

# SMOCK♦STERLING

## Strategic Management Consultants

### NOT MEASURED, NOT MANAGED: USING THE BALANCED SCORECARD IN A SOPHISTICATED LAW FIRM

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It has been over 10 years since Robert Kaplan and David Norton published their landmark business treatise, *The Balanced Scorecard*. The concept of a balanced scorecard is now so entrenched in the field of strategic management that application of balanced scorecards is literally “old news” to strategists. At *Strategy & Leadership* – a leading strategic management journal – case studies and other articles related to the balanced scorecard draw yawns from peer reviewers.

Yet, this proven and widely supported concept is rare to non-existent within law firm management circles. In the summer of 2005 (and for the first time), Smock♦Sterling was formally asked to propose the inclusion of a balanced scorecard as part of a law firm strategic planning process – nearly a decade after the tool became widely accepted in corporate America. The success of that planning process – in particular, the results that client has achieved since adopting the strategic plan emerging from that process – has convinced us that consideration of balanced scorecards in the context of law firm strategy is long overdue and a potentially powerful tool in law firm management.

This monograph provides a brief overview of the balanced scorecard concept (for the uninitiated), a discussion of how the tool can be successfully applied in a law firm environment, a prediction regarding the objections law firm management are likely to encounter in applying the concept, and our recommendations for firms exploring the use of a “*balanced scorecard*.”

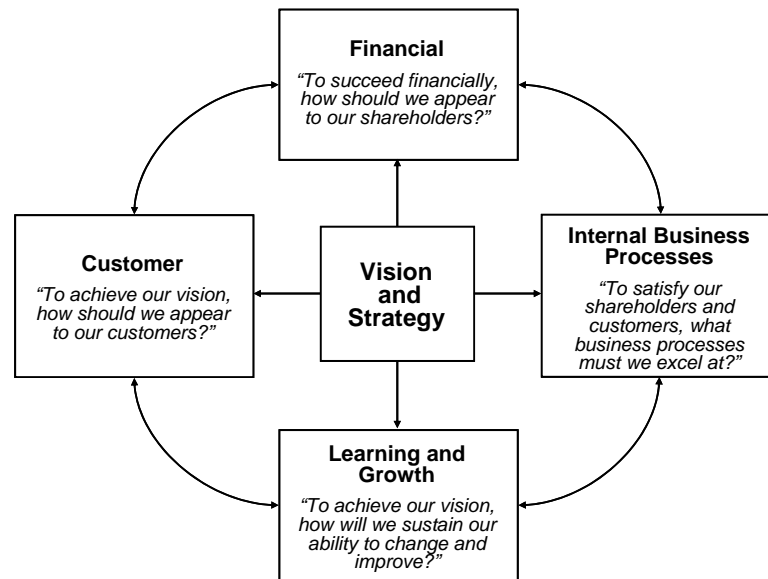
#### **BALANCED SCORECARD 101: WHAT IS THE BALANCED SCORECARD?**

Kaplan and Norton developed the balanced scorecard as “*a link between strategy and execution*.” The authors, taking their lead from the long standing management truism – “*not measured, not managed*” – focused on augmenting financial metrics with other measures closely linked with strategy execution. Specifically, they developed a framework to translate strategy into operational terms. And, they expressed that framework in terms that enable management to measure success in each area, consistent with the overall strategy.

The four fundamental dimensions of the balanced scorecard framework are:

- **Financial measures** – those measures that define what shareholders need and expect from the organization. In some circles, the balanced scorecard was seen as a backlash against focusing on shareholder value – not true, the authors simply recognized that management needed to measure other elements of strategy and operations if it was going to deliver superior financial results.
- **Customer measures** – those measures that capture how well the organization is satisfying customers. Simply, how does the organization appear to its clients (e.g., flexible, responsive, intelligent, innovative, etc.)? Law firms have historically focused intently on client service, yet do relatively little to measure client's perceptions of their firm's performance.
- **Learning and growth (human development) measures** – measures that capture how well the organization's people are able to change and improve. Ultimately, are the organization and its workforce getting smarter? In a law firm environment, this entails measuring whether people are more valuable to clients and to colleagues as the legal issues and the markets change.

- **Internal business process measures** – those measures that track improvement in the business processes most important to strategic success. In a law firm environment, that translates to improving processes that directly impact client service delivery (tracking improvements that make processes more efficient, more effective, or both).



Interestingly, chief financial officers (the executives presumably most likely to resist the adoption of non-financial measures) report that it is the best way to drive strategy implementation. In fact, a recent survey of members of the Institute of Management Accounting found that only companies using a balanced scorecard considered their measurement systems to be effective in supporting and communicating their strategy.

### **APPLYING THE BALANCED SCORECARD IN A LAW FIRM ENVIRONMENT**

The balanced scorecard is a tool to help a firm operationalize its strategy. Thus, the application of the tool can only logically follow the articulation of a coherent strategic direction for the firm. At its core strategic direction requires defining what factors are critical to success and, among those, which can truly differentiate the firm among key stakeholders (e.g., clients, attorneys, referral sources, etc.).

Assuming the firm has a clearly defined strategy (i.e., your firm understands where it needs to excel and why), developing a balanced scorecard is a function of working through some questions.

- What **do** we actively measure today (i.e., what measures do we report at the management, equity partner, practice group, and firmwide levels)? How much of what the firm actively tracks and communicates actually illuminates how well the strategy is working across the previously mentioned four dimensions?
- What **can** we measure via proprietary and public sources that will further inform our understanding of how well we are executing our strategy? What new data gathering and/or reporting practices could the firm adopt to track operational performance vis-à-vis processes, people, clients and finances?
- Most importantly, what **should** we measure given the strategic direction the firm is pursuing (i.e., the factors the firm has agreed are critical to long term success)? A firm should focus on a relatively few significant metrics for each dimension of the balanced scorecard.

Applying the balanced scorecard framework requires a degree of creative thinking. **Financial measures** are easy to identify and there are ample sources, both internally and via public sources (e.g., American Lawyer, CitiGroup, PwC, etc.). Clearly, revenue per lawyer and profit per equity partner are critical measures of overall financial performance. A few other significant metrics – specific to the firm’s strategy (e.g., leverage, realization, write-ups, etc.) – should be added to further clarify what drives financial performance vis-à-vis the strategy.

**People, process and client measures** are generally the dimensions that present a greater challenge and require more expansive thinking. A few examples of how a firm can measure progress against each of the other dimensions may help start the discussion and thought process at your firm.

- **People development (i.e., learning and growth)** – measures for learning and growth are often difficult to quantify because, conceptually, the dimension is characterized by so-called “soft” accomplishments. Nevertheless, there are measures that can capture firm-specific growth relative to people development. And, it is a critically important dimension in a professional service firm.
  - Growth in billing rates and/or realization on standard rates can be a very valid quantitative measure of learning and growth – after all, if people are learning and growing, their value to the market (measured by rates and realization) is highly relevant.
  - Firms targeting local or regional pre-eminence (in selected practices or firm-wide) can use third party listings (e.g., Best Lawyers in America, Chambers USA) as a surrogate for external recognition of the quality of its professionals.
  - Other information sources can be used creatively as well – including CLE statistics (internally and externally earned), retention rates of junior lawyers, exit interview feedback, and employee alignment/satisfaction surveys.
- **Internal process improvement** – depending on the focus of a firm’s strategy, this dimension is fertile ground for measurement – both via internally generated statistics and external benchmarks.
  - The industry’s prevailing benchmarking surveys (e.g., CitiGroup, PwC, etc.) provide a raft of comparative metrics to enable firms to target and track improvement across a raft of internal processes (e.g., days in WIP, aged receivables, administrative costs, etc.).
  - However, over-reliance on those statistics can lead to an excess focus on processes unrelated to client service. Thus, it is important to consider metrics related more directly to service delivery as well (e.g., staffing ratios, leverage, blend rates realized, etc.).
- **Client satisfaction** – in some markets, syndicated research can help to provide direct feedback on how the firm is perceived relative to competing organizations. Proprietary client surveys also provide valuable measures for the client dimension. Other creative metrics include cross-marketed revenues; number of clients over some threshold (e.g., number of \$100,000 clients, \$1million clients, etc.); percentage of a partner’s billings performed by others; and share of the top 20% of clients’ legal spending (note: this requires asking clients what percentage of their outside legal spending your firm represents).

### **LIKELY OBJECTIONS TO THE BALANCED SCORECARD**

Ironically, lawyers are incredibly adept at performing to nearly any measurable goal put before them, yet they resist new metrics with remarkable ferocity. Perhaps it is simply human nature (i.e., aversion to change). Nevertheless, we anticipate resistance to the balanced scorecard in most firms that adopt the tool. Among the likely objections:

- *“All these measures boil down to NIPP anyway, who are we kidding?”* – to which we would argue, *“not if you do this right.”* While all business endeavors are at some level about creating profits, balanced scorecard metrics are intended to provide sign-posts along the road to successful (or failing) strategy implementation.
- *“Measures that aren’t tied to partner compensation are meaningless, if it isn’t tied to partner comp, it won’t happen.”* First, there is a grain of truth to this objection and we believe strategy implementation and partner compensation should be aligned. But, in reality, there are many things occurring in a successful law firm that are not tied directly to partner compensation (for instance, associate training and mentoring is remarkably under-compensated). The balanced scorecard shines a spotlight on some of the most important activities beyond profit creation.

- *“If you tie this to partner compensation, you are changing the rules in the middle of the game.”* Frankly, the external marketplace is changing the rules of the game. Strategy is a means of responding to and benefiting from that change. The scorecard is simply a tool to improve strategy implementation – to improve the probability of success. If the firm determines that something is strategically important, then the rules should change to reward what is important.
- *“This tool doesn’t apply to law firms, it is too complicated and it is too hard to measure these things.”* Over the years, we have heard that many things didn’t apply to law firms (e.g., strategic planning, marketing, consolidation), yet in the end it was clear that they did. The key to making this tool workable for law firm management is keeping it relatively simple.
  - Focus primarily on firm level metrics (major practices or departments may have a cut at it as well) – that’s it, do not make this an exercise in tracking and measuring everything.
  - Return to the three key questions in the previous section – build on existing systems and metrics and use readily available *“surrogate measures.”*

In the end, all of the objections can be refuted with a simple point. Namely, this is a proven tool used successfully by companies in a wide range of industries. If it can keep a firm focused on what is important throughout the implementation process, why wouldn’t a sophisticated law firm adopt (and adapt) the tool?

### **SMOCK♦STERLING’S RECOMMENDATIONS ON THE BALANCED SCORECARD**

We are not dogmatic advocates of the balanced scorecard. Certainly, we have seen the tool used quite successfully – particularly on the commercial side of our practice. And, we strongly believe that for firms that have struggled with implementation in the past (i.e., agreeing on a compelling strategy, but then falling well short in implementation), this is a tool that can dramatically improve focus, accountability, and execution. But, other factors are also important (e.g., communication, involvement in strategy development, action planning and budgeting, organizational and technology alignment, etc.) in driving successful implementation. They cannot be ignored or scrapped for the balanced scorecard.

For those adopting this proven and powerful tool, we recommend:

- Revisiting your firm’s strategy to ensure it is well defined and widely understood
- Put initial emphasis on the client and people development dimensions – they are the most critical in a professional services environment and the most easily understood across the organization
- Avoid creating measures that cannot be readily tracked via existing systems and/or easily accessed sources – the idea is to focus on implementation, not on gathering data or committing considerable resources to brand new data gathering
- Keep the metrics at a high level and measure macro level performance – the firm, its departments and its practice groups can track many other statistics at a tactical level, but balanced scorecard metrics should remain at a strategic level
- Build on existing, widely understood measures where ever possible – the more the metrics focus on things people understand to be important already, the better their chance of driving successful implementation of the strategy across the law firm.

As always, Smock♦Sterling stands ready to assist your firm with strategy development and implementation. If you have questions regarding the balanced scorecard, its application in to law firm management or other topics, please call any of us directly.

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