advancing what's possible ❯

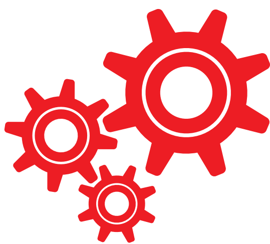
PCLaw®

DRIVING PROFITABILITY FORWARD

Move your firm's money-making gears in the right direction

Number One in the series from LexisNexis®

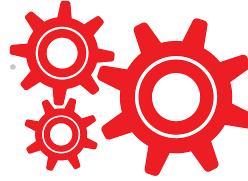
As a law firm stakeholder, you affect your firm's profitability every day, with every move you make. More importantly, you affect it with every move you don't make, which is actually much better news than you may realize.



You can't move one gear without affecting the others, sometimes in the most unintended ways.

Once you understand that you affect your firm's financial picture even by doing nothing, it becomes easier to take positive action instead of sitting back and hoping good things happen.

The five "gears" of law firm profitability, and their movements, are all firmly in your hands. It's merely a matter of fine-tuning each gear, one at a time, to get them all working smoothly together.



Why gears?

Think about the movement of gears in a well-oiled machine. While they're all working together toward a common purpose—driving the machine forward or backward—adjacent gears are actually moving in opposite directions.

The same goes with the five primary gears driving law firm profitability. Instead of the gears moving independently, they're all interdependent. You can't move one gear without affecting the others, sometimes in the most unintended ways.

So it stands to reason that moving gears perfectly in sync is a process of constant adjusting. Each adjustment means analyzing the numbers to help understand where to make the next one.

Before we get ahead of ourselves, let's start at the beginning—defining the five gears.

The five gears driving law firm profitability

We're not interested in turning you into an accountant, so let's keep this simple:

- **Production Value** – the amount of fees timekeepers are expected to bill
- **Utilization** – the actual amount of billable time that a timekeeper logs
- **Realization** – how much money your firm is paid vs. how much you bill
- **Leverage** – matching the right resource to the task
- **Margin** – the difference between the money your firm brings in and the amount you spend

Getting back to the interdependent movements of the five gears, let's look at how a singular focus on cost-cutting to improve margins can affect your total profitability picture with unintended consequences.

There are a couple of obvious targets for extreme cost-cutting, both of which can easily set into motion the law of unintended consequences:

1. Employee layoffs
2. Technology cutbacks

Employee layoffs

With a grim economic outlook in the Great Recession after 2008, many firms worked fiercely to increase their profit margins by cutting costs. That meant layoffs for thousands of lawyers and cuts to benefit programs. As a result, short-term margins improved.

But extreme cost-cutting is a temporary bandage, one that eventually has to be ripped off. And when it is, it generally reveals more painful challenges for the future.

With a singular focus on cost cutting, both leverage and margins end up taking a hit:

1. The combination of layoffs and employees leaving due to cutbacks, leaves fewer employees for partners to leverage. Less work gets done, which decreases revenue and growth opportunities.
2. Lower-level tasks have to be performed by higher-level employees at a higher cost, eventually eating into the profit margin.

That's a painful result however you look at it. And unfortunately, the effect can be even worse when firms slash costs by delaying technology investments.

Technology cutbacks

In an ideal world, firms looking to increase profitability in the face of layoffs would balance out the productivity loss by making smarter investments in technology, allowing the remaining employees to get more done in less time.

But in their pursuit to cut costs, some firms also brought technology spending to a grinding halt. The result: a one-two productivity hit that made it almost impossible for firms to recover momentum even when the economy started to improve.

Cutting technology budgets only delays expenditures; by no means does it eliminate them. Because of the nature of technology, those delays often result in higher costs in the long term.

The moral of the story: Profit margin is important, but it's just one of five gears. If you're betting your firm's profitability entirely on extreme cost-cutting, you'll bring other profitability gears to a grinding halt.

Part 2 in the series will explore the first gear in our list—Production Value—and dig a little deeper into creating billable hours targets for each timekeeper.

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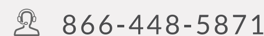

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