What Do You Really Know About Your Best Clients?

By breaking down clients into segments with similar growth partners, KermaPartners Alliance member Redwood Think Tank found an effective means to better drive marketing and business development strategies.

By Kris Satkunas

At a time when law firm budgets are tighter than ever, the question of how to prioritize marketing resources has taken on a new urgency. In this climate, a number of firms are discovering there is tremendous value in a new type of client profiling that identifies client groups that produce the most value for a firm over time – as well as those that have potential to produce more value.

Breaking a firm's client base into segments that have common growth patterns based on their lifetime value (LTV) to the firm allows managers to learn characteristics about these groups that can drive more effective marketing and business-development strategies.

Developing Client Profiles

At the Redwood Think Tank,[1] we develop analytical approaches that help law firm leaders manage by fact rather than by gut. According to our studies, annual attrition of existing client hours averages 15 percent. Firms can combat client attrition, of course, by expanding their existing relationships. But the effectiveness of this strategy depends upon knowing which relationships are most likely to grow.

One of our recent projects has been to develop a unique approach to segmenting clients that allows firms to identify clients that are of high value over time (in comparison with typical "Top Client" lists, which only rank recent stars). Our approach identifies clients in other important segments as well, such as those that have potential to be strong performers, and clients that once were strong performers but have dropped off in recent years.

This type of client profiling does much more than create a general approach to marketing—it provides immediate actionable information concerning the specific clients firms should target, and why they should take action.

For example:

- This approach illuminates the percentage of a firm's work that comes from clients that are inconsistent in the hours provided to the firm. If that percentage is high, a firm should be focused on identifying which of its inconsistent clients are good candidates for initiatives designed to strengthen those relationships.

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[1] The Redwood Think Tank is an independent research organization. Our members are thought leaders, who represent a broad cross-section of law firm leadership.

- Segmenting clients can help firms identify which practices serve as “feeder” practices that really do attract clients that eventually provide the firm with other types of work as well. This data may support anecdotal convictions (e.g., litigation to compliance), or not.

- Client profiling identifies relatively large clients that have been left off recent ‘Top Clients’ lists because they haven’t provided as much recent work as newer clients. While it is human nature to focus on newer, sexier clients, firms neglect older, stable clients to their peril.

The Competitive Landscape

The goal of client profiling is to segment a firm’s clients to help strategically prioritize business-development efforts. Our researchers begin by examining a firm’s full client history to assess the lifetime values (LTV) of all clients.

We build upon our LTV analysis by incorporating knowledge about the firm’s relationship strength with clients and its competitors for client business. The compilation provides firms with a full picture of the progress of their key client relationships, and separates clients into low-opportunity clients and clients that can be targeted for growth.

An exciting advantage to client profiling is that it enables firms not only to study their own relationships with their clients—it provides a powerful context in which to study competitive data on client relationships with other firms. For example, once a firm measures how much work a key client is sending to a given practice, the firm can look at the work of the same type the client is sending to competitor firms. By measuring both of these over the lifetime of the client’s relationship with the firm, we can determine whether a firm’s share of the client’s work is growing or shrinking.

Delivering Consistent Value

A crucial component of client profiling is the recognition that clients that produce high value consistently are much more valuable to a firm than clients that are less consistent. So we divide clients into four Quadrants:

> Quadrant 1 - Clients that deliver the largest amount of work with the most consistency
> Quadrant 2 - Clients that deliver large amounts of work with less consistency
> Quadrant 3 - Clients that deliver less work but on a consistent basis
> Quadrant 4 - Clients that deliver less work on a less consistent basis

The example in Figure 1 illustrates a firm with more than 2,400 clients. Quadrant 1 clients provided an average of 2,000 hours per year to the firm on a relatively consistent basis.

Examination of the clients in these four segments revealed that the quadrants needed a finer cut to support the types of targeted business development that was our aim. So we went a step further and broke each quadrant into four subquadrants (see Figure 2).[2] For example, Quadrant 1 was broken into Quad 1A, 1B, 1C and 1D with 1A clients being the best of the best.

How big a difference was there between subquadrants? Within Quad1, it turns out, quite a bit. For one firm, the difference between a 1A client and a 1C client in the average amount of hours provided to the firm a year was a multiplier of five. This of course, reinforces the point that not all stars are alike, and some are really superstars that merit treatment as such.

Looking for Patterns

Once we developed a framework for segmenting clients,[3] the next step was to examine these groups for characteristics that would drive more strategic marketing and business development efforts. What did clients in various segments have in common? Did mature clients in a particular segment follow the same path to get there?

To find answers, we compared every variable that seemed relevant. We started with information that can be gleaned from most firms' internal systems:

- Lifetime hours;
- Average hours;
- Number of practices that provided service to the client;
- Number of partners who worked on client matters;
- Number of top-performing partners (we call them "Tier 1" partners) who worked on client matters;[4]
- Billing rate;
- Realization;
- Matters per year;
- Average matter size;
- Attrition risk.[5]

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[2] Though not perfectly to scale, the size of the bubbles generally indicate the volume of work received from those clients.

[3] In segmenting clients into groups, we anchored each client to the first month they provided work to the firm so we could compare the introductory period of each client on the same footing—just as a pediatrician benchmarks each child according to other children of the same age.

[4] We defined Tier 1 partners as the top ten percent of a firm's partners, based upon their standard billing rate.

[5] The Redwood Think Tank has studied client attrition risk, and developed approaches for law firms to track this issue. *See* Kris Satkunas, "Client Attrition: More Tools to Stem the Trickle of Lost Work," *Accounting and Financial Planning* (ALM Law Journal Newsletters), June 2008, at http://www.lexisnexis.com/redwood-analytics/pdf/Client%20Attrition%202.pdf; and Kris Satkunas, "Client

Leading Indicators

Client segmentation has resulted in the ability to clearly identify many of the leading indicators that separate high-LTV clients from others.

At one firm, for example:

- Clients in quadrants 1 and 2 provided nearly identical amounts of volume in their first year at the firm. But by the second year, quadrant 1 clients continued to grow while most quadrant 2 clients plateaued or dropped off in terms of volume.

- Quadrant 1A clients were more likely to have a "Tier 1" partner involved in their relationship early in their lifetime.

- Quadrant 1A and 1B clients were highly likely to have started their lifetime by providing a particular type of work to the firm.

Having employed this segmentation approach with several firms, we have learned that the value of much of this information is firm-specific; the paths to developing successful client relationships at one firm may not apply at another. To craft effective business development strategies, firms need to analyze the unique patterns of their own clients.

Prioritizing BD Efforts

Armed with deep knowledge about clients, managers can apply this intelligence to develop focused business-development strategies.

Our analysis produces four quadrants with four subquadrants (i.e., 16 client-segments) – that's a lot of bubbles. We can pop a few right now. One of the keys to successful marketing is prioritization, and if you examine the client segments, the clients in the top row –1A, 1B, 2A and 2B – outdistance clients in the other segments in volume by quite a bit. These are the clients that produce high-volume work, though their consistency varies.

On the other hand, the bottom row –3C, 3D, 4C, 4D and arguably the row above it, contains clients that produce volume so low that regardless of consistency should never be the focus of BD efforts.

However, consider clients in the subquadrants around the center of the chart—those in 1D, 2C, 3B and 4A are not that far apart from each other, and therefore could easily move from one quadrant to another. This too is useful information; clients in these quadrants that exhibit characteristics of 1A clients may be worth treating as stars-in-training.

Client Profiles

Attrition Analytics: Firms Can Control Whether Clients Stay or Go," *Accounting and Financial Planning*, January 2007, at http://www.lexisnexis.com/redwood-analytics/pdf/client_attrition_analytics.pdf.

Creating marketing plans for these client segments differs dramatically from the approach many firms take to create "top" client lists because it drives BD efforts according to client behavior over the long term and client potential, rather than merely by how much revenue they produced the previous year.

Superstars

Chances are that most firms will recognize the names of the relatively few clients that fall into subquadrant 1A. These clients likely represent a significant portion of the firm's annual revenue and have dependably brought the firm enormous amounts of work for years. These are the clients for which a firm should make sure it has "Star" client teams in place.

It's notable that a firm's superstars almost always start out as high-volume clients (though they wouldn't fall into Quadrant 1 until they provided high-volume work consistently). The segmentation approach provides the tools to analyze information about the early, formative years of client relationships. Our research here validates the findings of an early Think Tank study that debunked the "Acorn Theory".[6]

Potential Stars

You've looked under the hood, and know the patterns the firm's best clients, i.e. 1A clients, have exhibited over their lifetime. We've pointed out that 1A clients almost always start their lifetimes providing high volumes of work. So a logical approach would be to identify high-volume clients that are relatively new (1 - 4 years old). These clients will fall into subquadrants 2A or 2B because they haven't yet provided enough consistency to be a Quadrant 1 client.

Perhaps your analysis will reveal that 1A clients typically started by providing large amounts of a particular type of work. This will help further narrow down the pool of potential stars.

It is particularly helpful when evaluating potential stars to bring in competitive intelligence. To really understand the true potential of a prospect, it's necessary to know the amount of legal work that is provided to all firms, and to have some knowledge of the company's growth potential. There are several tools available in the marketplace that support this type of analysis.

Backsliders

What about a client that used to consistently provide the firm with high volumes of work but either has dropped off in volume or consistency (i.e. moved from Quadrant 1 to

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[6] Ron Paquette, "Cracking the Acorn Theory: Do Small Clients Grow To Be Big Clients?" *Strategies: The Journal of Legal Marketing*, Sept. 2007, at http://www.lexisnexis.com/redwood-analytics/pdf/acorn%20theory%20article.pdf (Noting most large clients began their relationship with firms as large clients).

Quadrant 2 or 3)? The partner with the strongest relationship should be armed with information about its history, as well as competitive data concerning whether they are providing work to other firms.

Loyal But Unknown

Think about quadrant 3, particularly quadrants 3A and 3B. These are clients that have been very consistent in the amount of work they provide, but the volumes are too low for them to have hit the marketing department's radar screen. Note that clients in subquadrants 1C and 1D may fall into this category as well. These clients have been loyal to your firm – perhaps they have other types of work that they provide other firms and don't know you have the strengths to perform well.

Our research has indicated that very few clients move from quadrant 3 to quadrant 1, but that doesn't mean that incremental volume doesn't exist for these clients.

The other group of clients that fall into the "loyal but unknown" group will be those that are dependable but just don't have much legal work. They are unlikely to grow, but since they are loyal, a retention strategy should be in place. Regular touchpoints should be on the roadmap, although perhaps not from top-tier partners.

Given the economic realities of the current climate, most firms will only have resources to focus on the top row of client segment bubbles. But for ambitious firms, it's a good idea to expand the analysis to determine whether any secondary segments deserve a smaller investment of resources. It may turn out that one of these segments only contains ten clients and therefore is an easy project for one member of the BD staff to tackle.

Going Forward

Firms employing client profiling have provided an enthusiastic response. We will report back on their efforts and any refinements to our approach.

Ultimately, business analytics methods and tools are developed to drive improved performance. Client segmentation has the potential to provide a more focused, strategic approach to business development. Given the economic climate, the timing is right for an approach that helps firms spend their marketing resources wisely.

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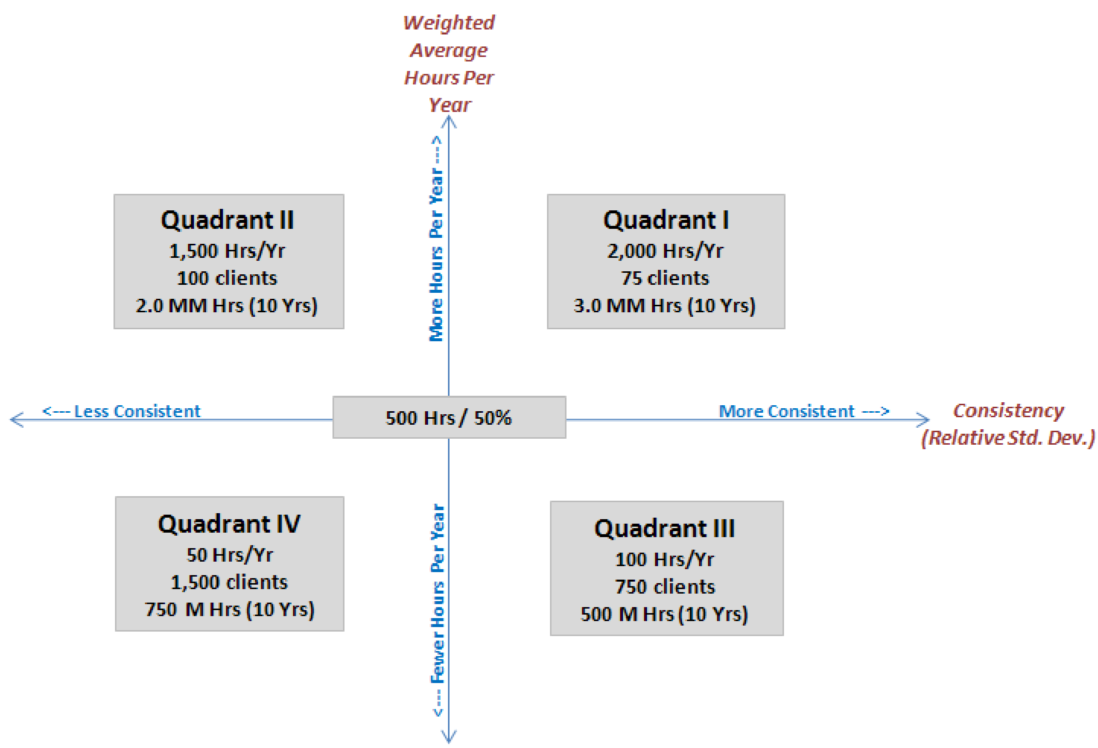
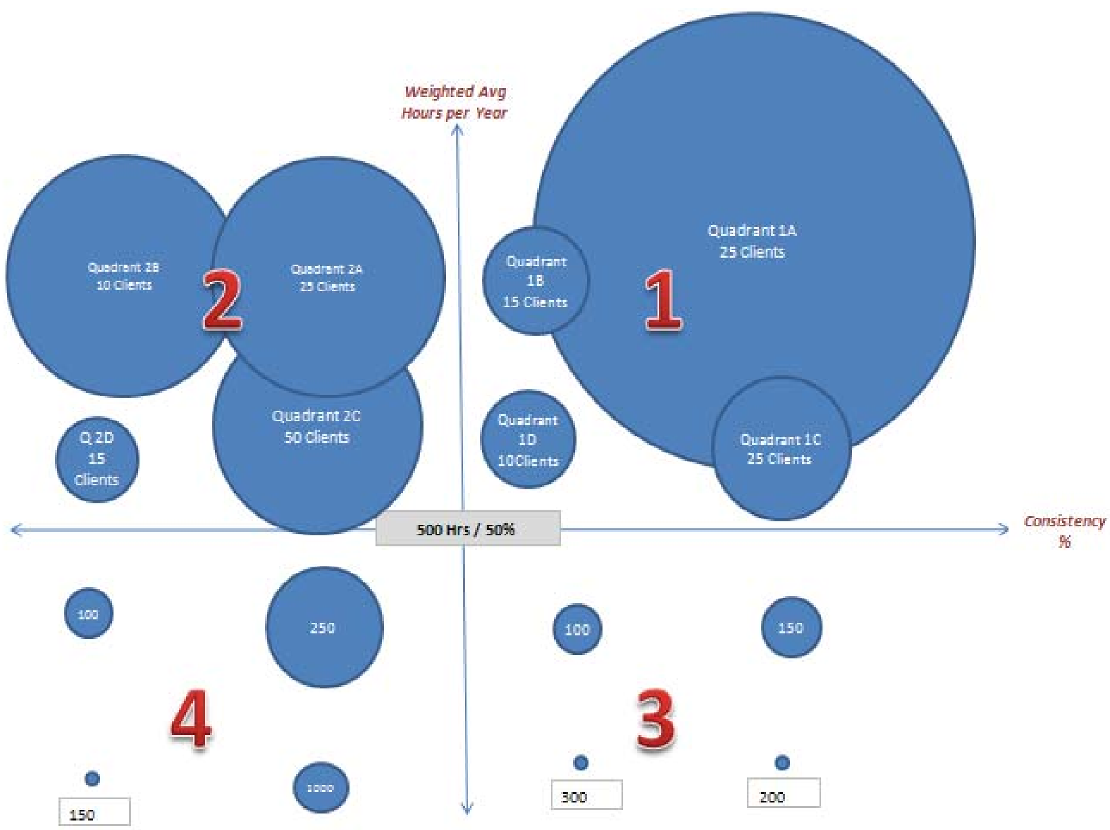

Weighted Average Hours Per Year
More Hours Per Year --->
Quadrant II
1,500 Hrs/Yr
100 clients
2.0 MM Hrs (10 Yrs)
Quadrant I
2,000 Hrs/Yr
75 clients
3.0 MM Hrs (10 Yrs)
<--- Less Consistent
500 Hrs / 50%
More Consistent --->
Consistency (Relative Std. Dev.)
Quadrant IV
50 Hrs/Yr
1,500 clients
750 M Hrs (10 Yrs)
Quadrant III
100 Hrs/Yr
750 clients
500 M Hrs (10 Yrs)
<--- Fewer Hours Per Year


Weighted Avg Hours per Year
Quadrant 2B
10 Clients
2
Quadrant 2A
25 Clients
Quadrant 1B
15 Clients
Quadrant 1A
25 Clients
1
Q 2D
15
Clients
Quadrant 2C
50 Clients
Quadrant 1D
10Clients
Quadrant 1C
25 Clients
500 Hrs / 50%
Consistency %
100
250
100
150
4
3
150
1000
300
200