

Financial Benchmarks for Your Firm

by Peter Roberts

We are often too busy to step back and think about the financial benchmarks or standards that a solo or small law firm should achieve. Doing so is a good idea, because you deserve to know how well your practice is performing. There are obvious and not-so-obvious measures of a practice's "financial health." The financial benchmarks to consider include net income, gross fees, realization, and trends.

What is net income for a lawyer? Net income comprises three elements: 1) compensation; 2) fringe-benefit costs; and 3) retirement-plan contributions. The sum of these three components should equal 50 to 75 percent of your gross fees as a solo or per lawyer-owner in a small firm. The remaining percentage pays the overhead expenses of the law firm.

Why is the percentage range this wide? A solo practitioner with staff likely has a net income percentage nearer 50 percent. That lower percentage does not necessarily mean less income than a lawyer with no staff. Having staff can increase your ability to handle more matters. More matters should reflect in higher gross fees. A solo without staff may have a net income percentage up to 75 percent¹ but perhaps with lower gross fees.

Developing a budget for gross fees is important because it:

- Generates data for use in decision-making.
- Defines standards that can be used in performance appraisals.
- Forces planning to occur.
- Creates a need for communication and collaboration.
- Serves as a powerful source of motivation.

A basic way to construct a budget is to use last year's numbers from your tax return for this year. Budget or no budget, gross fees drive the success of the law firm. Most members I meet know pretty well how well the gross fees are doing each month.

Let's look closely at what drives gross fees, net income, and everything in between.

Flat or Fixed Fee. It's your money up front; you earned it with the caveat that if you are unable to do the work, ethics and good client relations suggest that you refund part or all of the fee. The WSBA Board of Governors Trust Account Responsibilities and Retainers Task Force is studying whether and when fees paid to a lawyer in advance must be deposited into a trust account.²

Advanced Fee Deposit. These are monies paid to you that are not yet yours. Always insist on this payment. It tests client resolve. Cash in the bank beats an account receivable any day of the week.

Timekeeping. Capture as much effort as possible in your automated or manual system. Time not recorded is time not billed. Use of the telephone is often under-recorded. Devise better ways to record the time spent for your incoming and outgoing calls, such as using Microsoft Outlook's timer and journal entry feature.³

Capture Soft Costs. Bill for reimbursement of copies, faxes, and long-distance charges. Washington allows a flat nominal percentage of fees for this purpose that avoids the labor of "keeping track" of actual usage by client.⁴

Billing. Billing means you are extending credit. If you extend credit, know whether the client is capable of writing a check for sufficient funds to pay your bills. "Capable" is one thing, "willing" is quite another. Be sure to assess your overall client service and communication. Good service helps persuade the client to write the check.

Reduce Unnecessary Overhead Costs. Look closely at where your money goes for supporting the practice. How large a Yellow Pages ad do you really need? Is there a way to pass on part of the health-plan cost to employees? Can you sublet an extra vacant office? There are few ways to significantly reduce overhead. That is why it is always more productive to focus on increasing gross fees.

Financial Reports. Limit reports to one page. Use graphs for showing trends. One report I prefer is the "Pipeline Report." The pipeline illustrates the relationship of unbilled fees to billings to gross fees received. See Figure 15 for an example.

Accounting systems can generate many types of reports in varying detail. Use only those data that are easily understood. Figure 1 combines data from several reports on a spreadsheet to yield a more intelligible overview of the generation of gross fees — the engine of your practice.

In Figure 1, several things may be discerned:

1. The table compares each lawyer with herself or himself last year.
2. The table compares each lawyer with each other lawyer.
3. The listing of lawyers can be sorted by best realization or other criterion each month.
4. A lower realization will signal a higher inventory (balance) of fees receivable. See Mr. Piper's numbers this year.
5. Total fees (adding Ms. Jones's and Mr. Piper's fees received together equal \$145,000) indicates the two-lawyer firm's fees received equaled last year's fees received. Look more closely to find that Mr. Piper's realization is down to 75 percent from 87 percent. If his realization equaled last year's 87 percent, the firm would have another \$9,600 in fees received. Absent this report, that fact may be overlooked.
6. Contingent-fee matters may obscure below-average realization for hourly-rate work. Use a three-year moving average analysis or similar trend to smooth out spikes in the data.

Qualitative factors in your practice can be as important as financial factors, if not more. Examples include pro bono efforts, new business development activities, and time devoted to mentoring. Acknowledge the importance of these factors often, and do not allow the numbers to dominate your office culture.

Your firm can maximize the profitability and satisfaction of your law practice by understanding the economics that underlie financial success and the qualitative values that underlie your firm's culture.

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NOTES

1. See Altman and Weil's Small Law Firm Economic Survey, published annually.
2. See www.wsba.org/lawyers/groups/-trustaccounttaskforce/default1.htm for more information.
3. Attend a free Hands-on Computer Clinic to learn this tip and other tips for using Microsoft Outlook. The clinics are held at the WSBA each month. See www.lomap.org for the dates.
4. See Informal Opinion 1935 (2001).
5. Consider your firm's culture. Do the lawyers accept such a circulated report? Consider circulating only a lawyer's own report without a comparison with other lawyers. In large firms, it may be possible to segregate the presentation within hourly and contingent-fee practices. Another alternative is not to distribute the report. Keep the report within the management committee. Be sure to understand fully the derivation of all of the numbers so that you can respond to questions on the spot.
6. Realization is the percentage of fees received to fees worked.