Financial Planning and Management for Law Firms

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PART ONE

Financial Planning and Management – Best Practice
Chapter 1: Matching financial planning with the firm’s strategic aims

As with any profit-maximising organisation, the primary financial planning concern for most law firms is ensuring consistent, predictable profitability. While law firm partners are generally adept, talented legal professionals, many lack the formal training necessary to accurately price and consistently manage client engagements profitably. Although significant gains have been made in this area over the past decade, much remains to be done. Partners and associates must be better educated on pricing methods and project management. Managing partners and practice group leaders must learn to track and manage profitability metrics in real time at multiple levels – firm wide down to specific matters. Perhaps most importantly, firms must learn to align their financial planning and incentive systems with their strategic goals.

Too often, financial planning is treated as a science, with strict rules on leverage ratios, utilisation rates or profit margins. While such metrics certainly have their place, they must be put into the context of a particular firm, with a particular client base and long-term goals. Once this environmental and strategic context is clearly understood, firms can define useful metrics and project management methods to drive profitability.

In the days of hourly rates, which were the dominant pricing method for over three decades, financial planning was significantly easier. Hourly rates ensured, through self selection, that engagements were almost always profitable. Law firms would simply turn down work that did not meet their cost-plus profit requirements. Firm-wide, hourly rates also tended to ensure steadily increasing profits, due to the fact that hourly rates tended to increase year by year. This created a situation where partners could ensure profitability by only managing inputs, namely costs and revenue. Financial planning in this context required managers to hire sensibly and continue bringing in a steady flow of work. In many firms budgeting was a relatively simple case of multiplying fee earners by expected hourly rates and billable hours. Very little attention was paid to the pipeline of work or likely fee arrangements.

Recent changes in pricing structures have fundamentally reshaped the nature of financial planning for many law firms. With the rise of alternative fee arrangements (AFAs), managers can no longer guarantee profitability solely through restrained hiring and more business development. Fixed fees have done away with the assumption that engagements will be profitable by design. This, in turn, elevated the role of project management. Under this new pricing regime, firms must actively manage profitability by understanding the key drivers of their firm’s economics – at the firm, practice and individual level and by work type and client.

The rise of AFAs also changes the nature of budgeting for firms as they must clearly understand the pipeline of work, the type of fee arrangements that the pipeline is likely to have and, therefore, the level of profitability that can be achieved given a particular fee-earner structure.
Generic financial planning strategies backed by best practice project management systems will not yield best results. Financial structures must be tailored to a firm’s specific conditions. Metrics like leverage, overhead costs and even utilisation must be targeted to account for the firm’s position in the marketplace, its short and long-term goals, as well as the value the firm or individual brings to clients.

Fundamentally, each firm must understand how it attracts clients and earns profit before determining which financial planning strategy it should adopt and what indicators must be tracked and managed by firm leaders. This is a common stumbling block for many firms. Firm leaders typically either focus on macro metrics such as profit margins or profit per equity partner (PEP), which can effectively highlight firm-wide profitability problems, but provide little information on specific areas for management intervention. Or they could either focus on micro metrics such as staffing levels or matter profitability, which can hide wider structural problems. Equally common, particularly at the practice or individual level, is a focus on a particular metric, such as utilisation. While this financial planning technique provides lower-level associates with clear goals, it ignores the reality that law firms are relatively complex organisations with various inputs, outputs and long-term goals that all affect profitability.

The ‘Profit Tree’
Many law firms find the ‘Profit Tree’ illustrated in Figure 1 helpful in identifying key profit drivers. The tree broadly illustrates 12 variables that contribute to a firm’s PEP – the most widely-accepted gauge of firm-wide profitability. Of the 12 variables, six (those shown in light grey) are drivers which could potentially form the basis of dashboard reports, helping guide management decisions at different levels in the organisation. The following is a brief description of each driver with a short discussion on its impact on profitability at each level of the organisation and its role in strategic planning.

Leverage

Equation/definition
This is the ratio of fee-earning staff to equity partners.

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\text{Leverage} = \frac{\text{Fee earners (Excluding equity partners)}}{\text{Equity partners}}
\]
Firm wide/practice importance
At the firm wide or practice level, leverage is relatively fixed in the short to medium term. Changing leverage will most likely require an increase or decrease in headcount at one or multiple levels of the organisation. Increasing headcounts will require recruitment, selection and possibly expansion of facilities, which will all take time and financial investment. Reduction in headcounts can theoretically occur quickly in jurisdictions with limited labour protections such as the US, but can involve significant time and expense in other markets, such as mainland Europe. In either case, large-scale headcount reductions rarely happen as they often have negative effects on a firm’s image in the marketplace and can negatively affect service quality and future recruitment efforts. Due to these reasons, leverage is often only changeable in the medium to long term.

For this reason, target leverage ratios must be clearly stated and managed closely at all times.

Client/matter importance
At a client/matter level, leverage can be altered easily in the short term. At the onset of an engagement, the lead partner will typically select a team assembled of lawyers at multiple levels, who will work on the matter in question. The lead partner should clearly state which tasks are to be completed by each member with stated time targets. This will create a target time-spend leverage model for the engagement. As the engagement unfolds, this model can be changed to reflect cost overruns on particular tasks by shifting time from more senior staff members, to junior staff members. In doing so, the engagements leverage ratio can be altered to ensure profitability.

Target range
Firm or practice leverage will depend highly on the type of legal services the firm offers its clients. Among the top 100 UK law firms, leverage ratios in 2010 ranged from 2.7 to 16.6.1 Specialist firms providing high-value add services will have low leverage models, as partner involvement is a key component of the firm’s value proposition. On the other hand, firms providing low-value commodity services will require high leverage ratios, to ensure services are offered at the lowest possible price. Practice leverage ratios will follow similar patterns, but will be somewhat reflective of the organisation’s firm-wide leverage ratio to ensure consistency of services. It is important to remember that leverage ratios will have a direct impact on profit margins, when the cost of equity is accounted for. For highly-leverage firms with fewer equity partners, the cost of equity will be lower and profit margins may appear higher. For firms with low leverage, the opposite will be true. These firms would expect lower profit margins once notional salaries and the cost of equity are included. For example, two firms with identical revenue and overheads costs but different leverage ratios, will result in different profit margins. The more leveraged firm will appear significantly more profitable. This is due to the larger number of equity partners in the lower-leveraged firm. Costs emanating from equity partner notional salaries and the expected cost of equity will depress accounting profits and result in lower margins. It is important to note that these are paper differences rather than cash differences – both firms will deliver similar equity payments to their equity partners.
Strategic/operational implications
Operationally, leverage ratios raise important questions on the role of equity partners within firms. Many equity partners, particularly in smaller firms, have a tendency to continue operating as associates or partners, devoting a significant amount of time to client engagements. Such a strategy can have negative implications on engagement profitability and fails to leverage the partner’s unique skills. Equity partners’ proper role in a firm is team oversight, client management and training of junior lawyers.

Utilisation rate
Equation/definition
Utilisation rate is the hours charged as a percentage of the total hours a fee earner is contracted to work. Available hours should be adjusted to include paid time off such as holidays, vacations and sick leave. For example, an employee with four weeks of vacation, two weeks of national holidays and an estimated one week of sick leave would have 47 weeks of available hours, multiplied by 40 hours per week, to equal 1,880 hours per year.

Firm wide/practice importance
Utilisation can be an effective metric to gauge the intensity at which a firm or practice group is using its fee-earning staff. Low utilisation rates imply that a firm is overstaffed for the amount of work it is currently bringing in, suggesting that it should either reduce headcount or increase business development activities. Abnormally high utilisation rates, on the other hand, can be a warning to management that fee-earning staff are overworked and additional hiring may be needed to ensure staff availability and consistent quality of services.

Client/matter importance
On a project/matter level, utilisation can be an effective tool to gauge if a project is being managed effectively. At the beginning of an engagement, the lead partner should clearly state how many hours each team member should devote to the matter in question. If a team member has charged more time to the engagement than their target, their utilisation rate for the engagement will be above 100 per cent and provide an early warning to the project managers of profitability risks.

Target range
Firm-wide or practice-level utilisation targets should range between 90 per cent and 75 per cent. Lower utilisation rates imply that the firm is overstaffed while higher utilisation rates imply that fee earners might be overworked. On an individual basis, utilisation targets should depend on the individual’s role within the firm. Typically, utilisation targets should decrease with seniority. Individuals with management, training or business development duties, such as equity partners should have significantly lower utilisation targets than associates, who should be primarily focused on fee-earning work.

Chargeable rate per hour
Equation/definition
To recognise how time affects profitability, chargeable rates need to be assigned to fee earners, even for flat fee or other alternative billing arrangements. Chargeable rates are often calculated from historic information and determined on a cost-plus method. The calculation is usually based on the total
revenue the firm requires to cover costs and deliver a desired profit margin, divided by historical billable hours, adjusted for the level of historical write-offs. This average rate is then adjusted by fee-earner category. This chargeable rate gives an indication of the necessary level of income required to cover firm-wide costs and deliver a profit if the fee earner achieves the desired number of billable hours.

Firm wide/practice importance
Chargeable rate per hour can be an effective metric to gauge the value a firm is providing to its clients. Achieving relatively higher rates imply that the firm or practice area is providing higher value add to its clients, while lower rates imply that a firm is providing low value, routine commodity services. This information, if tracked over time against competitors, can provide valuable information to firms if they are moving up or down in terms of their peer group. Within firms, chargeable rate per hour can be a useful gauge to evaluate the relative profitability of different practice areas. If a firm has a wide range of chargeable hours, it must ask itself difficult questions as to why it is offering lower-value services and whether they are essential to its overall strategy.

Client/matter importance
On a client/matter level, chargeable rate per hour can be a useful gauge to determine the relative worth of a particular service or client. Similar to its use in practice areas evaluation, firms can determine the chargeable rate for a particular kind of matter or client. This can allow firms to spot areas of opportunity, which could warrant further investment and areas with low returns, which could warrant retrenchment. Evaluating matters by chargeable rates can be particularly useful to spot problems in project management. Theoretically, comparable matters should have similar chargeable hourly rates. While hourly rates will rarely be identical, wide ranges of rates among similar matters should help firms identify best practices and problem areas.

Target range
There is no rule of thumb for chargeable hourly rates. Rates will vary widely depending on a firm’s reputation and service offering. Furthermore, rates will often vary widely within firms, depending on the practice area or matter type. To target chargeable hourly rates, firms must choose an appropriate peer group for each practice area, research their stated hourly rates and then adjust to estimate for billable hours and write-offs.

Strategic/operational implications
Chargeable rate per hour is, to some extent, a fixed item in the short to medium term. Over time, rates can be influenced by improvements in a firm’s reputation or mix of services offered. This implies that chargeable rates are a function of a firm’s long-term strategic planning and that firms should explicitly target long-term rates in their three to five year strategic reviews.

Realisation rate
Equation/definition
This is the difference between the chargeable per hour rate and the rate paid by the client after all write-offs, discounts and other adjustments have been taken into consideration.

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\text{Realisation rate} = \frac{\text{Average rate at selling price} - \text{Average realised rate}}{\text{Average realised rate}} \times 100
\]
Firm wide/practice importance
At the firm-wide or practice-area level, realisation rates can provide managers with a better understanding of how write-offs, due to reductions in price or cost overruns in fixed fee arrangements, are affecting revenues. This, in turn, can provide valuable information on how well partners are pricing and managing projects. If write-offs originate from discounts, partners should be better educated on the baseline prices the firm requires for each matter type. If, on the other hand, write-offs occur due to cost overruns, the firm must learn to price its projects more appropriately and train its staff on project management to ensure profitability. It should be noted that not all write-offs are inherently negative. Managers must take into account business development and client retention activities when evaluating realisation rates.

Client/matter importance
On the client or matter level, realisation rates are most often affected by discounts or write-offs. It is important that partners recognise the impact of discounts on profits, especially where a firm may have already agreed discounted rates as part of volume agreement with a large client. Additional rate reductions, after volume discounts, can erode profit margins quickly. For this reason, it is important to model all rate reductions and discounts prior to price negotiations with clients. This will give partners a clear understanding of the lowest price that the firm can agree for any particular matter.

Target range
Realisation rates for most firms should be greater than 85 per cent. Rates below this figure suggest that the firm’s rate structure is out of line with its value add and that continued write-offs or discounts are necessary to maintain client relationships.

Realisation rates for firms with a large amount of fixed fees should be closer to 100 per cent.

Strategic/operational implications
Realisation is a short-term driver that partners can control by giving greater attention to project management, pricing, billing, collections and any further discounts given during these processes. This implies that it is a metric that gauges operational efficiency, rather than strategic effectiveness. Operational metrics are particularly sensitive to information availability and training activities. Realisation rates are therefore best managed through a combination of regular training of partners and associates on project management techniques and continued gathering and analysis of past engagements to determine proper pricing and best practices.

Salary cost per lawyer
Equation/definition
There are two distinct types of salary costs that must be accounted for to determine the average salary cost per fee earner: non-equity fee earner salaries and equity partner notional salaries. Non-equity fee earner salary cost is simply the cost of salary and other direct benefits (such as pension, healthcare, etc.) paid to employed fee earners. Given that equity partners are paid from the profits of the firm and do not have a direct cost – except for benefits – a notional salary must be estimated for them to ensure that sufficient profit remains to adequately compensate them for their time and expertise. If a notional salary is not included, the firm’s accounting cost base will be skewed lower which, in turn, will negatively affect chargeable rates and profits. If a notional salary is not used, it also means that practice groups or teams
cannot be fairly compared as they may have different leverage structures. There are a number of ways to calculate a notional salary. The simplest is to take the highest salaried fee earner in the firm and apply a premium, for example, 25 per cent. Another option is to consider what a general counsel would be paid in equivalent corporate settings and use this as the salary level.

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\text{Direct salary costs} + \text{Direct benefits} + \text{Notional salary costs} \over \text{Fee earners}
\]

**Firm wide/practice importance**

On a firm-wide level, salary costs are relatively fixed in the short term, as firms cannot reduce headcounts quickly or renegotiate salaries. Furthermore, salaries are relatively out of the control of most firms, due to the competitiveness of legal labour markets. This implies that firms should be wary of over hiring, even in times of market expansion.

**Client/matter importance**

Due to the fact that salary costs help determine chargeable rates, they have a large impact on the profitability of matters and the fees that clients pay. The most effective strategy to minimise salary costs on a particular engagement is to reduce the involvement of senior partners. This can prove difficult as law firms and clients often disagree on necessary involvement of senior partners. For this reason, it is important to justify the salary cost and implied chargeable rates for each fee earner on an engagement. This exercise will help clients better understand the value add that each team member brings to the table and, in turn, allow for the most appropriate allocation of resources.

**Target range**

Salary costs are determined by labour market activities and the types of fee earners a firm targets as its employee base. Salary costs will range significantly based on country and city. Likewise, they will vary depending on the level of expertise, specialisation and background of the individual in question.

**Strategic/operational implications**

Several firms have the stated goal of hiring the best and brightest legal experts in their jurisdiction and will therefore strategically plan to pay above-average salary costs. Such efforts can only be justified for a very select group of firms which have premium pricing power due to well-entrenched reputations. Most firms will have to benchmark and model the impact of salaries on chargeable rates and profits to ensure that they fit in with the firm’s overall financial plan. This is particularly true for office raids or partner poaching exercises, which can require the offer of above-market salaries. Such moves should be done carefully and deliberately, with a clear understanding of the moves’ impact on the firm’s financial plan.

**Overhead costs per lawyer**

**Equation/definition**

These are all non-salary earner salary costs, including real estate, other salaries, technology, business development and other costs, divided by the number of fee earners. Overhead costs can either be shown as a percentage of revenue (showing the overhead cost of a unit of revenue) or as a cost per lawyer. We prefer the cost per lawyer approach as it clearly states a revenue amount that all fee earners must generate after their own salary cost to achieve profitability.

\[
\text{All non-salary costs} \over \text{Fee earners}
\]
Firm wide/practice importance
It is critical to remember that a firm must match its cost base to the market position it is aiming to achieve. For example, if a firm wishes to operate at the top of the market, then there is a significant cost base required to provide fee earners with the support needed to ensure the high-level service that premium clients expect. Likewise, firms specialising in commodity work will need to minimise their overhead costs, to ensure that their prices are competitive. This is the reason many commodity-focused firms have large offices in smaller cities, rural areas or are considering outsourcing portions of their workload to lower-cost markets such as India or the Philippines. It is interesting to note that the most profitable firms in the UK market also have the highest cost per fee earner, however, this is due to their focus on high-value work and the need to provide a high level of back up to their lawyers.

Client/matter importance
There is some disagreement on how overheads should be charged at the client or matter level. Some argue that engagements, which clearly require less administrative time, should be charged a smaller portion of overhead costs. While there is some validity in this argument, we strongly advise firms, for simplicity sake, to charge overhead on a per-lawyer basis, rather than on a practice, client or matter basis. This simplifies pricing, project management and project evaluation, creating a single hourly rate to charge for each lawyer. Many firms have also taken the decision to only measure net contribution at client or matter level, rather than full profitability. By measuring net contribution, it removes the arguments about how overheads are distributed and also provides a measure of the costs associated with delivering the revenue attained from that matter or client. Net contribution is calculated by taking direct costs from the revenue.

Target range
There is no target for overhead costs as they vary significantly from firm to firm, depending on the amount of auxiliary services needed to deliver expected value to clients. While targeting overheads may be difficult, it is important to ensure that they remain in line with salary costs and do not depress margins. If direct costs are around 40 per cent, then overheads need to be in a range up to 30 per cent if there is to be a reasonable profit margin.

Metric implementation
Identifying potential profitability metrics is the first, and most simple, step in financial planning. The heavy lifting begins when firms ask themselves the difficult questions that are necessary to match their financial plan with their strategic aims:

- What pricing band is reasonable for the services offered?
- What utilisation is reasonable if business development is a primary goal?
- Are lower profit margins a tolerable cost to defend market share? and
- Are differences in office or practice area profitability reasonable for new ventures? If so, for how long?

Such questions are particularly important for large firms with complex multi-office, multi-practice area strategies. These firms often cannot manage on a single financial plan and instead, have firm-wide plans created from a combination of market development plans, new venture plans and more office or practice area plans to address specific issues related to individual units. Fundamentally,
however, the financial planning cycle for these units is similar to that of small firms. Whether it is individual units of entire firms, management must first address the current environment that the organisation exists in and then address its long-term goals. Both will have implications on the organisation’s financial plan and target metrics. Note that most of the analyses that follow could be applicable to a practice area or individual office but ‘firm’ will be used for simplicity.

The first step in this process is to identify the firm’s core client base and underlying value proposition. It is important to relate the value the firm brings to its clients against other firms within the market, so as to understand the firm’s relative value. This is because, in markets with little competition, a firm’s value is significantly higher than in markets with heavy competition – even for the same product. Once a firm’s relative value is understood, a pricing band for its services should become apparent. For planning purposes, a notional chargeable rate needs to be established, although this may vary across the firm, with different practices working at different value points in the market. This rate will, in turn, help define the firm’s leverage ratios and direct costs. For firms operating in high value-add services with high chargeable rates, lower leverage ratios and higher direct costs will be appropriate as clients will demand a larger role for senior fee earners and a greater amount of administrative services.

On the other hand, firms specialising in low-value commodity work will want to maximise leverage ratios and minimise overheads costs. Some firms may even opt to have non-fee earning supervisors managing fee earners, thereby reaching perfect leverages. It is important to note that this exercise should not solely be done on a firm-wide level. Prices, leverage and overhead costs requirements should be calculated on a practice area or office basis, to ensure that different market conditions are accounted for. Once unit targets are created, they can then be combined to form firm-wide targets.

Once a firm’s current situation is accounted for, its strategic plan for the future must be incorporated to ensure that the financial plan supports management’s medium and long-term goals for the organisation. This process can be significantly more complex than the previous financial planning exercise due to the fact that implementing strategic plans often requires investments which, in turn, require profitability tradeoffs. For this reason, there are no rules of thumb for strategic-focused financial planning. Profitability tradeoffs are almost always the result of a negotiation within the firm on the potential risk of investment versus the short-term costs. To facilitate these discussions, we outline financial planning exercises for various strategic goals further.

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<th>Strategic goal</th>
<th>Financial planning guidelines</th>
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<td>Grow capabilities in new markets</td>
<td>A strategy demanding growth in new markets – whether it is in foreign countries, additional offices within home countries or new practice areas within existing offices – will incur additional costs in new staff and supporting overhead. Business development activities and the slow generation of revenue, which is expected in most new ventures, will produce below average utilisation rates. Realisation rates may also be abnormally low due to discounts which are often necessary.</td>
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<td>Strategic goal</td>
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<td>to gain market share from competitors</td>
<td>To account for these factors, firm management should set targets for new ventures on revenue generation, utilisation, realisation and other important metrics for the short and medium term. Furthermore, management should be clear on the expected costs, benefits and potential risks of each venture prior to decisions. This will allow the firm to evaluate potential projects against each other. Ventures should be tracked diligently to determine the actual cost and variance from budget.</td>
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<td>Grow existing markets</td>
<td>If the firm’s strategy is to grow existing markets, it may be possible to hold business development, overhead and other related costs neutral, while growing revenue and/or utilisation. This is particularly true in fast-growing markets, such as southeast Asia, where additional demand is outpacing new entrants. In slower-growing competitive markets, however, a firm may have to sacrifice some profitability for greater market share. In this case, greater investment in business development may lead to lower utilisation. Firms should track the costs and revenue gained from each method of business development (speaking at conferences, one-to-one meetings with potential clients, etc.) to gauge their relative usefulness.</td>
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<td>Defend market share</td>
<td>If a firm is facing competitive pressures firm wide or in specific business units, it may choose to defend its market share through reduced rates or additional non-fee earning services to clients. While such efforts will often result in lower profitability, there are methods to defend market share while protecting profit margins. Firms should attempt to reduce overhead costs and freeze new hiring. This will reduce chargeable rates per lawyer and raise utilisation. If these methods are not an option, the firm may have to make the difficult decision of choosing to accept lower profitability, if only for a short period of time, or retrenching from a specific geographic region or practice area. Such decisions should be made by evaluating the strengths and weaknesses of competitors and determining if short-term profitability reductions can yield long-term benefits in terms of competitor retrenchment or future possibilities in the market in question.</td>
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<td>Move up the value chain</td>
<td>Firms often state that their long-term strategic goal is to move up the value chain to higher-value add services. Such a strategy involves significant investments in salary costs, overhead and business development. Poaching of senior</td>
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Financial reporting and reviewing tips

Once firms select their financial strategy, the next step is to create useable financial reports to help management track performance and inform future decision making. While many law firms currently employ some form of reporting structure, few have reached the level of rigour that has become commonplace among top-performing professional service firms over the past two decades. This is not for lack of trying – law firms typically have an abundant amount of data available. Unfortunately, this information often fails to be useful on two critical measures – consistency and clarity.

Management reports are often data dumps, pulled from accounting databases that were originally built to facilitate end-of-year tax preparation, rather than track costs and revenues in real time. Such reports may overwhelm busy equity partners with too much information. To best facilitate decision making, it is essential that the information be collected and displayed in a way that is consistent, clear, concise and supportive of the firm’s culture. The following tips outline best practices in law firm financial reporting and aim to help firms avoid common stumbling blocks.

Tip one – Avoid repurposed information

Some management reports are based on analyses of re-purposed data that was originally gathered for other reasons. The most common source of re-purposed information is accounting databases. While such data might be useful as part of quarter or year-end financial reviews, it has several problems. The most glaring is that a reliance on re-purposed information can often leave some essential data out of management reports. Furthermore, accounting data is often cash based – counting costs and revenues when they are paid or received rather than when they are incurred. This accounting method can make real-time tracking of matter profitability difficult while also misrepresenting firm-wide and practice-level data. The mistiming of revenues and costs can distort key profitability ratios by incurring costs and revenues in different periods.

For these reasons, we recommend gathering data for managerial reports separately or, at least, ensuring that financial databases are equipped for tax accounting (often cash based) and managerial accounting (accrual based).
**Tip two – Ensure that reports are readable**

There is an old accounting adage that says, ‘You can’t manage what you don’t count’. Equally apt, however, is the idea that the metrics that are being counted must be clearly and concisely presented. The most effective management reports are as brief as possible and present only the data required to facilitate decision making. Managers – whether they are at law firms, investment banks or ‘Fortune 500’ companies – are almost always strained for time. They should therefore not be expected to wade through raw data or create analyses themselves. A single summary page should provide a manager with the information necessary to identify potential issues on which to focus attention. These reports should employ the pyramid approach – starting with the big picture and progressing to detail as required. The big picture should focus on the key metrics of profitability that the firm has identified in financial planning exercises. These metrics should be compared against agreed-upon targets, and those overperforming or underperforming should be singled out for greater inspection.

**Tip three – Consistency**

It is imperative that management reports be internally consistent in both format and content. Consistently-formatted reports provide the same categories of information to all levels of the organisation with the appropriate amount of detail, i.e. firm-wide reports should provide big-picture summaries of the same information provided in reports at the practice area and individual partner level. This is not to mean that management reports must be one-size-fits-all. New offices, practice areas or other ventures may have additional metrics which need to be followed. Senior partners focusing on management will have to be treated differently than those focused on business development. The key to consistency is not to treat all aspects of the firm identically but rather, to have similar information about every component of the firm to understand the trade-offs of certain activities versus others. For example, tracking the utilisation and chargeable rate per hour of a partner focused on business development may seem like an unproductive use of time. However, fully understanding the opportunity cost of the partner’s time will help managers evaluate the profitability of their business development activities.

**Tip four – Distribution of data should be treated carefully**

It is vital to ensure that the content and distribution of management reports reflect the firm’s actual culture and support its desired culture. For example, widely-disseminated reports that display the performance data on peer performance and/or individual utilisation metrics may create a culture of competitiveness. While this may be desirable, it can also undermine team-building efforts designed to spur collaboration. Advance consideration of who will be permitted to view information and the effects of dissemination on the firm’s core strategic goals should be considered closely at senior levels.

**Financial planning – An ongoing endeavour**

In the short to medium term, these reports should help team leaders and firm managers steer projects and firm-wide initiatives toward consistent, sustained profitability. This is particularly true on the matter or engagement level, where regular reporting can help inform project management. At the outset of an engagement, team leaders
should identify the resources needed for the project’s completion and create a detailed plan stipulating each member’s deliverable due dates and target hours spent. Regular profit and loss (P&L) reports for each engagement should inform team leaders on deviations from the plan. Cost overruns on portions of an engagement should be offset whenever possible by cost reduction methods such as replacing low-cost fee earners for partners. The importance of regular engagement reporting and proper project management cannot be underestimated, particularly in the era of fixed fees and other alternative billing arrangements. Ensuring that each engagement is profitable is the simplest way for firms to meet their financial goals and ensure firm-wide profitability.

Many law firms make the mistake of viewing reporting structures as a tool built solely for current decision making. When data is appropriately collected, it can be used to inform decisions long after it has been gathered. Project management, pricing, new venture investment and other key management decisions should always be informed by historical information. This is best accomplished through P&L reports on each activity. Whether it is a single matter or a new office, P&L reports can help define success and failure and, therefore, help identify best and worst practices. For this reason, it is essential for firms to have after-action reviews and standardised P&L reports stored in a firm-wide database that can be easily searched and analysed. This data, combined with the conversations that are spurred from after-action reviews, should help partners price engagements more accurately, manage projects more effectively and, ultimately, help firm managers drive profitability.

Financial planning should not be viewed as a singular event or something that is carried out once a year, quarterly or even at the end of every month. Financial planning should be an ongoing endeavour informing almost every decision that firm managers make. On the matter level, lead partners should be monitoring the cost of each portion of an engagement. This will allow them to shift resources, cut costs and bring engagements back towards profitability, long before any money is lost. Similarly, firm managers should monitor the key drivers of each business unit – offices and practice areas – in real time to spot trouble before it takes its toll on firm-wide profitability. To do this, firms will not only have to rethink the way they view finances and strategic planning but also, in some cases, invest in new technology and additional human resources.

Reference