

# Key Metrics to Run Your Law Firm Profitably

December 1, 2011

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# Agenda

- Introduction
  - Importance of getting Managing Partner to focus on profitability
  - How to educate partners about profitability
- Key performance indicators
  - Define what is important
  - Calculate and measure what is important
  - Improve metrics, performance and profitability

# Focus on Profitability

- Managing Partners are responsible for the strategic vision of the firm and for holding everybody accountable for performance.
- What contributes to act against these goals?
  - Practicing Law
  - Other partners with conflicting goals
  - Managing Partner not prepared to stand up to other partners for the good of the firm
  - Too much focus on **Expenses**; not enough focus on **Revenues**

# Law Firm Profitability

Firms do not grow  
by focusing on  
**Expenses**

Firms grow (and therefore Profits per Partner grow)  
by focusing on **Revenue**

# Educate Partners on Profitability

- What attorneys say about financial data:

“I am only interested in how much cash is collected on my clients”

“We need to focus on cutting back on the firm’s expenses – that is how we are going to make more money!”

“I rarely read all the financial reports I am given”

“I need the financial info summarized in graphical form”

“We don’t need to retain capital”

“How can we have taxable income if we don’t have any cash?”

# Key Profitability Drivers

- **Hours**
- Utilization
- Average Bill Rate
- Time Value Added
- Fee Billings
- Realization
- Fee Receipts
- Income before shareholder compensation
- Net Income
- A/R Days Outstanding
- WIP Days Outstanding
- Leverage

# Hours

- What are the hours?
- Make hours worked an important "key indicator of profitability" in your firm
- Hours should be tracked daily
- Partner chargeability. What is it at your firm?
- Hours are best indication of real growth
- Recording daily increases accuracy and time by 5% vs. monthly
- Budget considering seasonality and vacation trends

# Billable Hours

		Jan	Feb	Mar
Attorney	CY	150	200	130
	CYTD	150	350	480
	PY	190	180	100
	PTD	190	370	470
	Budget	200	160	150
	BYTD	200	360	510
	CY vs PY	-40	20	30
	CYTD vs PYTD	-40	-20	<b>10</b>
	CY vs Budget	-50	40	-20
	CYTD vs BYTD	-50	-10	<b>-30</b>

# Hours Hi-Lo

		CM	YTD	
Attorney #1		210	420	
#2		180	400	
#3		150	300	
#4		140	290	
		680	1410	

# Key Profitability Drivers

- Hours
- Utilization

**Billable Hours**

**Divided by**

**Total Hours**

**1600/2500 = 64%**

# Total Allocation of Hours

- Billable for owner 1,600 - 1,700
- Administration 200
- Marketing 300
- Vacation /Holiday 200
- Other 200
- Total 2,500 - 2,600
- 10 total hours - five days per week.

# Utilization Reports

- Tracking Utilization monthly
- Comparing annual trends
- Analyzing seasonality
- Benchmarking with other firms
- “Culture” should not be an excuse for lack of accountability
- Productive non-chargeable hours
- What is **scheduling** process at your firm?
- How do you detect if people are unscheduled, appropriately scheduled or over-scheduled?

# Dashboard Report

HOURS:		CY	Budget	PY	Var bud	%	Var PY	%
	total hours worked current month	2,900	3,000	3,100	(100)	(3%)	(200)	(3%)
	total hours worked QTD	5,600	6,000	5,900	(400)	(7%)	(300)	(7%)
	total hours worked year-to-date	5,600	6,000	5,900	(400)	(7%)	(300)	(7%)
UTILIZATION:		CY	Budget	PY	Var bud	%	Var PY	%
	total hours worked/total hours CM	75%	80%	65%	(5%)		10%	
	total hours worked/total hours YTD	72%	80%	70%	(8%)		2%	

# Utilization Grid

$$\text{UTILIZATION RATE} = \frac{\text{Total Billable Hours for the period}}{\text{Total Hours for the period}}$$

UTILIZATION RATE	HIGH	<b>Scheduling Problem? Working enough?</b>	<b>The Goal !! But Enough Delegation</b>
	LOW	<b>Motivation / Supervision Problem Are they billing all time actually worked?</b>	<b>"Burnout" possibility Manage productive non- chargeable hours</b>
		BILLABLE HOURS	HIGH

# Key Profitability Drivers

- Hours
- Utilization
- **Average Bill Rate**
  - **Billings**
  - **Divided by**
  - **Billable hours**
- **Time Value Added**
  - **Billable hours**
  - **Times**
  - **Standard Billing rate**

# Average Billing Rate

- Review this by practice area
  - Mature with flat or declining average billing rates for a commodity type practice.
  - HOT and cutting edge can command higher billing rates.
- This information is a lead indicator of firm's growth potential by practice areas and its competitive advantage.

# Average Billing Rate

- The firm's average billing rate is important to track for trends
  - If the firm has been increasing billing rates, but the average billing rate is going down. Why?
  - There should be a steady increase in the firm's average billing rate. If not, are you losing your competitive advantage?

# Billing Rate and Time Value Added

	Rate	Hours	Time Value Added	change rate	New TVA	change hours	New TVA
Attorney #1	\$ 200	1800	\$ 360,000	\$ 220	\$ 396,000	1,900	\$ 380,000
Attorney #2	\$ 150	1800	\$ 270,000	\$ 160	\$ 288,000	1,900	\$ 285,000
			\$ 630,000		\$ 684,000		\$ 665,000

# Production to Salaries Ratio

<b>PRODUCTION TO SALARIES RATIO</b>							
			<b>Salary</b>	<b>Hours</b>	<b>Production</b>	<b>Ratio</b>	
			<b>A</b>		<b>Hours x Rate</b>	<b>B</b>	<b>(B / A)</b>
AAA	Partner		\$200,000	1710	\$ 598,500		3.0
BBB	Partner		\$180,000	1650	\$ 511,500		2.8
CCC	Partner		\$160,000	1750	\$ 472,500		3.0
DDD	Associate		\$110,000	1920	\$ 384,000		3.5
EEE	Associate		\$100,000	1950	\$ 370,500		3.7
FFF	Associate		\$90,000	2105	\$ 336,800		3.7
GGG	Associate		\$95,000	2010	\$ 301,500		3.2
HHH	Associate		\$80,000	1900	\$ 285,000		3.6

# Key Profitability Drivers

- Hours
- Utilization
- Average Bill Rate
- Time Value Added
- **Fee Billings**

# Billings

- Total firm billings
- Billing of the firm's top 50 clients
- By area of practice
- By billing and originating attorney
- All billing partners should receive a one-page list of the billings by month for their clients sorted by year-to-date totals.
- Firm's should strive to bill every dollar, every month.
- Cash can be deceiving as an indicator of profitability
- 80/20 rule

# Billing Analysis

CLIENT NAME	AREA OF LAW	ORIGINATING ATTORNEY	MANAGING ATTORNEY	REFERRAL SOURCE	AVG BILL RATE	BILLINGS YTD	BILLINGS PYTD	BILLINGS 2ND PYTD	TOTAL 3 YEAR
#1	LIT	KJK	KJK	BOA	\$ 180	900,000	600,000	300,000	1,800,000
#2	ESTATE	KJK	NFS	F&D	\$ 250	800,000	700,000	800,000	2,300,000
#3	TAX	NFS	KJK	F&D	\$ 360	200,000	100,000	525,000	825,000
#4	CORP	NFS	NFS	ABC	\$ 160	100,000	500,000	25,000	625,000
TOTAL						2,000,000	1,900,000	1,650,000	5,550,000

# Billing Target Analysis By Partner

BILLINGS TARGET ANALYSIS BY PARTNER									
Partner	Month	Actual	Target	Var	Actual YTD	Target YTD	Var YTD		
				Over (Under)				Over (Under)	
AAA	Jan	53,467	55,000	(1,533)	53,467	55,000	(1,533)		
	Feb	61,234	60,000	1,234	114,701	115,000	(299)		
	Mar	63,456	60,000	3,456	178,157	175,000	3,157		
	Apr	54,334	50,000	4,334	232,491	225,000	7,491		
	May	43,403	40,000	3,403	275,894	265,000	10,894		
	Jun	32,454	35,000	(2,546)	308,348	300,000	8,348		
	Jul	37,869	35,000	2,869	346,217	335,000	11,217		
	Aug		35,000			370,000			
	Sep		40,000			410,000			
	Oct		45,000			455,000			
	Nov		50,000			505,000			
	Dec		50,000			555,000			
	Total 2006	346,217	555,000	11,217					
	Total 2005	521,300	500,000	21,300					
	Total 2004	501,300	475,000	26,300					
	Total 2003	460,000	450,000	10,000					

# Dashboard Report

BILLINGS (\$'000):		CY	Budget	PY	Var bud	%	Var PY	%
billings - current month		38	35	31	3	9%	7	23%
billings - current QTD		38	35	31	3	9%	7	23%
billings - YTD		346	335	305	11	3%	41	13%

# Key Profitability Drivers

- Hours
- Utilization
- Average Bill Rate
- Time Value Added
- Fee Billings
- **Realization**

**Billings**

**Divided by**

**Time Value Added**

# Realization

- Less than 95% realization may mean a number of things:
  - Attorneys aren't billing work on a timely basis
  - Attorneys aren't billing enough work
  - There is an efficiency problem with staff
  - There is a pricing problem
  - It could be a guilt problem

# Realization

- Improve realization by constantly worry about Adding Value from a client's perspective
- You can increase Realization by 5% very quickly just by measuring it and being aware of its importance

# Dashboard Report

REALIZATION:		CY	Budget	PY	Var bud		Var PY
	realization - current month	92%	95%	91%	(3%)		1%
	realization - QTD	93%	95%	90%	(2%)		3%
	realization - YTD	93%	95%	90%	(2%)		3%

# Key Profitability Drivers

- Hours
- Utilization
- Average Bill Rate
- Time Value Added
- Fee Billings
- Realization
- **Fee Receipts**

# Cash Receipts

- When cash is slow, you need to pump up your collection efforts
  - Do not delay
- Poor cash receipts may be as simple as:
  - Bills were not mailed timely.
  - Bills were mailed without required detail that client has requested.
  - No one is responsible for following up with the client.
- All partners should be concerned about Collections

# Cash Receipts

- Or poor cash receipts can be an indication of greater problems:
  - Unsatisfied client
  - Inaccurate bills
  - Poor results
  - Financially unstable client or area of practice

# Cash Receipts

- Have **STRONG** client acceptance procedures
- Be cautious about running up large litigation bills without retainers and monthly payments from clients
- Give attorney's goals for what their collections should be based on
  - Billings
  - Outstanding accounts receivable

# Dashboard Report

COLLECTIONS (\$000):		CY	Budget	PY	Var bud	%	Var PY	%
	collections -current month	460	600	500	(140)	(23%)	(40)	(8%)
	collections -current QTD	1,050	1,200	950	(150)	(13%)	100	11%
	collections -YTD	1,050	1,200	1,200	(150)	(13%)	(150)	(13%)

# Cash Budget – Email to Partners Daily

STAFF	COLLECTION FOR Apr-02	% OF MONTHLY GOAL TO DATE	* GOAL MONTH TO DATE/+	VARIANCE MONTH TO DATE (under) over	GOAL	MONTHLY TOTAL VARIANCE (under) over
Partner #1	195,000.00	119.81%	147,257.24	47,742.76	162,758.00	32,242.00
Partner #2	20,000.00	39.71%	45,572.86	(25,572.86)	50,370.00	(30,370.00)
Partner #3	125,350.00	83.27%	136,192.00	(10,842.00)	150,528.00	(25,178.00)
Partner #4	18,000.00	112.19%	14,516.00	3,484.00	16,044.00	1,956.00
<b>Subtotal - Practice Area 1</b>	<b>358,350.00</b>	<b>94.38%</b>	<b>343,538.10</b>	<b>14,811.90</b>	<b>379,700.00</b>	<b>-21,350.00</b>
Partner #5	80,000.00	116.47%	62,147.19	17,852.81	68,689.00	11,311.00
Partner #6	25,000.00	165.69%	13,651.05	11,348.95	15,088.00	9,912.00
Partner #7	2,000.00	57.14%	3,166.67	(1,166.67)	3,500.00	(1,500.00)
Partner #8	1,500.00	124.48%	1,090.24	409.76	1,205.00	295.00
<b>Subtotal - Practice Area 2</b>	<b>108,500.00</b>	<b>122.62%</b>	<b>80,055.14</b>	<b>28,444.86</b>	<b>88,482.00</b>	<b>20,018.00</b>
<b>TOTAL</b>	<b>466,850.00</b>	<b>99.72%</b>	<b>423,593.24</b>	<b>43,256.76</b>	<b>468,182.00</b>	<b>(1,332.00)</b>

19 DAYS

21 DAYS

# Key Profitability Drivers

- Hours
- Utilization
- Average Bill Rate
- Time Value Added
- Fee Billings
- Realization
- Fee Receipts
- **Income before shareholder compensation**

# Law Firm Profitability

Fee Revenues "Receipts"		<u>\$ 5,000,000</u>	<u>100%</u>
Compensation Costs:			
Associates		1,200,000	24%
Administrative		300,000	6%
Employee Benefits		330,000	7%
Total Compensation Costs		<u>1,830,000</u>	<u>37%</u>
Occupancy Costs		600,000	12%
Equipment Costs		150,000	3%
Marketing and Promotion		200,000	4%
Reference Materials		100,000	2%
Other Expenses		250,000	5%
Total Overhead Expenses		<u>1,300,000</u>	<u>26%</u>
Total Operating Expenses		<u>3,130,000</u>	<u>63%</u>
Income before Shareholders' Salaries or Partners Draws (allocable income)		<u>\$ 1,870,000</u>	<u>37%</u>

# Key Profitability Drivers

- Hours
- Utilization
- Average Bill Rate
- Time Value Added
- Fee Billings
- Realization
- Fee Receipts
- Income before shareholder compensation

- **Net Income**

- **Revenues**
- **Less expenses**
- **Less taxes**
- **= Net Income**

# Dashboard Report

NET INCOME (\$'000):		CY	Budget	PY	Var bud	%	Var PY	%
	net income - current month	120	150	100	(30)	(20%)	20	20%
	net income - current QTD	240	300	210	(60)	(20%)	30	14%
	net income - YTD	240	300	210	(60)	(20%)	30	14%

# Dashboard Report

NET INCOME %		CY	budget	PY	Var bud		Var PY
As % of Total Fee Billings:							
Professional Salaries		45%	30%	50%	(15%)		5%
Overheads		30%	20%	35%	(10%)		5%
Net Income		25%	50%	15%	(25%)		10%

# Key Profitability Drivers

- Hours
- Utilization
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- Realization
- Fee Receipts
- Income before shareholder compensation
- Net Income
- **A/R Days Outstanding**
- **WIP Days Outstanding**

# AR and WIP

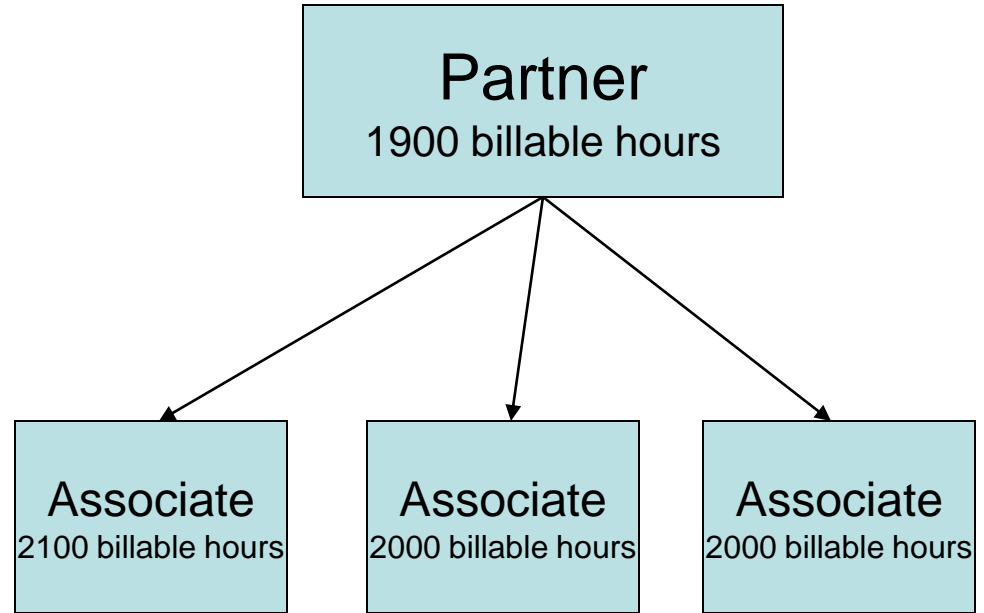
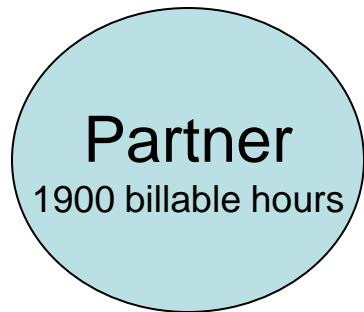
ACCOUNTS RECEIVABLE																	
	Current (0-30)	%	31-60	%	61-90	%	91-120	%	Over 120	%	Total	Billings for period	A/R Turnover	A/R Days O/S			
8/31/2006	165,000	50%	40,000	12%	15,000	5%	-	0%	110,000	33%	330,000	\$ 1,600,000	4.85	50			
12/31/2005	115,000	31%	75,000	20%	25,000	7%	45,000	12%	110,000	30%	370,000	\$ 2,000,000	5.41	68			
WORK IN PROCESS																	
	Current (0-30)	%	31-60	%	61-90	%	91-120	%	Over 120	%	Total	Billings for period	A/R Turnover	A/R Days O/S			
8/31/2006	20,000	5%	35,000	9%	-	0%	-	0%	350,000	86%	405,000	\$ 1,600,000	3.95	62			
12/31/2005	35,000	7%	3,000	1%	25,000	5%	15,000	3%	450,000	85%	528,000	\$ 2,000,000	3.79	96			



# Key Profitability Drivers

- Hours
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- Average Bill Rate
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- Realization
- Fee Receipts
- Income before shareholder compensation
- Net Income
- A/R Days Outstanding
- WIP Days Outstanding
- **Leverage**

# Which partner is more profitable to the firm?



Total “Managed Charge Hours”:

1900 hours

8000 hours

# L x U x B x R x M

Leverage x Utilization rate x Billing rate x Realization x Margin

A	Total Partners		10	10	10	10	
B	Total Billable Personnel		40	40	40	50	
C	Total Chargeable Hours		45,000	45,000	60,000	70,000	
D	Time Value Added		5,800,000	5,800,000	7,200,000	9,000,000	
E	Net Fees		5,220,000	5,220,000	6,840,000	8,550,000	
F	Total Expenses		3,130,000	3,130,000	3,130,000	4,600,000	
G	Net Income		2,090,000	2,090,000	3,710,000	3,950,000	
	Leverage (B/A)		4.0	4.0	4.0	5.0	
	Utilization (C/B)		1,125	1,125	1,500	1,400	
	Billing Rate (D/C)	\$	129	\$	129	\$	129
	Realization (E/D)		90%	90%	95%	95%	
	Margin (G/E)		40%	40%	54%	46%	
	Average Partner Income		209,000	209,000	371,000	395,000	
	From "Managing the Professional Service Firm" by David Maister						

Increase any of the five measures and Average Partner Income will increase

# Dashboard Reports

	<u>CY</u>	<u>Budget</u>	<u>PY</u>	<u>Var bud</u>	<u>%</u>	<u>Var PY</u>	<u>%</u>
<b>HOURS WORKED:</b>							
Current month	2,900	3,000	3,100	(100)	(3%)	(200)	(3%)
YTD	5,600	6,000	5,900	(400)	(7%)	(300)	(7%)
<b>UTILIZATION:</b>							
total hours worked/total hours CM	75%	80%	65%	(5%)		10%	
total hours worked/total hours YTD	72%	80%	70%	(8%)		2%	
<b>BILLINGS (\$'000):</b>							
Current month	38	35	31	3	9%	7	23%
YTD	346	335	305	11	3%	41	13%
<b>REALIZATION:</b>							
Current month	92%	95%	91%	(3%)		1%	
YTD	93%	95%	90%	(2%)		3%	
<b>COLLECTIONS (\$'000):</b>							
Current month	460	600	500	(140)	(23%)	(40)	(8%)
YTD	1,050	1,200	1,200	(150)	(13%)	(150)	(13%)
<b>NET INCOME (\$'000):</b>							
Current month	120	150	100	(30)	(20%)	20	20%
YTD	240	300	210	(60)	(20%)	30	14%
<b>NET INCOME %</b>							
As % of Total Fee Billings:							
Professional Salaries	45%	30%	50%	(15%)		5%	
Overheads	30%	20%	35%	(10%)		5%	
Net Income	25%	50%	15%	25%		10%	
<b>AVERAGE BILLING RATE:</b>							
Current month	\$131	\$135	\$130	(\$4)		\$1	
YTD	\$133	\$135	\$129	(\$2)		\$4	

# Capital

## Benchmarks of Firm Capital:

### Cash Basis Capital

1. Achieve 2 months of Operating Expenses in Capital
2. Equity to Debt ratio of 2:1

### Accrual Basis

1. One Year's Earnings in Capital
  2. 30% of Fee Billings
- Firms with Contingent-Fee Practices should have more capital
  - Avoid pitfalls of recently restructured or dissolved firms

# Capital

## **Firms with a strong capital position can:**

- Make better business decisions
- Work through the unexpected loss of a client or sudden unanticipated expenditures
- Can consider strategic investments

# Setting individual partner performance measurements

- Everybody must contribute to achieve the firm's strategic goals
- **Partners** are the drivers of profitability
- **Individual partners** need to be held accountable for performance
- **If it is important, measure it.** Metrics should be set and agreed and then tracked on a regular basis

# Key Financial Indicators and Benchmarks

<u>KEY FINANCIAL INDICATOR</u>	<u>RATIO</u>	<u>FREQUENCY OF REVIEW</u>	<u>YOUR FIRM</u>	<u>BENCHMARK NEW ENGLAND LAW FIRMS (ANNUAL)</u>	<u>COMMENTS</u>
ACCOUNTS RECEIVABLE (AR) DAYS OUTSTANDING	$\frac{\text{Month End AR} \times 360}{\text{Annual Billings}}$	Monthly		36 days * (Lower Quartile)	
AVERAGE DISTRIBUTABLE INCOME PER EQUITY PARTNER	$\frac{\text{Income Before Shareholder Comp Or Partner Draws}}{\text{\# Of Partners / Shareholders}}$	Monthly		\$226,280 *	
STAFF RATIO	$\frac{\text{\# Non-Legal Staff}}{\text{\# Legal Staff}}$	Annually		1.02 : 1 *	Should try to decrease.
LEVERAGE	$\frac{\text{\# Associates}}{\text{\# Equity Partners}}$	Annually		0.43 : 1 *	An Increase in this measure with the right people will result in the firm making more money.
AVERAGE ADVANCE COSTS	$\frac{\text{Avg Dollar Disbursements Outstanding}}{\text{\# of Lawyers}}$	Monthly		\$6,272 *	Keep stable and track monthly.
SPACE UTILIZATION	$\frac{\text{Total Sq Ft Office Space}}{\text{Headcount}}$	Annually		Varies by class. Review annually with Real Estate Brokers.	
AVG SECRETARY SALARY	$\frac{\text{Total Secretary Salary}}{\text{\# Secretaries}}$	Annually		\$33,316 *	This measure is probably closer to \$40-\$45k in Boston.

\* taken from *The Survey of Law Firm Economics, 2004 Edition*, published by Altman Weil Publications, Inc.

# Key Financial Indicators and Benchmarks

<u>KEY FINANCIAL INDICATOR</u>	<u>RATIO</u>	<u>FREQUENCY OF REVIEW</u>	<u>YOUR FIRM</u>	<u>BENCHMARK NEW ENGLAND LAW FIRMS (ANNUAL)</u>	<u>COMMENTS</u>
AVERAGE ASSOCIATE SALARY	$\frac{\text{Total Associate Salary}}{\text{\# Associates}}$	Annually		\$100,007 *	Varies by area of law and years since admitted to bar
STARTING ASSOCIATE SALARY		Annually / Hiring		\$74,575 *	
PER SQUARE FOOT OCCUPANCY COSTS	$\frac{\text{Total Rent}}{\text{Sq Ft Rented}}$	Annually			Varies by class. Review annually with Real Estate Brokers.
ATTORNEY SALARY COVERAGE	$\frac{\text{Value of Hours Billed}}{\text{Salary}}$	Annually			Generally between 3 and 3.5 is a good measure.
OCCUPANCY AS % OF REVENUE	$\frac{\text{Occupancy Costs}}{\text{Total Revenue}}$	Annually		7% - 9%*	

\* taken from *The Survey of Law Firm Economics, 2004 Edition*, published by Altman Weil Publications, Inc.

# Recommended Reading - Books

- ***Managing the Professional Service Firm*** by David H. Maister
- ***Good to Great: Why Some Companies Make the Leap and Others Don't*** by James C. Collins
- ***Execution: The Discipline of Getting Things Done*** by Larry Bossidy and Ram Charan