Boosting Your Law Firm’s Profitability

Making simple adjustments to three business metrics can have a positive impact on your bottom line.

If you are an equity partner, you can directly improve your law firm’s profits without asking clients to pay higher fees or asking employees to work more hours. All that’s required is re-thinking the way you approach three business metrics—realization, leverage and margin.

Realization: Better manage your receivables

Your realization rate measures how legal work is billed and collected, including how many months of work are tied up waiting to be billed, the average length of time between billing a client and receiving payment, and the minimum monthly cash-flow requirement to sustain operations.

When you can manage your receivables to improve on any of these factors—e.g., getting paid faster for more of the hours you’ve actually billed your clients, decreasing write-offs by assigning the most appropriate person to do the work, and putting a good collection process in place—you can bring more money into your firm. For every $100,000 a year you bill, improving your realization rate by decreasing write-offs by 5 percent means an extra $5,000 in receipts for the firm.

Leverage: Optimize your people power

The next business metric you can adjust is leverage, i.e. the extent to which you delegate work to your associates or support staff. During an economic downturn, given client demand for reduced billings, many firms, regardless of practice area, have found that a good strategy is to delegate as much work as possible to lower paid staff, providing more time for the experienced partners to seek more business and to work on existing client relationships. Giving your staff more challenging tasks will keep them motivated and interested and make them feel like they are truly part of the team. And paying your associates less to do the same work your partners do will naturally increase your profitability.

Each firm must determine the appropriate mix of business for both associates and partners. According to the LexisNexis® Economic Survey 2007, in the top 25th percentile of law firms, associates billed out 1,620 hours and equity partners billed out 1,840 hours, on average. A higher partner rate is still a major contribution to profitability.
**Margin: Improve processes to cut costs**

Of course, it takes more than adjusting one or two metrics to get to good profit margins. In addition to improving realization and leverage, you also need to consider how you are spending your money. Finding ways of doing things more efficiently will help you cut costs, and that in turn will increase your margin.

Successful law firms know that technology is the key to being more productive and billing more hours, especially if it helps the staff bill their time instead of working on administrative tasks. Take a look at what processes you and your staff are doing manually and see if there is a tool to help you do this more efficiently.

Also, don’t forget to look at how much costs you are advancing your clients—this could be substantial and can impact the cash flow your firm needs to make it through these tough times. Think about amending your engagement agreement and asking for retainers to pay client-specific costs from the trust account to decrease the amount you are financing on behalf of your clients.

**Technology as a measurement tool**

The first step in adjusting your firm’s profitability is to regularly analyze your most critical performance indicators with accounts receivable, work-in-progress, timekeeper, and realization reports. Most billing programs provide this information.

If you are not sure where these reports reside on your firm’s software, independent consultant Kelly Jones, a partner of 7 Second Systems, suggests you look for these clues:

- Reporting functions with the words “profitability” or “productivity” in the title
- Reports that compare things such as time billed versus fees collected to help you understand your profitability
- Reports that show what is being recorded as billable time versus non-billable time to understand your productivity

When you know what your employees are working on, you’ll be able to delegate tasks that will help convert non-billable to billable hours.

**Get buy-in for productive change**

Management decisions that involve revising processes and policies are usually made behind closed doors.

Open-door decisions are transparent to staff and clients because you ask them to contribute and be part of the solution. Some of the quick wins usually involve new software tools and the training to make sure everyone uses them to the fullest.

If you are launching an initiative to optimize your reporting programs, all your users need to be on board. Employee buy-in is especially important in today’s economy. Employees feel more secure—and tend to work harder—when they know why changes are being made and that they are valued.

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*Comparison data based on information available as of 08/2011.
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