Following the RULES for Law Firm Profitability
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We as marketers have an obvious and direct impact on our firms' revenue stream, and we can serve an equally important but sometimes overlooked role in improving firm profitability. To do so requires a decent grasp of basic firm financials and the ways a law firm enhances profitability. If you do not currently receive your firm's full financial reports, try implementing some of the following suggestions to demonstrate why you should play an important advisory role.

Ideally, you have or will have access to and a good understanding of these statistics:

- Total number of clients
    - By area of law
    - By industry
    - By department or practice group
    - By office
- New clients per year
- Total number of matters now active
- New matters per year
- Client retention and loss rates
- Total billable hours
- Cost of a billable hour
- Billed hours
- Realization rates
- Cross selling
- Gross revenues
- Net revenues
- Revenue per partner
- Revenue per lawyer
- Profits per partner
- Total marketing expenditures
- Total time (attorney and staff) spent on marketing.

Few marketers (and few firms) have information readily available on all the above indicators, so just start wherever you are. And, don't assume that all partners understand your firm's financial position and what makes it profitable (or not). You may have to educate yourself first, so that you can lead them in understanding. If you don't understand finance and accounting basics, pick up a general book on finance and accounting for non-financial managers.

Law firms generally look at net income per partner (NIPP) as an important marker. Let's look at the factors which determine NIPP—the RULES for profitability. "RULES" is a mnemonic. It stands for:

R = Rates and realization (blended average billing rate and percent realization}
U = Utilization (average billable hours)
L = Leverage (ratio of non-partner timekeepers to partners)
E = Expenses (really, margin, or attorney compensation as a % of gross revenues
S = Speed (how long it takes to turn work into cash in hand)

Each component of RULES interacts to determine profitability. Let's look at each briefly and then focus how we can help our firms improve.

Billing rates and realization percentage are key markers of your firm's brand strength. Try looking at your standard rates and at your blended average billing rates by category of timekeeper. Are you able to bill premium rates? Must you frequently offer discounts? How do your rates compare to those of your competitors. The answers can be revealing. I recently performed the following analysis for a Texas firm:

- Using two year's worth of rates published in the *National Law Journal*, I prepared a spreadsheet indicating partner high and low rates and associate high and low rates for large national firms.
- I sorted the spreadsheet by firm size, by city and by billing rate.
- From *American Lawyer*'s AmLaw 100 and 200, I added statistics on firm revenues and profitability.

This comparison allowed me to show firm management which of our competitors had raised rates the most and how those increases appeared to have affected their revenues and profitability. It gave us objective data to compare our rates to others, form opinions as to whether we were over or underestimating our value, and apply the conclusions to proposals and pitches to clients.

Where you peg your standard rates depends on your competitive position. Are you perceived as Neiman Marcus or as Wal-Mart? The best place to start may be on the high side, which enables you to offer in-house counsels a bargain -- a discount from standard rates. Just make certain that the discounted standard rate still allows your firm—ultimately—to show the kind of high net income per partner that appeals to productive partners, key laterals, merger partners, and the best law school graduates.

If your firm is opposed to discounting, and many are, then arm your partners with information about their competitors and help them construct persuasive ways to state their case. Even though 100% of $300 per hour is still less than 80% of $400, some clients and prospects just aren't happy without some concession on your part.

If certain partners are only too happy to discount their rates (since giving services away is easier than charging full fare), help them by pointing out the impact on profitability. Margin, for many firms, is about 35%--the firm keeps 35 cents from each dollar of revenue. For such firms, as Pete Peterson, a Minneapolis-based law firm management consultant, recently pointed out at an LMA leadership workshop, a 10% discount from standard rates is a 30% hit against profitability.

Undiscounted fee would have been	$100,000	
Less firm expenses (cost of goods sold) at 65%		$ 65,000
Firm profit		$ 35,000
Discounted fee		$ 90.000
Less firm expenses (expenses don't change)	$ 65,000	
Firm profit		$ 25,000

The "lost" $10,000 is very nearly 30% of the $35,000 profit you would have realized at standard rates. We'll look at margin again later when we review expenses.

Realization is another critical factor and is sometimes discussed in tiers:

- Percent of billable or booked hours billed (billed to billable ratio).
- Percent of billed work collected (collected to billed ratio).

The end game is to have a high collected to billable ratio. If your overall ratio is less than 87%, you are probably in trouble. If your overall ratio is greater than 95%, you might consider raising your rates.

Marketers can help firms increase their realization rate, not only by helping set realistic rates and discounts, but also by urging prompt billing of clients "while the tear is still in their eye" (citing Pete Peterson again) over good results.

Even more important is to view the actual bill as a core communication tool. Far too few partners think of them in this way. Review some of your bills to clients carefully, since for some clients this may be the only tangible work product they lay hands on. Some obvious "don'ts" include misspellings and double billing for office conferences where more than one attorney attended. I have seen entries such as "Office Conference, $500," with no mention of the purpose of the conference or how it advanced the ball for the client. You may be able to do your firm a great service by raising their consciousness on this point.

Improving overall **utilization** (average billable hours) is more likely to be the purview of practice group leaders, but you might meet with them to see whether they would like your assistance in coaching certain attorneys or in working with them to develop a marketing plan Similarly, even without a direct impact on **leverage,** you can gather and analyze data about competitors to help assess deviations.

- **Expenses,** those dollars we subtract from revenues to derive net income, determine **margin**, and margin, as we saw earlier, is important. How can we help? Is every member of your staff fully deployed on the things that matter most?
- Do you have the right people, the right talent, working on the right projects

- Have you examined the remainder of your budget with fresh, a zero-based perspective on what you need in order to accomplish the firm's most important marketing goals?
- Do you review all contracts with vendors and consultants carefully and periodically?
- Can you answer questions about which expenses are generating the greatest returns?

When a partner asks your support to fund a table at a client event, do you help the partner analyze what the client generates in revenue compared to what the firm has "spent" in discounts and entertainment? If your firm's overall budget for marketing is 2% of revenues, is there any reason to spend more than 1% of this client's revenues on them? (Of the firm's overall budget, half or more may be committed to staff salaries and to central firm marketing expenses, leaving 1% or less to be "spent" on key clients.) This 1%/2% test is simply one way of thinking about marketing expenditures.

Do you apply the same analysis when a partner wants to put on a seminar that costs the firm approximately $25,000 (forget the staggering cost of attorney and staff time)? The typical argument that the firm need only obtain one new piece of business for $25,000 to cover the cost is faulty thinking. If your firm's margin is 35%, you must gain $71,428.57 of new business in order to break even. ($25,000/.35 = $71,428.57). There may be other reasons to do the seminar, but understanding the true breakeven point informs your thinking.

The more we understand about the financial underpinnings of our firms, the more help we can provide. And, by demonstrating a grasp of profitability, we enhance our value with the highest levels of firm management and leadership.