

in focus

Profitable Practice

Using Performance Benchmarks to Maximise your Opportunities

Sam Coupland writes that profitability in the Australian legal market is becoming polarised. Successful firms are meeting the challenge of increased competition and rising costs by effectively managing their resources. The strategies employed by these firms can be adopted by all practices to maximise their opportunities.

You don't have to be big to be profitable. In fact, you don't even have to be busy. Being big or busy does not ensure profitability. The profits of even the busiest firms can be hampered by poor managerial practices.

Understanding and managing the economic drivers of your practice will make it profitable – and keep it that way.

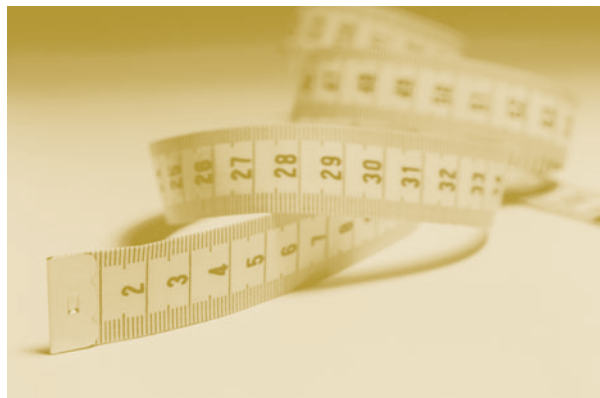
The FMRC Legal 'Law Firm Performance Benchmarks – 2005' shows that profitability in Australian legal practices is becoming polarised. This polarisation is towards either end of the profitability spectrum and does not necessarily correlate with size or location.

The benchmarks show that successful practices are building on their success, while struggling practices are continuing to see the rewards for their efforts diminish.

This is not to say that struggling practices are beyond repair. These practices require well thought out strategies to maximise their potential given the market in which they operate. Principals need to know the current status of a number of performance indicators

and profit drivers. From this point they can work towards a set of clearly defined goals.

Whilst the more financially successful firms share some strategic and operational traits, there is no one true model for guaranteed success.



What are the successful practices doing?

When defining success, many practitioners use descriptions such as challenging work, good client base, financial freedom and lifestyle. A familiar theme in these discussions, either as a direct objective or a means to an end, is firm profitability.

The most common method of measuring profitability of a legal practice is on a 'net profit per equity principal' basis. This is determined by dividing the total dollar value of the firms' profit (before principals'

salaries) by the number of equity principals. This indicates there are two key drivers of profitability – the quantum of profit, and how many ways this profit is to be divided (think: size of the pie and the number of slices).

Whilst some practice areas may be more profitable than others, the real differentiator is how well firms manage the delivery of the legal advice.

Some firms have achieved considerable success through the efficient management of the cost base in what may be considered low profit matters. Other firms may have high value work, but there are limitations in the quantity of it as well as the number and cost of solicitors

capable of doing it. In both instances, success will be driven by how well the practice manages its available resources.

Successful firms are optimising their performance by focussing on:

- Practice group structure
- Fee earner productivity
- Time utilisation
- Margin management

Practice Group Structure

Increased competition across all sectors of the profession has resulted in increased price sensitivity. Accordingly, clients are placing and enforcing different

values on different work types.

In some matters, price (either hourly rate or fixed fee) is not the primary concern due to the complexity or specialised nature of the matter. These matters deliver a high profit margin, though the volume of such matters may be limited.

At the other end of the scale are the low margin matters where clients are shopping on price. Individually, these matters deliver very little profit margin, but if a firm has sufficient volume it can be lucrative work.

The key to success across the spectrum of work types is the cost of production of the individuals working on the matter. Successful firms know that cost of production attaches itself to an individual, not an activity and structure their practice groups (and firm) accordingly.

Low margin high volume work is conducted by paralegals, articulated clerks and junior solicitors. The role of the principal or senior lawyer is primarily one of supervision. These practice groups generally have a leverage ratio (number of fee earners per equity principal) of greater than five to one.

The high margin matters are more difficult to leverage as they usually require senior people to do the work. These people are scarce and often expensive. Depending on the matters undertaken, these practice groups generally operate with leverage ratios of between one and three fee earners per equity principal.

Whilst leverage is often seen as one of the key profit drivers of a legal practice, success is determined by having an appropriate leverage structure given the firm's client base and legal offerings.

Fee earner productivity

The productivity of the employed fee earners will have a significant impact on the success or otherwise of the practice. For fee earners to be effective they need

to generate income in excess of their salaries and associated on-costs (their share of support staff salaries and non-salary overheads).

The performance benchmarks showed a huge variance in fees generated by employed solicitors – a range from \$95,000 to \$270,000 per annum.

Whilst some of the variance is location specific (CBD vs regional), it also indicates differentials in basic employee management such as: the relative skill levels of solicitors, the training given, the quality of files assigned, the monitoring of performance and the delegation process.

The successful practices invest significantly more time training their employed fee earners, matching skill sets with workload and monitoring performance. These practices define what they consider to be excellent performance and communicate this to their fee earners. Often the definition of 'performance' will involve

both subjective and objective factors and include measures such as:

- chargeable hours, billings, collections, WIP and debtor management
- file velocity
- quality of work performed
- involvement in client maintenance and development
- non-legal contribution to the practice – such as training, supervision, etc
- contribution and commitment to the firm's culture and values

Successful practices give consideration to the information they share with their key fee earners. Recently FMRC Legal asked some of the better performing firms to identify what they believed contributed

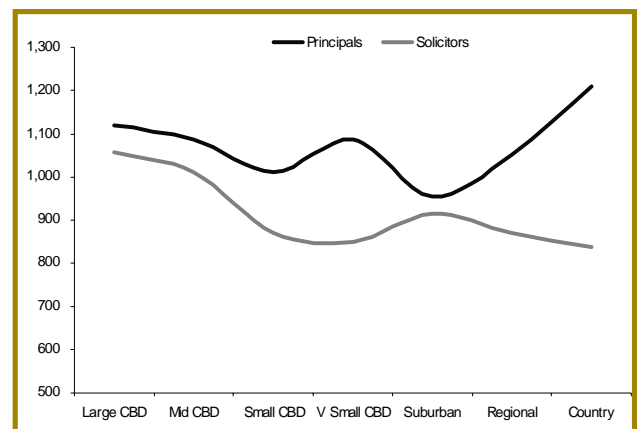
to their financial success.

The majority of firms identified 'financial management education for all fee earners' as one of their success factors.

Time Utilisation

Individual fee generation correlates strongly with chargeable hours recorded. On average, principals and solicitors record around 1,200 chargeable hours per year (5.2 hours per day).

The following graph shows the 'effective chargeable hours' for principals and solicitors. Effective chargeable hours are equal to recorded chargeable hours less write downs. This provides a sensible guide to the productivity of each fee earner.



The most striking feature of the graph is the decline in effective chargeable hours for solicitors and the correlation with practice size and location.

There may be many reasons for this differential. As with fee earner productivity, it may be a result of the quality of files solicitors are working on, the level of delegation in the practice or the level of performance monitoring.

Poor time recording often occurs because solicitors feel that they cannot charge for a certain activity, therefore they do not record it. Solicitors should be encouraged to record all activity and any necessary (and approved) write-offs can be made as part of the pricing decision when it is time to invoice the client.

Principals in the successful practices generate sufficient work to keep

themselves and supervised lawyers productive.

Margin Management

Over the past 5 years increases in practice costs have not corresponded with proportional increases in productivity and profit. Salaries, as a percentage of income, have increased significantly. Non-salary overheads have also increased. The practices that have adapted well have identified where the firm is likely to be exposed and focused on the components of profitability, work allocation and cost recovery.

The successful firms delegate effectively, constantly monitor performance and invest in job specific training. In these practices low margin work is largely systems driven and performed by those with a lower cost of production. Completion times for fixed fee matters are closely monitored to maximise the return per matter.

High performance practices actively recover soft disbursements such as phone calls, photocopying and faxes. These costs can total up to 5% of total practice. Non-recovery of these expenses can, in some instances, be the difference between an average profit year and an excellent one.

The Benefits of Benchmarking

Emulating the performance of the successful firms is within reach of most practices regardless of size. Information is an essential tool in this process. Using benchmarks to analyse the performance of your firm relative to others across a number of different performance indicators is a logical starting point.

The following table provides an extract of some key benchmarks from the FMRC

Legal 'Law Firm Performance Benchmarks – 2005'. It is important to note that these are averages from the participating firms and not averages of the profession as a whole.



Implementation is the biggest hurdle many firms face when change is required. Most practitioners know what needs to be done to improve performance but for whatever reason don't do it.

Benchmarking provides an indication of the potential of your practice. It illustrates your areas of strength (to be capitalised on) and areas where the practice needs to focus attention. This forms a solid base when determining appropriate performance targets for the firm.

Sustained success comes from a focus on performance improvement as opposed to profit maximisation. The idea is to identify an activity (or economic driver) where the firm is under performing and make a commitment to improving and developing lasting change in that area.

For lasting change to occur, these initiatives will require the support and commitment of everyone in the practice.

Common economic drivers that successful firms have focussed on are:

- practice group structure
- improved delegation
- completion times and profitability of fixed fee work
- recorded chargeable hours
- minimising WIP write-offs
- improvement in debtor management
- expense management

Success in law firm management is not about analysing the numbers but more about managing the results. Whilst the benchmarks show the way, initial change and lasting success will come from your ability to manage people. It is important that there is dialogue within the firm as to how your strategies can be implemented and how the change will benefit everyone involved.

As leaders of the firm, you need to ensure the people have the skills and resources to bring about the change. You will need to continuously monitor performance, encourage the successes and fine-tune when the wheels start to wobble. Make some small gains then start to take some bigger steps. Before long you will find yourself capable of running.

	Mid Size CBD	Small CBD	Very Small CBD	Suburban	Regional	Country
Expense Margins						
Salaries (excluding principals)	40.54%	38.43%	35.78%	36.10%	37.20%	37.94%
Non salary overheads	32.77%	32.82%	33.22%	30.31%	29.85%	28.37%
Profit Margin (*bps)	26.69%	28.75%	31.00%	33.59%	32.95%	33.70%
Leverage	4.85	4.61	3.76	3.53	4.08	3.23
Effective Chg Hrs						
Principals	1,085	1,010	1,085	954	1,050	1,209
Solicitors	1,012	870	849	914	870	837
Paralegals	916	683	618	819	1,038	904
Hourly Charge Rate						
Principals	\$352	\$344	\$330	\$320	\$301	\$289
Solicitors	\$248	\$262	\$243	\$249	\$241	\$201
Paralegals	\$138	\$142	\$126	\$169	\$148	\$139
Blended	\$266	\$279	\$262	\$258	\$236	\$213
WIP Write offs						
Principals	7.11%	12.39%	15.50%	10.81%	11.72%	0.19%
Solicitors	16.65%	24.83%	25.23%	12.21%	20.75%	16.99%
Paralegals	13.34%	21.58%	20.92%	13.82%	16.43%	9.31%

* bps = before principals salaries

Law Firm Performance Benchmarks

The proven management tool used by successful law firms to enhance their performance.

You will receive the latest law firm performance information that canvasses all aspects of the practice. Your results will be benchmarked against firms with similar turnover; staff leverage; regional and state location and areas of law.

Each year more than 200 firms take part in this benchmark project including Australia's best performing firms. This is an unique opportunity to take your firm to the next level.

1. Customised Benchmarks & Overview Report

Immediate performance feedback - The questionnaire we provide generates immediate feedback on how your firm is performing over a range of key performance indicators (KPI's) against the 2005 benchmarks.

Your Customised Benchmarks and Survey Snapshot - Your results are compared to the benchmarks of similar firms. By comparing your firm's results with those of your peers, you will be able to make informed and constructive management decisions.

Overview Report - This four page summary gives every partner a quick overview of the benchmarks and your firm's performance.

2. Partner Briefing Report

Your firm's performance is ranked against that of your peers for 45 critical KPI's in a special report on your practice. You receive:

- Visuals that illustrate your firm's results against relevant benchmarks.
- A commentary on your firm's performance and where the firm needs to focus its management attention in the next 12 months.
- Details on how to improve profits based upon improvements to some of these critical performance indicators.


Timing

Information collected: July - September 2006.

Partner Briefing Report: Prepared upon receipt of questionnaire.

Customised Benchmarks: Released Dec 2006.

Overview Report: Released early 2007

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Price

- All 3 Reports - Partner Briefing Report, Customised Benchmarks and Overview Report \$1,540 (incl GST)
- Customised Benchmarks and Overview Report \$880 (incl GST)

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