



Improving the profits and efficiency of a law firm

By Hans Schuurman, interim CFO, consultant and founder of Law4ce

In a situation whereby the demanding client puts pressure on the prices, how do you keep the profitability of the firm at a high level? What is the business sustainably profiting? In addition, what the last pitch; did we keep a healthy margin? What vision do we have on the law firm's financial performance and funding within the next 3 to 10 years? This article shows possibilities to improve the profitability of the law firm. The model for the improvement is the "Financial Metro Map", which schematically shows the interrelationship of all profit-determining factors. In terms of plans and budgets, a structured analysis may be helpful to you.



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The Financial Metro Map

The net profit of a law firm is determined by a series of interrelated factors. This may seem like an open door; however, this raises the question of integration. Do you integrate these connections in your plans and in the daily management control? Sometimes, the interconnection is a chain of activities, such as Hours x rate which is turnover. Other factors are interdependent. Without lawyers and clients, there is no turnover, but clients only entrust matters to good lawyers. Moreover, a one-sided focus on one of the components brings about a firm's instability. The law firm must be viewed in conjunction. The balance between all factors is shown in the Financial Metro Map on the next page.

The metro map shows the different processes within the firm. The law firm is an empty building without the green line of employees and the red line of clients and matters. The orange line is the line of Project Management or structuring the work of the client: preparing, planning, executing, completing and evaluating a case. The law firm should take care of the relationship with the financiers on the black line of investments and innovation projects; the latter can be found on the pink line. Ultimately, all actions concerning the matter, the people and the business operations come together in the blue line; finance of the law firm. Finance is "just" the result of all operational actions.

What are the factors determining profit on the different lines? What operational actions of the fee earners contribute to the financial success of the firm? In the following section, an analysis of each component follows;

The red line: Clients

The Buying Legal Council's international research summarizes the developments concerning clients and the matters concisely with the following trends:

- Better spent analysis, based on data and audits on invoices
- Further pressure on costs
- Better management of legal work through better scoping in advance
- Legal Project Management with the goal: predictability, efficiency and lower fees

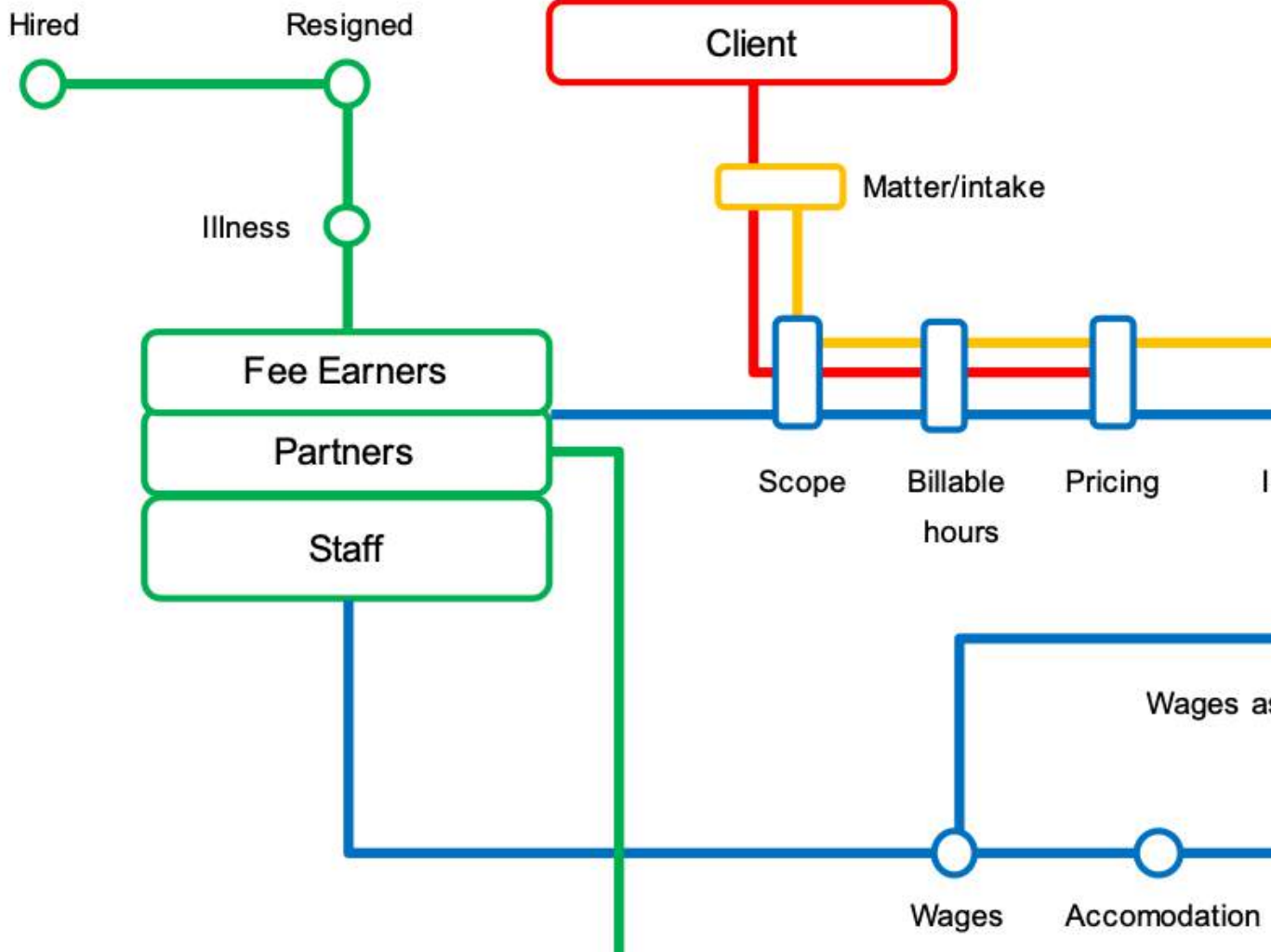
By:

- Discounts and alternative price agreements
- Formalization of the procurement process
- Selection of fewer law firms in a preferred supplier panel

The firm benefits from high-quality clients who provide an appropriate margin. The margin depends on the level of the tariff. It is therefore important to achieve a good match between the price of a matter and on the other hand, the added value experienced by the client. If the latter value is greater, the client experiences value for money.

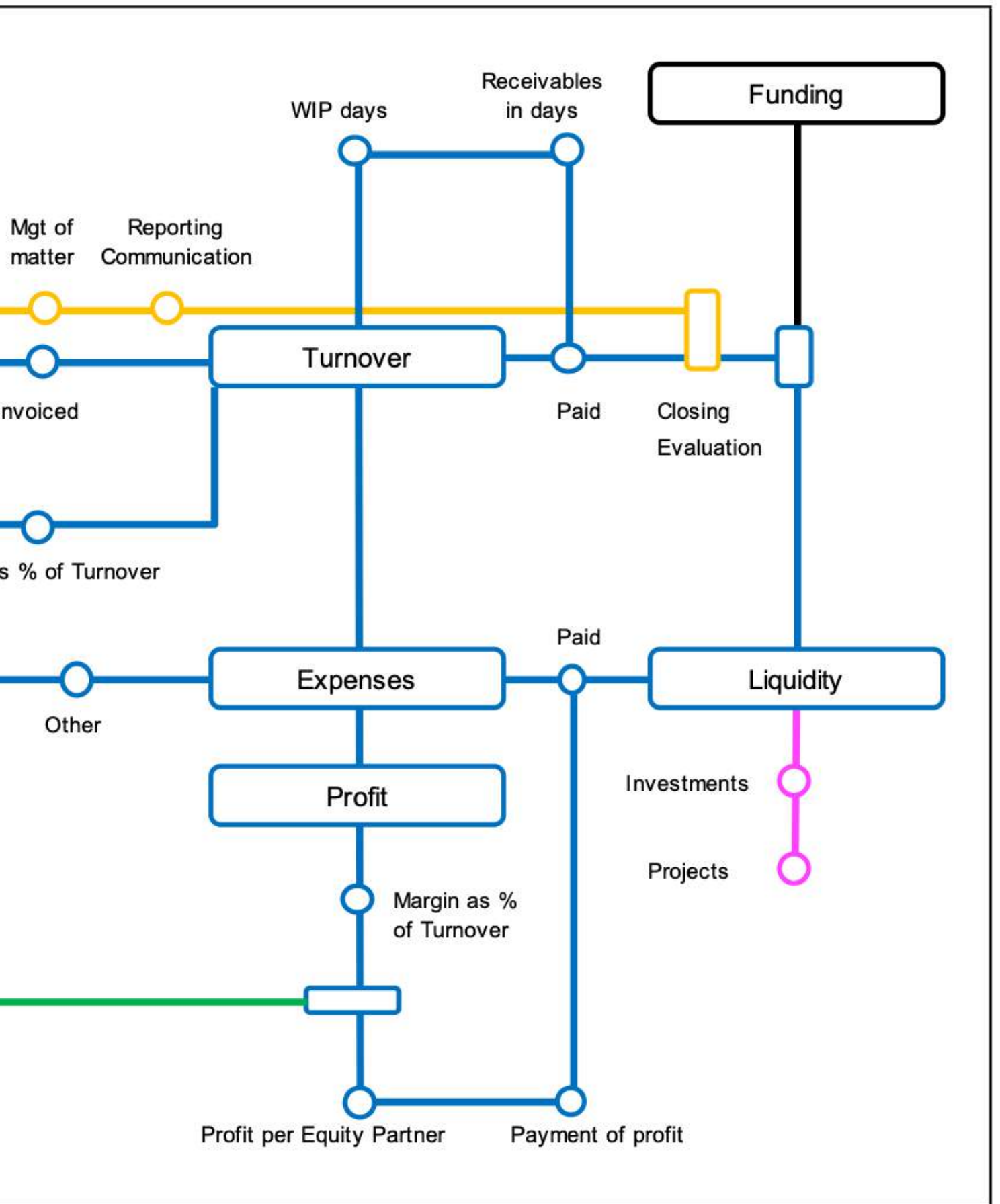
If the client experiences value contrary to their money, then the client is open to alternatives. If you consider the market from Porter's 5-competitive forces model, there will be plenty of alternatives. Firms are used to competing with other law firms, but the model shows more forces that enter the legal market. For example, substitutes (boutiques), new entrants (Riverview and the Big 4), clients (bargaining power and insourcing) and suppliers (publishers provide easier to use tools, directly to the firms' clients).

Financial metro map of law firms



Legenda

- Finance
- People
- Commercial
- Financing
- (Legal) Project Management
- Innovation and projects



What are the elements on the client side that affect profitability?

Pitching

To a great extent, procurement is present during the selection process of legal services. The Purchasing department objectivizes the process by issuing pitches and concentrating the services with fewer preferred suppliers thereby obtaining a higher value for money. Law firms respond more frequently by hiring specialists for pitching, like Pricing Consultants and Legal Project Managers.

Pricing and discounts

Pricing is balancing the costs of the matter with the value experienced by the client. Price management is therefore not only about determining a final price, but also about ensuring the client experiences the added value. In the same vein, this is the reason Legal Project Management spends so much time preparing and aligning expectations, communicating about progress and gathering experiences at the closing of the matter.

AFA

Pricing is less often about the hourly rate, but about other pricing models or Alternative Fee Arrangements (AFAs). Letting go of the hourly rate entails risks. In many models, the risk of exceeding quoted work shifts from the client to the law firm. Alternative pricing, therefore, goes hand in hand with better planning and management of a matter (see the yellow line of Legal Project Management).

Lifecycle

Pricing follows the life cycle of a new product. Each phase of a new service has its own price. At Harvard, the life cycle of a new service is

outlined on the axes; hourly rate and the cost of selling the product. An innovative product requires effort (costs) to introduce it into the market, and due to its innovative character, it justifies a higher price. If the market adopts the product, the selling costs decrease.

This does not go unnoticed as other law firms will also offer (copy) the service. This has a dampening effect on the sales price, so margins are under pressure. Only law firms that produce efficiently can then achieve a healthy margin.

The product and law firm are doomed to die when the margin is under pressure and the cost of sales increases because of extras like free training and discounts which lead to losses on the matters in this quadrant.

Margin of a matter

It is good to determine in which phase the service is, in order to make appropriate investments, relevant propositions or to end unprofitable services in time. An innovative firm does not allow itself to be tempted by price dumping, but constantly creates new products of high value (and therefore price) for the client. It is therefore also important to know the cost price of the hours so that it is already clear in a pitch that you are not offering a loss-making matter in advance.

The green line: people

Profit determinants from employees' side include:

Availability

Without lawyers with the right expertise, the work cannot be done. Correct availability requires careful planning and monitoring of staffing levels. Overstaffing leads to an inefficient firm.

Staffing and projection

The occupancy planning is not only about this year. It is necessary to also make a projection of the population into the future. In this way, the firm can anticipate falling gaps in the occupation or unwanted surpluses of a certain level of a lawyer.

Wage costs

Turnover is generated by lawyers. Lawyers receive a salary. In a situation of many lawyers in relation to the available work leads to overcrowding, which makes production too expensive in relation to the turnover.

Staff ratio

It is more convenient to use inexpensive employees for certain tasks, however; support also has its price. In the international market, benchmark figures are available on a healthy ratio.

A sound vision on service levels and costs are needed here.

Leverage

When considering the earnings per shareholder, there are two parameters; the law firm profits and the number of partners. American research shows that firms that monitor the performance of partners and ultimately draw consequences from the performance are able to realize 15% more profit per share than firms that do not monitor and manage the performance of partners.

Flex

Does the law firm want to connect everyone to the law firm or does the firm have a flexible shell to accommodate peaks?

It requires a thorough understanding of the developments in the market in order to

achieve a good match between the work supply and recruitment of the right people. And when a law firm succeeds in this match, people are happy and they have enough growth opportunities in a healthy law firm.

The black line: funding

An important issue on the black line is whether the law firm has sufficient financial resources at its disposal in case of bad times. It is therefore important that a budget (variable) is available to cover the short term and long term.

Short term

A law firm is only a few months away from bankruptcy when partners receive their full share of the profit yearly. When turnover and payments on receivables decreases, expenses continue while there is no income in return because many law firms pay out the entire profit for the financial year in full leading to a situation of having no reserves. It is therefore important to have a clear view of the elements of turnover monthly, from the start of a new matter without exempting the payment of the last invoice and to act where necessary.

Long-term

A monthly well-functioning law firm is no guarantee for financial success. In the case of a large investment, a significant amount must be put on the table at once. Does the law firm have these resources available? External funding or partner loans may then offer a solution.

Goodwill

A number of law firms run another risk. In the case of goodwill constructions, it is important to look further ahead. As the example of the renowned Dutch consultancy firm Boer Croon

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shows a sudden outflow of money by departing partners can kill the firm.

It is therefore not only important to budget for the coming year but also forecast the balance sheet of the law firm over a longer period of time.

The pink line: innovation and investment

A law firm must keep innovating to remain relevant. The client's call for "more for less" which must be met. Among other things, better management and knowledge systems must be ensured.

Relocation also requires investments in furnishing and other supplies. These investments can cause a large outflow of money. By reason of the law firm frequently distributing the profit for the financial year in full, there is no room for these investments without additional measures. It is, therefore, necessary to prepare investments well, include them in the budget and consider how to fund them.

The yellow line: legal project management

Write-downs put pressure on the profit margin of a matter. Many write-offs of invoices are caused by over-optimistic budgets, rework, a shortcoming in monitoring budgets or unnoticed duplication of work. To prevent this from happening, the attention for Legal Project Management has grown considerably in recent years.

When working within the framework of alternative price, agreements such as fixed prices, planning, budgeting and managing a matter is a must.

In short, project management makes implicit

assumptions explicit thorough (as far as possible):

- Define the goal and scope of the matter sharply with the client,
- Make a clear planning
- Based on this, determine the price
- Record this unambiguously for everyone on board (that is, confirmation of assignment)
- Manage the matter to a successful conclusion within these frameworks
- Identify deviations and communicate them with the client

And finally, evaluate with the client whether the goals have been achieved. Also, a statement on where there is a future need for improvement should be written down.

In this way, the client has more clarity in advance about what to expect and surprises are discussed as much as possible and solved together. In doing so, the firm meets the client's need for predictability, efficiency and cost control, as mentioned in the Buying Legal Council's investigation. And this is not only efficient but is an add-on to the client's perception of quality.

The blue line: financial

Many decisions in the Financial Metro Map lead to financial consequences. Most decisions in a law firm are not made by the board of Finance, but by each of the Fee Earners during their day-to-day work. They agree upon rates, billable hours, invoices and they settle disputes. Each of these activities has financial consequences and determines the extent to which a written hour leads to paid revenue. Modern accounting systems often have good reports which are specially designed for the law firm or firms are using a so-called Business Intelligence tool.

Improvements can be determined by entering into dialogue with the partners. Based on the generated reports about negative and certainly also about positive deviations, an open discussion about the figures and identifying actions together by Finance and the Lawyers ensures that leakage in the revenue chain from acquisition to paid invoice is prevented. Resulting in (direct) profit for both law firm and client.

Closing remarks

Improving the profits of a law firm therefore stands and falls with excellent cooperation between the lawyers, the staff and good coordination of the various internal and external components. The Board and the Finance/Control department are responsible for ensuring that the course of action is fully aligned with the budget and is sustainable in the longer term. All business units are then "tuned" to this. In addition, when implementing the plans, the board must be informed on all elements, so that appropriate measures can be taken to keep the law firm running optimally and to prevent inefficiencies. Leakage results in a loss of profitability, which harms the quality experienced by the client. The model helps in this respect and provides insight into the coherence, for example in the coming budget cycle.

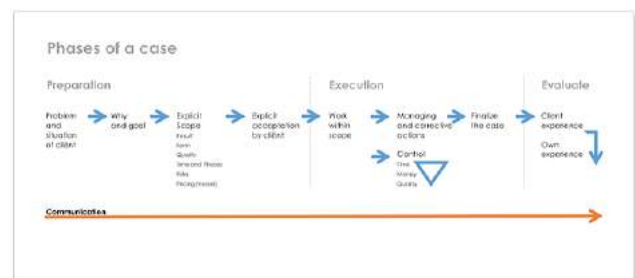
About the author

Hans Schuurman is a consultant and interim CFO. He trains law firms in the Profit Model of Law Firms and Legal Project Management. His primary focus is profit and efficiency improvement within legal services. Based on accessible management information, he improves processes from his Lean background.

He is used to leading large projects. Hans regularly speaks and publishes about the profit model of the legal profession, pricing, Legal Project Management and the new developments within the legal profession. He also participated in the book "De advocaat als onderneming" (The legal profession as a company), which has just been recently published in the Netherlands. Together with Law4ce's partners, Hans is able to continuously improve the business operations of a law firm.

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