

## WHY FIRMS FAIL? WHY FIRMS SUCCEED?

### A NEW STUDY IDENTIFIES THE REAL KILLERS IN THE CORRIDORS

by Burkey Belser and Mark T. Greene

**True or False?** Do great work and great work will follow.  
 Communicating firm goals below the partner ranks invites trouble.  
 Each relationship with a client should be controlled by only one partner.

Alas, the answers aren't self-evident. Conventional wisdom dies hard, and sometimes law firms die with it. Why do some firms achieve extraordinary success while others, also led by smart and devoted leaders, dissolve or merge out of existence?



You have certainly seen autopsies of spectacular firm failures, from Washington, D.C., to the West Coast. You may even believe you know why your firm will not join the string of failures from the past three years. In fact, just about everybody has a reasonable opinion about the causes of failure. But until now, no one had objective data to confirm – or contradict – those opinions.

We have tried to fill that gap. Six months ago, we compiled lists of 47 successful and 27 failed firms. We drew the successful ones from the last two published Am Law 200 lists; we identified the firms with 5 percent growth in gross revenue. (More than 50 percent of the successful firms we identified have a large presence in Washington). For the failed firms, we collected our group from published reports, including those in Legal Times, and from running tallies maintained by consultants Steve Barrett and Ann Lee Gibson.

We winnowed the list to those with 50 or more attorneys that failed within the last three years. A few merged out of existence; most of the others dissolved. Our lists in hand, we then sought out one or more leaders from each firm. We interviewed them using a questionnaire that included 140 law firm qualities -- everything from collections to values -- and looked for correlations. We scored the answers on a 0-10 scale. We found the most telling results by comparing the mean scores of the successful firms to those of the failed firms. Throughout this essay, we report the scores parenthetically.

Our report is called "Why Firms Fail; Why Firms Succeed." It proves that no single incident can cause the collapse of any healthy firm. In fact, there is no such thing as a precipitous firm collapse. It only appears that way. A sequence of events causes firms to fail. Likewise, there is no panacea that will ensure extraordinary success. But we have learned that there are characteristics that can affect the probability that a firm will fail or enjoy outstanding performance.

We're describing tendencies and probabilities here. Many of the failed firms had some or nearly all of the characteristics of the firms that succeeded. It would be simpler if we could point to a single fatal flaw. But life, even in law firms, is too complicated for that. What we can say with

confidence is that for success there is no substitute for strong leadership, good communication, and a clear set of shared values. Good clients, carefully nurtured, help too. At the most fundamental level, the study points to a revised job description for law firm leaders.

### LEADERSHIP 2.0: A NEW MODEL

First learned: A new model of leadership is required for firms to increase their probability of success. That new model hinges almost entirely on vision and communication, metaconcepts that pervade the entire study.

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Leadership today does not mean presiding over the 1970s model of partnership with its aggressive democracy ("one partner/one vote"), nor does it mean the pendulum has swung to the opposite extreme of pure autocracy ("down with committees, down with consensus"). The study showed that failed firms were much more likely to adopt an autocratic style (5.1 vs. 3.0) than successful firms. While democracy is still a greater predictor of success (6.4 vs. 4.9) than autocracy, the most effective management style is consensus-driven (7.9 vs. 5.0).



Clearly the key to building consensus is communication. In other words, as partners agree to cede decision-making authority to leadership, leadership must in return keep partners informed and involved. The study results confirm one piece of folk wisdom -- lack of communication leads to suspicion; suspicion leads to fear; fear leads to failure. Leaders who communicated a common purpose (7.8 vs. 3.5) and promoted a shared culture (8.6 vs. 4.3) were dramatically more likely to preside over extraordinarily successful firms. A clear road map leads everyone toward a common goal.

The study confirms this principle again and again. For example, 92 percent of successful firms communicated the strategic plan all the way down the chain of command to associates and staff, while only 43 percent of failed firms did so. One successful firm leader acknowledged, "The plan has been developed with input from all lawyers, including associates and the senior staff. . . . This is a significant change."

### CLIENTS MUST BE CLIENTS OF THE FIRM

Firms where clients belong to the firm rather than to individual lawyers are substantially more likely (6.4 vs. 3.2) to be very successful than the failed firms where a lawyer's Rolodex -- "their" practice -- is held back as a type of career insurance policy. This is one of the most persistent problems facing law firms. Our study does not attempt to pinpoint the blame for this contributor to failure (compensation, courage, partnership itself?). The data simply identifies the result: Client hoarding significantly increases likelihood of failure.

However, simple numbers do not convey one profound insight that resulted from the study: Cross-selling exists as a concept only when lawyers act as gatekeepers, controlling access to the client relationship.



In evolved firms where clients are clients of the firm, no one needs the individual lawyer's permission to sell services to the client. Clients are automatically offered the services they need! Thus, clients of the firm typically receive advice from many different parts of the firm: Call this "cross-serving." Our previous research had shown extraordinary differences, in which some full-service firms average more than six services per client, while others average fewer than three.

The most successful firms encourage or reward cross-serving of clients, while the failed firms permit client hoarding (7.7 vs. 5.0). The most successful firms employ client teams to introduce clients to their full suite of service offerings.

In firms that hoard clients, cross-selling should be called "permission selling." It is most often doomed because too many barriers prevent success, such as the compensation system, lack of confidence in the competence or relationship skills of other partners or associates, fear that the client will go around the

gatekeeper, and fear that the client will be serviced poorly. In this kind of firm, How can we improve cross-selling? is the wrong question asked at the wrong time for the wrong reason.

Finally, client hoarding sustains a "me" culture in preference to a "we" culture, ultimately creating a law firm foundation made with poor cement. Firms that kowtow to maverick partners with a substantial book of business are like houses built on a floodplain. The question is not whether disaster will strike, but when.

## THE RISE OF NONLAWYER MANAGEMENT

Things look different at the top in successful firms. Hiring and empowering C-level executives reveals striking differences between the successful and failed firm. Extraordinarily successful firms are three to five times more likely than failed firms to employ and empower nonlawyers as the various C-level executives. We found that hiring nonlawyer businesspeople is necessary for success, but not sufficient. In the C-level ranks, a CFO who is not empowered to demand prompt billing, substantial realization, or timely collections is not a CFO but a comptroller. CMOs who are hired to realize the firm's vision but only empowered to save money are fundamentally disconnected from their job titles. A CIO without a seat at the firm strategy table is a network manager, not a CIO.

## PAY ATTENTION TO THE NUMBERS

Dare we say it? It's the money, stupid. Even a small increase in realization or collections can spell significant differences in per-partner profits -- and success. Successful firms pay more attention to realization (8.3 vs. 6.4), prompt billing (7.7 vs. 6.3), and collections (7.8 vs. 6.7).

Businesses outside the legal profession -- which is to say, your clients -- can hardly imagine anything more obvious. But billing rates are so high and income so strong in law firms generally that poor management is very often covered in a cloak of cash. Firms have been doing this for so long that lack of accountability has become a prized feature of law firm partnership. As long as the firm is making money hand over fist, who looks at the details†

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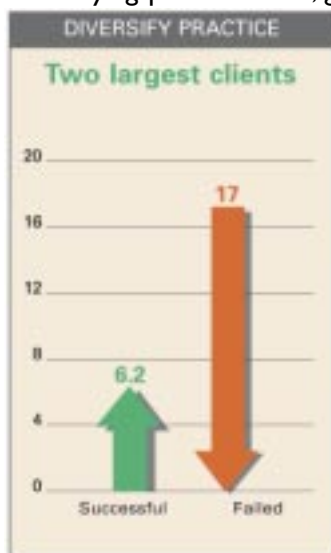
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Ninety percent of successful firms have a financial plan as opposed to only 67 percent in failed firms. Successful firms are much more likely to carefully manage their capital commitments (9.0 vs. 5.8). At the same time, successful firms are much more likely to carry a reasonable debt load (9.5 vs. 6.0). Tracking procedures in successful firms are clear and quantifiable. Penalties for failure to achieve the goals are understood, and individuals are held accountable.

Another insight: Greed kills. Successful law firms are much more likely to reinvest profits (4.7 vs. 2.7). But note that not even the successful firms are likely to win many prizes for their R&D initiatives.

## DIVERSIFICATION IMPROVES THE PROBABILITY OF SUCCESS

Diversifying practice areas, geographic focus, and client base improves the chances that a firm will weather downturns in business sectors and geographic areas, and the loss of key clients. For example, successful firms are much more likely to have a broad range of practice areas (7.6 vs. 4.4) and much less likely to be dependent on their largest office (60 percent vs. 73 percent failed), on their two largest clients (6 percent vs. 17 percent failed), or on a small number of rainmakers (4.4 vs. 7.7).



A narrowly focused firm can be successful -- after all, intellectual property or labor and employment boutiques have been very successful, but their probability of success over the long haul increases if they diversify their geographic and client bases. Firms with a narrow geographic focus would be wise to broaden their practice specialties or client bases. Narrow or niche focus has strong short-term benefits, but those strengths diminish over the long term as markets converge or mature. Reliance on a small number of rainmakers is a vulnerability that no firm should endure for long.

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### A SENSE OF BRAND IDENTITY MATTERS

There is a strong correlation between firms that believe they have a strong brand and firm growth. The study did not investigate whether these firms do indeed have a differentiated brand, but did prove that those who believe their identity is strong are more likely to grow and succeed.

Faith rules. Vision and leadership matter. Communication is critical.

### A MANAGEMENT DIAGNOSTIC

Of the 140 questions asked in the study -- or in research terms, the 140 hypotheses tested -- only 60 proved to be significant in predicting success or failure in law firms. But understanding both the significant and insignificant factors is valuable in several ways.

Some of those 80 insignificant factors are very important to success, but are already commonplace in law firms. For example, everyone seems to have hired a CFO, and it would probably be disastrous not to. But as we said above, not everyone has given their CFO the power to do more than run numbers.

The greatest value of our findings will come as individual firms apply what we've learned as they examine ways to improve their performance and strengthen their partnerships in an increasingly competitive environment.

### TRUE OR FALSE?

Taking managed risks is crucial to firm success.

Law firms can recognize danger signs and set a course for healthy growth.

Firms can match the positive aspects of their culture with predictors for success.

**TRUE. TRUE. TRUE.**

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