“What it means to be a Successful Firm"

Measuring Financial Performance and Improving Profitability

Presented by,

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2:00pm – 3:00pm

Quote

“You don’t need to master management jargon or get an MBA to understand your firm’s finances….the more you understand the business aspects……the more you can help your firm reach its productivity goals."

-**Edward Poll**

Understanding the Business

"Relationships"

What differentiates your firm, your lawyers from others?

What do your clients want from you and what do you want from your clients?

How are you perceived by your partners, associates and staff? What is your firm culture?

How are you perceived by your bank?

Understand your practice areas

Not all practice areas or matters within a practice area are equal

- Contingency matters
- Paid at Closing ("PAC") arrangements
- Fixed Fee matters
- Hybrid alternative fee arrangements
- Discounted matters
- Standard Rate billing

* Some practice areas and/or types of tasks may be loss leaders and meant to attract more lucrative work (i.e. preparation of wills in a T&E practice … estate work; trademark scans & searches … IP litigation)

Determine your profitability threshold

Profitability = "RULES"

- "R"ealization of Billing Rates
- "U"tilization of Timekeepers
- "L"everage of Lawyers
- "E"xpense Control
- "S"peed of Billing and Collection

Realization

Client Intake Procedures

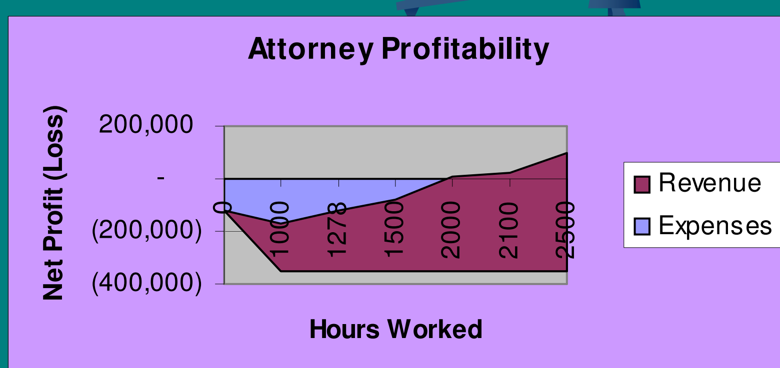
- Financial Stability – clients ability to pay
- Communication – client understands what is involved (scope of work)
- Timeliness – expectations are set for prompt payment
- Follow-up – change in previous status is addressed
- Conflicts – insure that the firm can do the work
- Billing Guidelines – understand what the client will and will not pay for

Utilization

Maximize your resources

- Expectations – set targets
- Retention – challenging work and overall confidence
- Behavior - responsible recordkeeping, timely & complete
- Headcount – avoid excess full time equivalent's ("fte's")
- Recruitment - Hire skilled lawyers & constantly evaluate
- Supervise - Better manage fee earners and insure work is assigned appropriately (i.e. associate mentoring)
- Flexible – ability to reassign outside of practice area

Utilization Levels- Chart



Leverage

Non-partners to partners

Pushing work down (efficient work performed at the right price)

- Skill set – match work with appropriate ability
- Marketing time – more partner hours available to develop new client work
- Professional growth – Continue to offer challenging work
- Succession Planning – prepare for retirement/departures
- Diversify – insure continuity of workflow
- Institutionalize clients – complete firm service
- Budgeted Work Plan – anticipate new associate class arrival when creating work assignments

Evaluate Expenses

- Review each expense category
  - Employment Costs
  - Occupancy Costs
  - Technology Costs

    Represents approx 80% of your overall costs
  - General Office Costs
  - Professional Costs (including Professional Liability Insurance)
  - Marketing Costs
  - Reference Material Costs
  - Contributions
  - Interest Expense

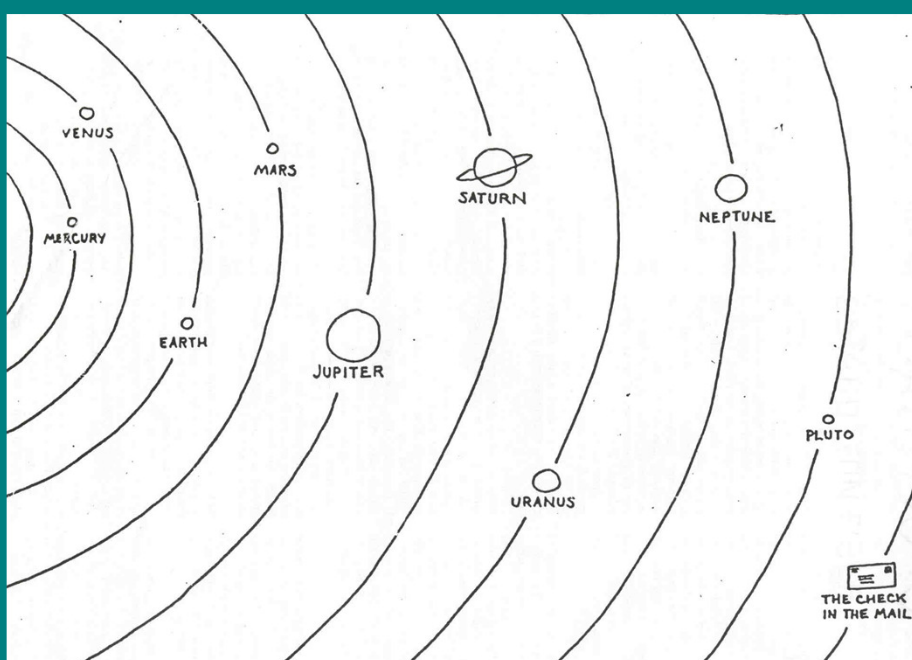
Speed of Billing and Collection

Determine the time it takes from when services are provided to when monies are received from the client

- Unbilled Time inventory divided by the monthly value of time added times days in the period
  - e.g. Average unbilled time balance of $5 million with $3.5 million in monthly billing equates to 43 days in inventory. ($5 / $3.5 times 30 days = 43 days). A 3 day swing indirectly effects profits by as much as $250k
- Accounts Receivable ("AR") inventory divided by the monthly amount of fees billed times days in the period

Reducing the time to bill and collect plays an integral role in a firms profitability and can also effect other factors (i.e. realization). Persistence and getting to the right contact are key.

Another way to gauge the strength of ones AR is to look at the AR that is current (i.e. % over 90 days; % over 120 days)



Don’t let this happen in your firm

Profitability Analysis

Profitability Formula

- Fees Collected – Expenses Paid = Net Profit available for distribution
- Net Profit Margin
  Shows how much profit (net income) is generated by each dollar of fees collected.
  = Net profit / Fees Collected
  Typical Ratios range between .33 to .40 for law firms

Fee Income per Working Attorney

- Define Working Attorney as all timekeepers
- Internal Computer System calculation of fees collected by timekeeper showing the actual dollars and respective hours collected

$ Fees/Hours Collected=Income per Hour

$972,000 / 1,800 hours = $540/hr

Fee Income per Working Attorney

OR

- Billable Hours Recorded times Billing Rate times Firm Collection Realization Percent which gives you an approximate estimate of Fees Collected for each Timekeeper

1,800 hours x $600/hr x 90% = $972,000

Expense per Hour

- Internal Computer System calculation of the total hours charged by each timekeeper

  $ Expenses/ Hours Charged = Expenses per Hour

  $43.2 million / 120,000 hrs = $360/hr

Net Profit per Hour

- Income per hour - Expenses per hour = Net Profit per hour

  $540/hr - $360/hr = $180/hr

  - Direct Contribution per attorney would be income less expenses directly associated with the generation of that income (compensation)

Profitability Analysis-Conclusion

- The calculated cost per hour can be applied to the time expected to be worked in a legal matter to determine the breakeven point.
- Managing a project by monitoring the time to perform tasks as compared to the time planned will most often avoid unprofitable matters and inefficient work habits.
- Know the cost to generate revenue as opposed to generating revenue at all costs.

Profitability Analysis- Conclusion

- Who uses this information?
  - Management to determine if all areas of the practice are contributing to the overall profitability of the firm as well as each matter individually.
    - Some practice areas may be a loss leader servicing existing clients or bringing clients in and introducing them to other practice groups
  - Business Development staff in determining fee estimates used in RFP responses

Current Trends

- Associate population is growing slightly with demand flat
- Number of Equity Partners is decreasing
- Occupancy space needs continue to decrease as space design becomes more efficient and the number of attorneys and staff right sized to match demand
- Commercial Real Estate combines new construction with expected movement from old space
- Clients are demanding AFA’s in various forms (less pricing control), continued scrutiny on disbursements and more clients requiring e-billing.
- Cyber Security Initiatives become a priority for law firms and law firm clients

Actions taken by Firms

- Continue to evaluate underutilized attorneys
- Focus on generating business through cross-selling between practice areas and geographic locations
- Continue to strengthen Balance Sheet by increasing Capital calls from partners and reducing debt and paying Undistributed Income ("UI") slower
- Collection efforts have become more persistent
- New matter evaluation requires more scrutiny, doing credit checks and/or seeking higher retainers to decrease risk
- Expanding the use of AFA's
- Concentrated focus on Cyber Security Initiatives

What Financial Institutions evaluate to determine risk

- Firm net worth as well as individual partner net worth, especially with smaller firms
- Capital Loan Guarantees and determine how much partners would be on the hook for
- Concentration risk vs. diverse practice areas
- Firm infrastructure (less in boutique firms)
- Rainmaker Risk
- Lending amount based on anticipated trends, not where a firm is today
- Relationships and firm management
- Volume of contingency work

Financing for Law Firms

- For most law firms, access to bank loans or lines of credit are necessary for their working capital needs.
- It stands to reason that better run law firms, those firms financially solid, will obtain the best terms and pricing
- Maintain a strong relationship with your bank, especially when times are good, so they better understand your practice trends and your firm culture and expect your financial needs before they arrive

Borrowing Base Considerations

- Cash
- Aged Inventory (accounts receivable & unbilled time)
  - Value is discounted by age so faster collections support a larger borrowing base
- Assets of the firm
  - Loans/lines are usually secured by UCC filings against the assets of the firm
- Realization Rates (reflective of discounts & write-offs)
  - Gross (billing realization)
  - Net (collection realization)
- Client Acceptance Criteria

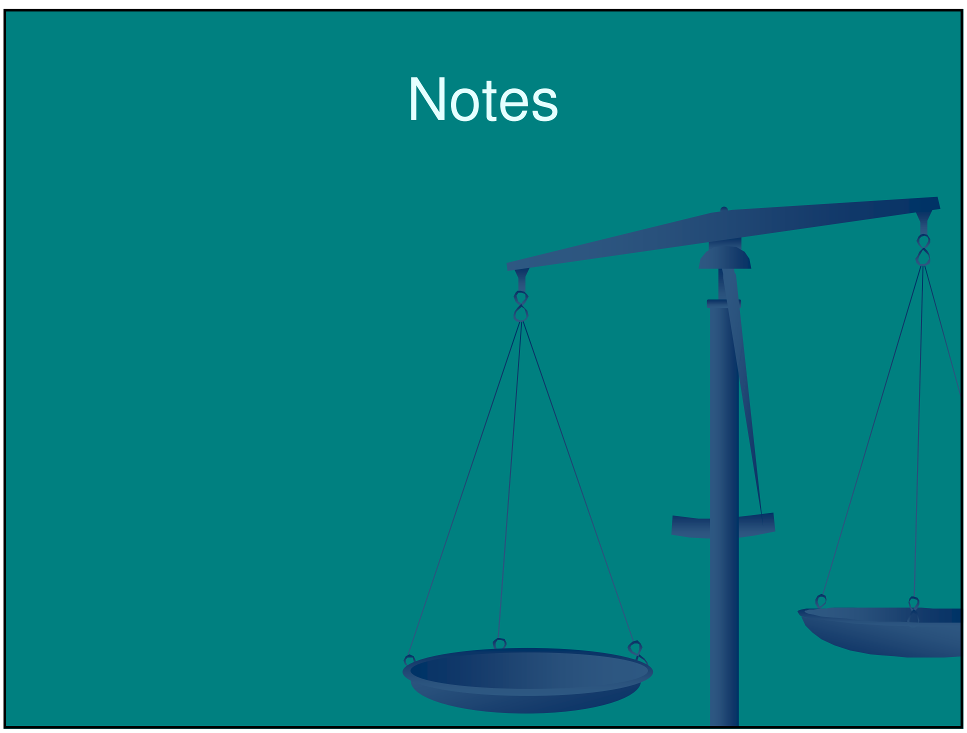
Panel Q&A

Speakers

Randolph C. Becker, MBA
Randy is an Executive Director at Richards Kibbe & Orbe LLP. He has more than 35 years of law firm management experience. He has been an active ALA member since 1993, presenting at other ALA local and regional venues and at NYC and NYS Bar Association seminars.

Henry Macchiaroli, CLM, MBA
Henry is the Controller for Phillips Nizer LLP. He has more than 25 years of law firm management experience at large, mid-sized and small law firms. He has been an active ALA member serving as a Regional Director, President of the NYC Chapter and as an National At-Large Director and presenting at other ALA local and regional venues and at the NYC Bar Association.


Thank You for Attending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