems built more on political power, and in some cases outright deception to the partners, rather than rational economics.

How much of that is *effective* at making a better law firm? More importantly, how *effective* is it at making the business a better provider of legal service to clients, which is critical to its medium to long-term survival?

• **Efficiency In Satisfying Clients**

Let’s look at one more example. Take the case of client satisfaction. Let’s say you conduct a survey and discover that some clients are disgruntled about something your firm is or isn’t doing. Perhaps some client didn’t think that their lawyer is as responsive as they might wish. The lawyer in question isn’t returning the client’s calls fast enough. What would most leaders do? They would start investing time and resources focusing on how to make this situation better. They might explore wait times for answering the

phone, returning calls and whether the firm needed to introduce some kind of formal procedures to enhance efficiencies.

An effective leader, in contrast, might want to know how this satisfaction rating correlates to importance. If a client is dissatisfied about something, how important is that to them. In other words, if you are trying to understand the value drivers, you need to know how clients rate such things as your fees, responsiveness and quality in terms of satisfaction *and importance*. It is the combination of satisfaction ratings and importance ratings that really matter – but leaders don't always think about the second part.

But for the purposes of our illustration, let's say that the client's dissatisfaction is combined with high importance. Now we do really have a red flag on the play! Again, an effective leader might look beyond this one expression of dissatisfaction to see how he or she might restructure the entire game rather than just fine tune. Remember, efficiency in any firm, in and of itself, is *not* a competitive advantage. In one firm we're familiar with, the expressed dissatisfaction caused the leadership to dig deeper into whether there were any particular kinds of calls that were not being returned quickly enough. They discovered that indeed, a good number of these calls were stimulated by clients wanting to know where their particular matters were at, having not heard from the lawyer over a period of a few weeks – even though the lawyer usually really had nothing new to report. This insight stimulated the firm to develop a technological-based, completely transparent system that would allow clients to easily access the real-time status on any and all of their matters without necessarily even having to speak with their lawyer.

In the final analysis . . . Are you being efficient or being effective, or do you even know?

Is your efficiency directed to the operation of the business and generating net revenue gains, or the consumption of your human resources for redistribution of a stagnant income pool, and thus hastening the demise of your firm? It isn't enough to be efficient on the right things, it is critical not to be efficient at doing the wrong things.

Back to Drucker once more: "Effectiveness is the foundation of success—efficiency is a minimum condition for survival after success has been achieved."

Things don't always have to boil down to either/or types of decisions. Balancing entirely different things is one of the critical success factors for good leadership. With the proper perspective and focus on the right things to be doing it is quite possible to be both efficient and effective. The two concepts can co-exist so long as the focus remains on more than just short-term results.

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Patrick J. McKenna (patrickmckenna.com) is an internationally recognized authority on law practice management and strategy. Since 1983, he has worked with the top management of premier law firms around the globe to discuss, challenge and escalate their thinking on how to manage and compete effectively. He is co-author of business bestseller *First Among Equals* and *Serving At The Pleasure of My Partners: Advice To The NEW Firm Leader* published by Thomson Reuters in 2011; was identified by Lawdragon as one of "the most trusted names in legal consulting" and the subject of a Harvard Law case study entitled: *Innovations In Legal Consulting*. He advises executive committees and boards on leadership selection and succession issues and co-leads a program entitled: *First 100 Days* (first100daysmasterclass.com) usually held at the University of Chicago. Reach him at patrick@patrickmckenna.com

Edwin B. Reeser is a business lawyer in Pasadena specializing in structuring, negotiating and documenting complex real estate and business transactions for international and domestic corporations and individuals. He has served on the executive committees and as an office managing partner of firms ranging from 25 to over 800 lawyers in size.