

## Milking a Cash Cow

By H. Edward Wesemann

With all of the reporting capabilities of sophisticated time and billing systems, it is easy to lose sight of the most basic rule of law firm economics: Cash in must exceed cash out. To that end, one of the most valuable assets any business can have is a cash cow. Yet, we find that many law firms never benefit from practices that could be cash cows because they just don't seem to understand the concept. I know, it sounds pretty simple — bleed as much revenue as you can out of practice areas in which your firm has a dominant position. But, somehow, we keep screwing it up.

### BASIC CONCEPTS

For the record, the concept of cash cows was developed 30 years ago by Bruce Henderson, founder of Boston Consulting Group. He suggested that business units (for our purposes practice areas) could be categorized by their com-

parative growth rates and share of the marketplace (see Figure 1 on page 5). By market share we are talking about the degree to which a specific practice of a firm is recognized as having a dominant position in a city or region (or — best of all worlds — nationally or internationally) and has a big chunk of the available client work in that specific practice. The growth rate, on the other hand, indicates how rapidly demand for the service is increasing.

At any given time, some practices are growing: The overall volume of work available from clients is increasing and, typically, the firm is attempting to increase the amount of work it does in the area (market share). And, at some point, growth slows down, practices become mature, and the law firm's positions in its markets become solidified.

### STARS

Stars are practice areas where the demand for services by clients is growing and which law firms with a strong market position hope to turn into future cash cows. Accordingly, these firms are attempting to grow these practices through lateral acquisition of attorneys with capability and business in the area or by developing the capabilities of lawyers currently in other areas within the firm. At the same time, firms that do not have a strong market position are constantly seeking to acquire laterals or poach whole practice groups from

competitors who have strength.

When we talk about practice areas, the definition can be as broad or limited as the firm wants it to be. Current examples of stars are biotech, certain specialized areas of intellectual property, some emerging corporate funding vehicles, and, in some markets, white collar crime defense.

The point here is that while the firm's financial reporting system may show a profit on stars, these practices actually consume cash. The cash is used to pay headhunter fees, fund the pipeline deficit until a new lateral's collections catch up to the cost of performing work, and to pay compensation in excess of value to get or keep lawyers in hot practice areas. When firms say they are investing in a practice area, this is what they are talking about.

### CASH COWS

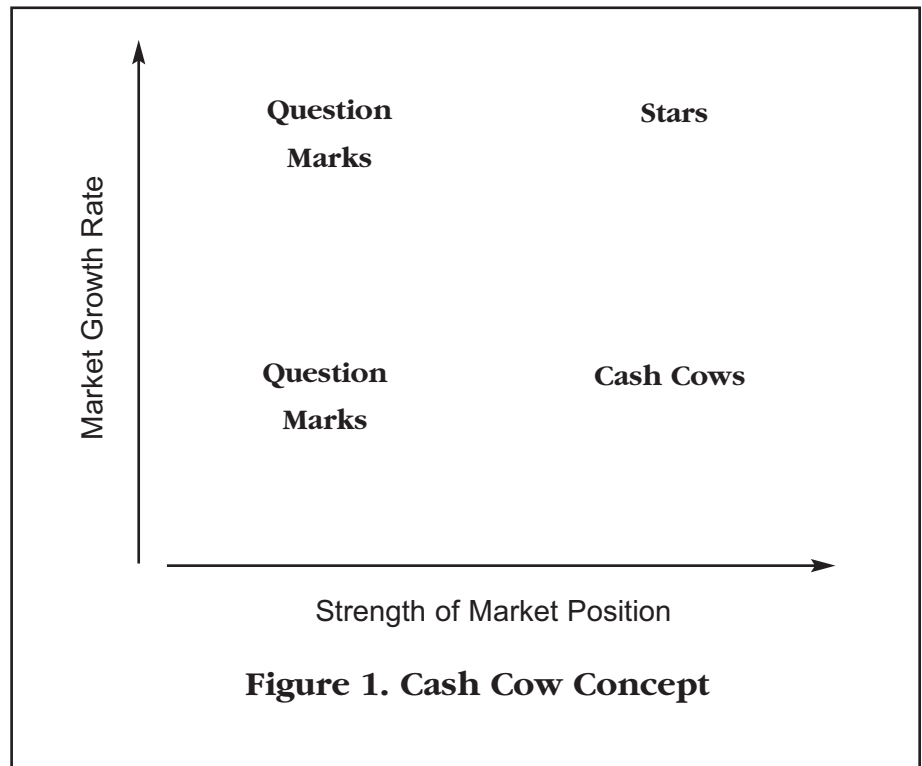
Eventually, all practices reach maturity where the growth of demand slows (please note that the growth slows, not the actual demand) and those law firms that are going to enter the practice have largely already done so. At this point, one of two things happens — the practice becomes (in Henderson's terminology) a cash cow or a dog. The firms that invested successfully in the practice and have created a position of dominance in the marketplace can enjoy the positive cash that the practice generates. They are at the point where it is

---

**H. Edward Wesemann**, an *A&FP* Board member and partner of Kerma Partners, consults internationally on law firm cultural, strategy, and profitability issues. He can be contacted at 877-922-2040 or [Ed.Wesemann@KermaPartners.com](mailto:Ed.Wesemann@KermaPartners.com). This article appears in Wesemann's new book, *Looking Tall by Standing Next to Short People & Other Techniques for Managing a Law Firm*. © 2007 H. Edward Wesemann.

not necessary to spend cash on growing the practice. Laterals who were overpaid when they came in have rationalized themselves in the compensation system, and competitors are less eager to pay premiums to raid dominant firms. In fact, the more entrepreneurial of the partners who created the star practice have now morphed themselves into new star practices. This is the cash cow: a practice that generates more collected cash income than is expended to maintain the practice. The formula for calculating this is simple (see Figure 2).

For many firms certain forms of product liability and mass tort litigation defense represent cash cows. Traditional labor, environmental, and some areas of commercial real estate are examples for other firms.



$$\text{Cash Collected for Work Performed} - \text{Prorated Compensation of Lawyers Doing Work} - \text{Prorated Overhead Costs} = \text{Positive (negative) Cash}$$

**Figure 2. Formula for Identifying a Cash Cow**

## DOGS

When a firm invests in a star but fails to build a position of dominance in its market, the worst of all worlds occurs, a weak market position in a mature, slow-growing practice area. At best, such practice areas are break-even, generating barely enough cash to cover expenses and pay the partners involved in the practice but not leaving any cash on the table. Firms will often hang on to dogs as a means of keeping marginal partners busy under the rationale that the alternative is even less attractive. The argument can sometimes be made that operating the practice on a break-even basis provides synergy to help grow stars or performs some other social good such as training associates.

Not surprisingly, the best examples of dogs are commodity practices where a firm only has a toe in the water. But almost any practice where growth has slowed can be a dog if the firm has a weak market position. Intellectual property, a recent star, can quickly become a dog as firms with small, weak patent prosecution and litigation practices can attest.

## MILKING THE CASH COW

When we have occasion to interview or survey partners, we often hear comments like, "We always invest our profits in growth but there never seems to be a return on investment." Here are seven rules to make sure the partners benefit from cash cows:

**Rule #1: Starve cash cows.** The key to milking a cash cow is to enjoy the return on previous investments. That means you only want to put as much money in as necessary to perform the work. Under no circumstances bring in lateral attorneys unless they are somehow bringing their work in progress and accounts receivable with them. Discipline yourself — the time for investment is over and now is the time to yield a return. If attrition causes a need for people, recruit them internally from the dogs.

**Rule #2: Understand the market.** Practices rarely go from high growth to maturity overnight. In many law firms the partners have more money invested in building practices than all of their

### Use Your Data Warehouse/Business Intelligence System to Spot Cash Cows, Stars, and Dogs

Practice Area	Star	Cash Cow	Dog
Number of clients	Growing	Growing to Stable	Stable to Declining
FTE	Growing	Stable	Stable to Declining
Leverage Ratio	Low	High	—
Capacity	High	Low	—
Production Value: Cash Receipts Ratio	> 1	1	<= 1
Profitability of Working Attorneys	Low	High	Low

Matrix designed by **Kris Satkunas**, director of the Redwood Think Tank, ([KSatkunas@redwoodanalytics.com](mailto:KSatkunas@redwoodanalytics.com)).

401(k)s combined, but management of the asset is all but ignored. Devote the internal resources to looking for signs that practice growth is slowing. It doesn't take much — a paralegal dedicating a couple of hours a week to tracking practice growth, measuring files opened versus files closed, and 15 minutes at each practice group meeting will go a long way toward enhancing your ability to get it right.

**Rule #3: Talk to your clients.** Over the years, we have done a lot of client interviews to understand where practice growth will occur. Amazingly the clients are almost always right — certainly right more often than lawyers. A simple technique is to take representative clients that give the firm work in star practice areas to lunch once a quarter and pick their brains. Don't worry about trying to sell them something — spend the time understanding where their business and industry is going.

**Rule #4: Pick your stars and be aggressive with them.** If you find an area of practice that is growing and the firm has a legitimate path to achieving a strong market position, devote the

resources to achieving that position. Remember, the worst of all worlds is to have made a moderate investment and failing to achieve dominance. Then you are enabling a future dog. But don't be too broad in your aggressiveness. All areas of an overall practice group do not grow and reach maturity at the same time. Manage risk by focusing on highly specific practices. Increase risk by expanding focus only when you have achieved market strength in the original area.

**Rule #5: Weigh the risk/reward relationship of investing in stars versus passing rewards on to the partners.** Long-range viewpoints are important, but balance them with the need for current returns on investments. Often when we see severe shifts in law firms' management perspective from long-term to extreme short-term it is a result of the firm's failure to ever actually reap the rewards of past investments.

**Rule #6: Cash cows can live on for a long time.** Don't let the name fool you into forgetting the need for the basics of operating a cash cow (such as

keeping billing rates competitive, monitoring client satisfaction, and developing business from new clients).

**Rule #7: Let sleeping dogs lie.** Never, ever invest in a practice that you have identified as a dog. If you have excess profits burning a hole in your pocket, buy your partners' assistants Rolexes. That will probably cost about the same as investing in a dog and most likely do more to create profitability.

### CONCLUSION

The moral to this story: Law firms that are able to milk cash cows are not beneficiaries from dumb luck. That is the way well-managed law firms create leverage to generate profits.

