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Client Concentration

There is always a bias towards metrics on which one performs well.

Some firms are proud of their focus on a small number of significant client relationships. Other firms focus on the fact that their client base is very extensive and not overly concentrated, with no client accounting for more than a very small percentage of their revenue.

There are, of course, pros and cons of each and a critical starting point for considering what is best for any firm is its current position and ability to change this. How many clients does the firm currently have? What proportion of revenue, and more importantly profit, is generated from the largest 10, 25, 100 clients? What proportion of clients is billed only a minor amount? In aggregate what proportion of the firm's revenue and profit do such clients generate? Are such clients of strategic value?

In our experience we have found that for the majority of firms aiming for larger and deeper client relationships should be a much higher priority. While this brings with it the risk of being overly dependent on too few clients, these risks are almost always outweighed by the benefits of fewer larger client relationships and, of course, acting for a large number of smaller clients is not without its own challenges.

The advantages of a having substantial client relationships are broad.

First, these relationships tend to be long term and institutional in nature. While firms need to continue to perform at a high level to retain the work and win new work, the institutional knowledge and relationships provide a major advantage and a barrier to competitors. Furthermore, firms with fewer relationships can focus on cultivating and managing these.

Second, large relationships tend to be multi-practice. Not only does this help solidify the relationship, but also serves to diversify the risk since there are many points of contact between the firm and the client. Multi-practice relationships also tend to mean the work is more complex and requires more specialist talent. Not only is such work more professionally rewarding for lawyers, it tends also to be more lucrative for the firm. It often has the added bonus of contributing positively to a firm's market reputation and profile with the firm seen to be working on major deals and cases for leading clients.

Third, such relationships are less likely to be subject to risk from a key partner defection. Even the lead relationship partner may find it difficult to move more than a small portion of the firm's work (if even that) should he or she depart.

In fact, departing partners (and their new firms) are frequently unpleasantly surprised at the strength of the incumbent firm's relationship over the individual partner relationship.

On the negative side, large relationships can be regarded as putting too many eggs in one basket. Certainly some firms have suffered when a key client has been acquired, or went bankrupt, or decided to change direction in their approach to hiring outside counsel. Normally, however, there is at least some warning and also the wind down of work tends to occur over a period of time.

A second downside of very significant relationships and in turn heavy dependency on a small number of clients is that firms can find themselves squeezed on price with clients utilizing the advantages of the leverage they have. We do often find that law firms achieve lower realization on at least some of their most significant clients – a clear indicator of this phenomenon.

By contrast, while firms with a large number of small clients are not at risk of losing a significant portion of their revenue with the loss of a single client, smaller relationships tend to be more single matter or transactional in nature, more dependent on single partners or practices, and more subject to shifts in client buying patterns. And the risk of losing the client with a partner departure is not only higher but increasingly common.

Profitability too can be as much or more of a challenge with smaller relationships as with large ones. The work can be price sensitive if it is routine and may also be subject to demanding procurement or RFP processes. And the time and administrative investment required to win the work, undertake client acceptance and set-up procedures and then manage the relationship is likely to be higher relative to the revenue compared to firms with fewer, large relationships. Utilization also tends to be lower in firms with a large number of small clients - except where the firm has in place effective procedures for managing such work. Quite simply it is much more challenging to achieve high utilization when dealing with a large number of small matters during the course of a day than a small number of large ones.

The argument put forward in many firms for continuing to accept small clients is that they may become the next $1 million or $10 million client. Such transitions are in reality extra-ordinarily rare, and besides firms can maintain the flexibility to accept smaller clients with particular promise without having a long tail of unprofitable clients.

Shifting the focus of a firm to larger client relationships is not without challenges. First, it is of course critical to have the practice mix, depth of capability and level of sophistication to meet the broader and more demanding needs of the desired clients. The most persuasive business developer won't be able to overcome a mismatch between client needs and expectations and firm service capabilities.

Second, the firm needs to support client team management. It is true that a small number of firms manage large relationships very effectively without formal processes in place but this is rare.

Third, the firm's values, culture and compensation system need to encourage and reward firm performance, team work and cross servicing. Firms that are heavily focused on individual performance in evaluating and rewarding partners tend to be ones where client relationships are limited.

Striking the right balance between large client relationships and a diverse set of smaller client relationships is a challenge. For firms that choose to have a large number of smaller relationships it is becoming ever more important to ensure that such work is undertaken in the most streamlined and efficient fashion. Overall, however, it is the firms with fewer, larger clients that are more likely to be seen as market leaders, have more satisfied lawyers, and be more profitable.

London

Principal: Giles Rubens
giles.rubens@fairfaxassociates.com
44 (0)20 3633 3943

Washington

Principal: Lisa Smith
lisa.smith@fairfaxassociates.com
202.365.4180

California

Principal: Kristin Stark
kristin.stark@fairfaxassociates.com
415.215.9294