

# CLIENT “DECILES” HELP FOCUS STRATEGY

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RESEARCH CONDUCTED BY THE REDWOOD THINK TANK CONFIRMS WHAT MANY BUSINESS CONSULTANTS TELL LAW FIRM MANAGERS — THAT THEY SHOULD BE JUDICIOUS IN DEVOTING RESOURCES TO SMALL CLIENTS. OUR DATA INDICATES THAT SMALL CLIENTS RARELY GROW INTO LARGE CLIENTS AND PERFORM WORSE THAN LARGE CLIENTS ACROSS MULTIPLE BUSINESS METRICS.

At Redwood, we approach client size analysis by categorizing clients according to decile based upon the amount of standard value each client provides the firm in a year. Each decile has the same number of clients but very different standard values. Decile 1 is comprised of the top 10 percent of the firm’s largest clients in terms of standard value. Each subsequent decile contains the next 10 percent of the firm’s clients.

The Redwood Think Tank examined 16 law firms of varying sizes and found that on average, the top 20 percent of clients — those in Deciles 1 and 2 — provided firms with 90 percent of their standard value. We call it the 90/20 rule (see Fig. 1).

Fourteen of the 16 firms fell within 3 percent (one standard deviation) of this average. And while conventional wisdom states that client revenue tends to be more concentrated at smaller firms (i.e., one large client can dominate the firm’s bottom line) this does not seem to be the case in our sample. There was no correlation between firm size and client concentration.

After categorizing the clients of these 16 firms into deciles, we decided to look at objective metrics that we could normalize for all the firms. We chose to look at billing realization, client investment speed (a proxy for inventory management), standard rate (to measure leverage) and practice concentration. The results of our study are discussed in more detail below.

## A PROXY FOR PROFITABILITY

Billing realization is a critical performance metric, and often is used as a proxy for client profitability. Anecdotally, we’ve heard that larger clients tend to demand the highest discounts, and therefore firm managers expect to see higher realization from smaller clients. In fact, the data suggest almost the

FIGURE 1

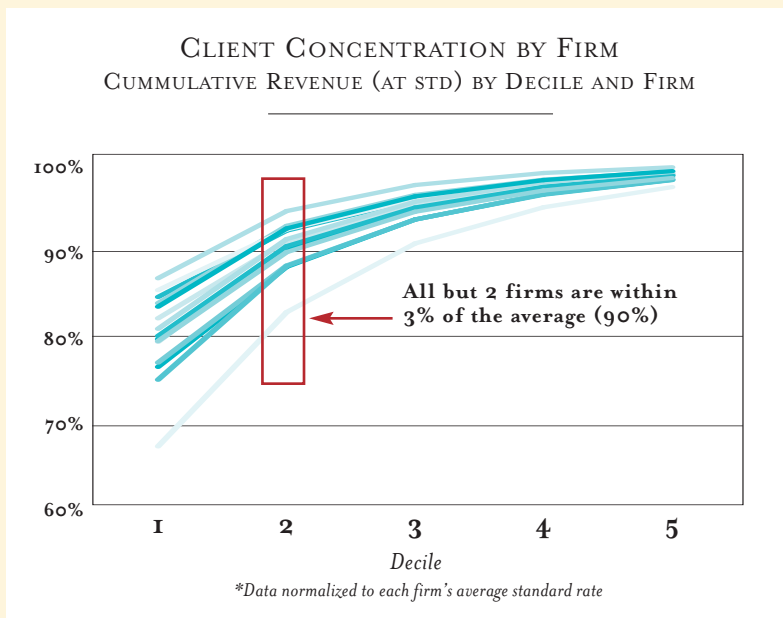
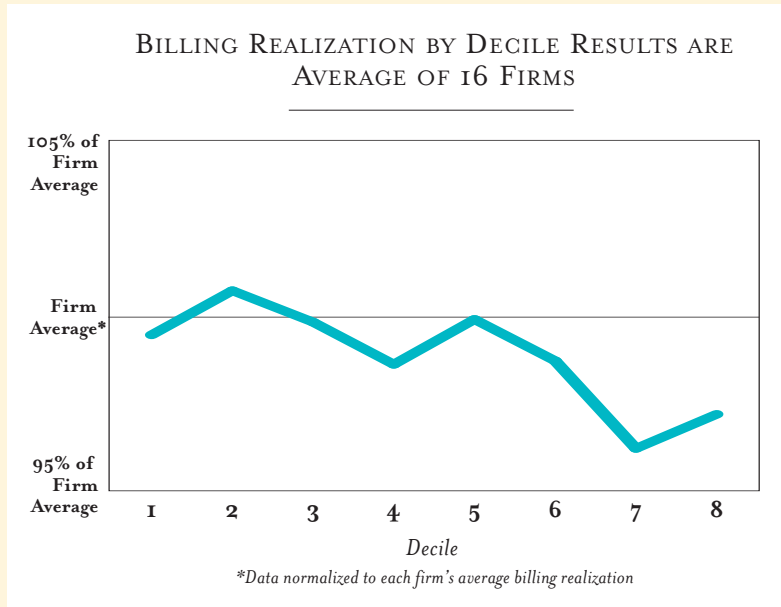


FIGURE 2



opposite. In the group of firms studied by the Redwood Think Tank, the clients in Deciles 4 and lower had worse realization rates than those in Deciles 1-3. (See Fig. 2.)

Interestingly, the clients with the highest realization were those in Decile 2. In other words, the very largest clients do receive a larger discount from standard rates. However, the real take-away from this data belongs to the clients in Deciles 4 and 7. The realization rates of these clients dip significantly below the firm average.

### INVENTORY MANAGEMENT

In examining client investment speed by decile, the Redwood Think Tank discovered that firms take longer to bill and

collect from smaller clients than from larger ones. A possible explanation may be a natural tendency to focus on the largest outstanding balances.

### RESOURCE ALLOCATION

An analysis of deciles provides similar insight into firm leverage. We used standard rate measurement as a proxy for leverage, because higher standard rates usually mean higher-rate timekeepers are serving the clients being measured.

The Redwood Think Tank examined standard rates across the 16 firms studied, revealing that clients in Deciles 2-7 had higher standard rates than clients in Decile 1 (see Fig. 3), indicating that smaller clients' leverage is not as good as that of the largest clients.

Good news relative to the firms' smallest clients is that those in Deciles 4-8 had lower standard rates than clients in Deciles 2 and 3.

### CROSS-SELLING, ATTRITION AND ACORNS

Examining the practice concentration of client matters by decile produces expected results — smaller clients have less diverse books of business. In fact, very few small clients provide multiple types of work. This makes sense, as firms have more opportunities to cross-sell larger clients.

In a separate study performed by the Redwood Think Tank using client deciles to focus specifically on attrition, we found that the attrition rates of smaller clients were much higher than those of larger clients. (Other factors affecting attrition rates include length of time a client has been with a firm, amount of successful cross-selling that has occurred and partner involvement in matters.)

The Redwood Think Tank also employed decile analysis to examine the so-called "Acorn Theory" that small clients, if nurtured, eventually grow to be large clients. Our study indicated that this theory rarely holds true in practice. At one firm we studied we found that approximately three-quarters of the firm's top five percent of

