

# Lawyers, Fun and Money!



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## Agenda

- Why Do We Need to Teach Law Firm Economics
- Lessons from a CFO
- Pricing Strategies & Legal Project Management
- How to Teach Lawyers the Business of Law

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## Why Teach Law Firm Economics?

- It matters to clients
- It matters to firm leadership
- It matters to associates – who need to know this now more than ever
- It will make them better lawyers and better firm citizens
- It matters to the bottom line – protecting (and trying to get a return on) our investments sooner
- It matters to us

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## Lessons From a CFO

- *The American Lawyer*
- The glossary: alphabet soup
- Revenue and expenses
- Investments in firm
- Challenges in the current environment
  - Trends
  - Profitability
  - Managing risk
  - Fee arrangements



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## *The American Lawyer*

AmLaw 100

AmLaw Mid-Level Associates Survey

Diversity Scorecard

Pro Bono Scorecard

AmLaw A-List Law Firm

The A-List score is calculated by doubling the firm's RPL and pro bono scores and adding those to the firm's associate satisfaction and diversity scores.



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## **The Business of Law: What are the Basics?**

- Generally accepted accounting principles (accrual basis)
- International accounting standards (accrual basis)
- Cash Basis accounting
- Modified cash basis of accounting (what most law firms use)
- Tax accounting
- Cash vs. accrual benefits, drawbacks

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## Alphabet Soup

- **A/R** - Accounts Receivable – Amounts billed but not yet collected
- **Capital** – Partners' investment in the firm relative to their ownership percentage
- **Days Outstanding** – Number of days it takes to turn time recorded into revenue
- **Debt** – Amount firm owes to third parties (ours is zero)
- **Draw** – Preferential distribution of profits
- **Percent Equity Partner Leverage** – % Equity Partner leverage is the ratio of timekeeper hours (excluding % Equity Partner hours) to % Equity Partner hours.
- **Net Contribution and Net Contribution Margin** – The net contribution margin indicates the Firm's profit as a percentage of potential revenue after direct costs and indirect costs are taken out.

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## Alphabet Soup (Continued)

- **PP%P** – profits per % Equity Partner represent the amount of net contribution or profits that would be available for distribution to the firm's % Equity Partners
- **PPP** – The profits per Partner represent the amount of net contribution or profits that would be available for distribution to all Partners
- **Partner Leverage** – Partner leverage is the ratio of timekeeper hours (excluding Partner hours) to all partner hours
- **Productivity** – Measure of how busy an attorney is at any part of the year
- **Rates** – Timekeepers' hourly (or alternative) fees
- **Rate Increases** – The yearly increase in rate which typically occurs in January
- **Rate Progression** – The increase in rates attributed to a timekeeper maturing in class which typically occurs in July
- **Realization** (effective discount) – Realization shows the effect of billings after all discounts and write downs are taken into account.
- **Revenues** – Amounts received from clients for time billed

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## Alphabet Soup (Continued)

- **RPL** – Revenues Per Lawyer – Figure utilized in surveys on firm financials, including *The American Lawyer's AmLaw 100*. Determined by dividing the firm's gross revenue by the number of lawyers, rounded to the nearest \$5,000
- **TVR** – Time Value Recorded – Hours x standard rate, used to analyze utilization
- **UBT** – Unbilled Time – Time that is recorded but not yet billed
- **Utilization** – The number of billable hours a lawyer actually works as compared to the number of hours of capacity
- **Operating Expenses:**
  - Compensation
  - Rent
  - Recruiting Fees
  - Professional Development
  - Client Development
  - Publications/Research
  - Liability Insurance
  - Office Expenses (e.g., Postage, Duplicating, Travel)



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## The Business of Law

### What drives revenue?

- Revenue is a factor of:
  - Rates (\$\$/hour)
  - Hours billed (per attorney per year)
  - Realization
- Profitability
  - Leverage
  - Operating expenses
- Profits per equity partner

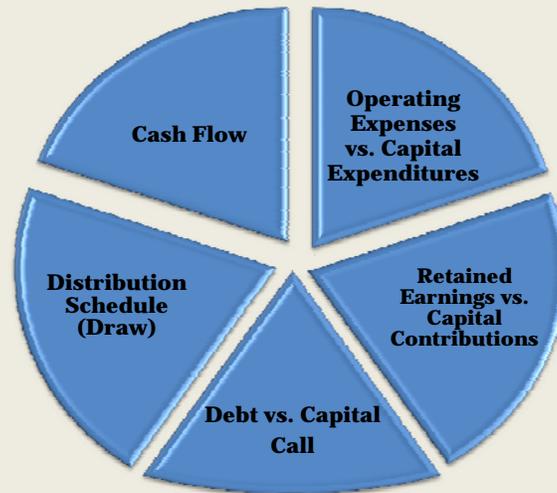
### What comprises expenses? (AmLaw 100 data):

- People: ~65%
- Rent: ~26%
- Everything else: ~9%



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## Investment in Firm



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## Challenges in Current Environment

- Rate pressure
- Discounted work at lower margins vs. less profitable work
- Legal fees going through client procurement process
- Credit is not as available and more expensive
- Fewer major deals
- Associate salary levels represent large fixed cost
- Natural reaction is for firms to protect what they have

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## Trends



- Cuts in legal budgets and focus on attorney fees
- Procurement involvement
- Predictability of legal spend
- Detailed requests for pricing
- Clients applying “best” deal to all matters
- Reporting outside normal billing cycle
- Revisiting former arrangements outside normal RFP cycle

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## Managing Risk



- All revenue is NOT good revenue
- Understand if revenue is accretive/dilutive to firm standards
- Leads to strategic decisions aligning with firm goals
- Pricing process should be part of go/no go decision
- Potential to affect long standing client relationships
- Helps better understand firm performance

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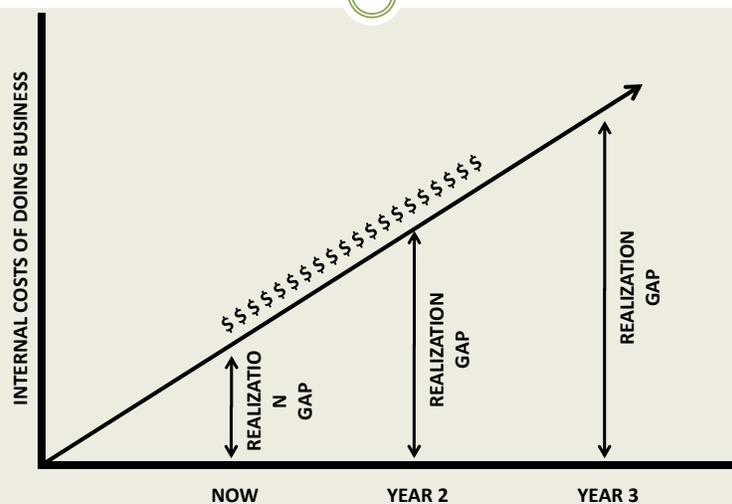
## Fee Arrangements

- Standard hourly rate
- Percent discount
- Blended hourly rate
- Rate freeze
- Volume-based discount
- Fee cap
- Fixed fee
- Flat fee
- Success or bonus rate



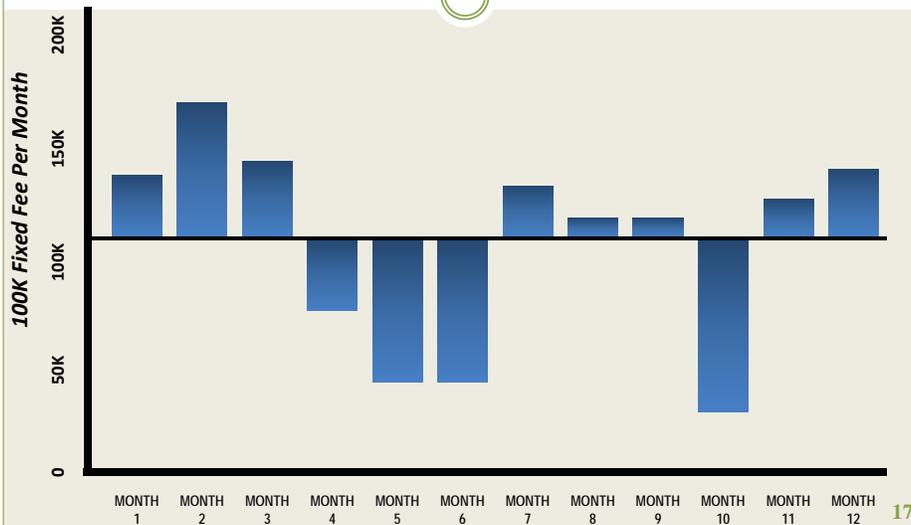
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## Setting Prices Now for Future Work



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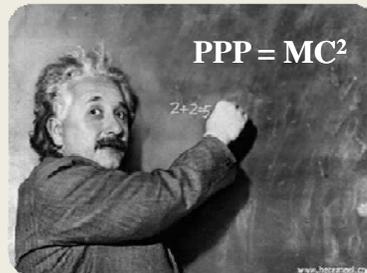
## Managing a Fixed Fee Arrangement



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## How We Are Teaching This

- **Orientation**
  - Understanding Timekeeping (Policy explanation, how a timesheet becomes a bill and examples of bad timesheets)
  - Panel on client service principles (Efficiency, value, etc.)
  - Informal advice from associates
- Quarterly State of the Firm addresses
- Associates Committee presentations
- Practice group and office meetings
- Our core competencies (includes adding value, accountability, client-centered approach)
- Midlevel Associates Retreat (The Business of Law Firms)
- Project Management training
- Collaborating with Finance Department



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## How Others Are Teaching This



### **Program titles:**

- Where Does the Money Come From (and Where Does It Go)
- Everything You Wanted to Know About Law Firm Finances ...
- Budgets, Billing and the Bottom Line
- Law Firm Econ 101
- How an Hour Becomes a Dollar
- Womblenomics
- Commercial Awareness

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## How Others Are Teaching This



### **Presenters:**

- CFO's, COO's, controllers, ED's, firm chairs
- PD Staff
- Business Schools (e.g. Milbank at Harvard)
- Fullbridge and other external providers

### **Formats:**

- Orientation programs
- Midlevel and senior associate retreats
- New partner orientations
- Quarterly/monthly meetings
- Lunch and Learns
- E-Learning module

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## Recommended Reading



- *The American Lawyer* and *The AmLaw Daily*
- Law.com
- Adam Smith, Esq. blog
  - <http://www.adamsmithesq.com>
- *Wall Street Journal*
- *Financial Times*
- *Managing the Professional Service Firm*, David H. Maister
- Your firm's news/financials/reports/results
- NALP-industrynews Digest
- PDC website and listserv
- ABA (Journal, Law Practice Management Section Publications)
- Reports from the banks and consultants

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