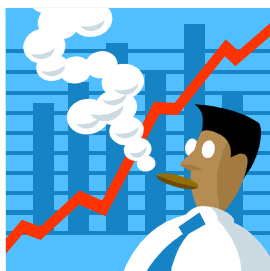


## THE ROAD TO HIGHER PROFITS

If better financial management can produce significant results, why are so many firms lagging behind?

(Oct 05)



Part of the answer to this problem is the secretive behaviour of law firms when it comes to benchmarking their performance. Sure, some large firms are using a certain Australian service, others use the 'Waikato' or our own LegalBestPractice on-line system [www.legalbestpractice.com](http://www.legalbestpractice.com) but how many actually take the remedial actions that can deliver increased profits or margins? Not enough, is the answer.

Part of the problem is that current performance information is not widely published, despite our own efforts. At the end of the day too few partners can readily peel off their own firm's key performance indicators (KPIs) much less know what Best Practice standards are attainable. In Europe and the US this is not the case; performance data is freely available and many firms (to my certain knowledge) apply performance criteria tied to drawing rights/income when setting the goals of their management staff and managing/finance partners. Whilst I am not advocating a move to threatening 'carrot and stick' contracts it would be an improvement if some accountability were introduced. For example, when a large firm has marketing and finance departments why are the senior managers not tasked with delivering specific financially measurable outcomes? A number of firms allocate a % of fees to marketing but few have robust measuring systems for pay-back. The number of website hits is NOT a worthwhile KPI, whereas an increase in fees over time from existing clients in response to a fully costed marketing initiative is. The parallel for finance partners and key financial managers may be to measure and hold them accountable for productivity increases resulting from investment in IT equipment/software or specific improvements in average WIP and debtor levels.

When firms start to see their performance data discussed openly, significant improvements in the whole of the profession should result. To offer some support for the hypothesis that disclosure leads to higher performance we need look no further than productivity as measured in time sold at full selling price. The NZ and Australian markets have been stuck at around 1000-1100 hours for partners and 1150-1250 for assistants for two or more decades. (Whether these figures are kept low by the relatively large % of lawyers who work in small firms is a moot point.) In the US the comparable figures are 1350 per partner and 1700 per assistant. The European figures are behind the US but catching up, fast.

One measure that shouldn't upset any sensibilities through disclosure is WIP, debtors and WIP + debtors. Typically this is measured in 'debtor days' so no fiscal Dollars and Cents disclosure is required. If it is accepted that the fundamental requirement is to convert work done to cash in the shortest practicable time then it would make sense for firms to indicate their year-on-year performance in this area. No one appears to want to go into print on this – perhaps because too few really know what can be achieved and hence don't want to expose their position. LegalBestPractice will shed some light on this by setting out some guidelines:

- First and foremost the type of practice you operate is a fundamental consideration. Peer to peer comparison across the board is futile. A firm generating a major proportion of its income from defended insurance actions will always have a long tail of WIP as actions are often long running and interim billing is not always possible. Insurance firms should not have high debtor levels as insurance companies pay up when the matter finishes.
- Comparison on a 'like for like' basis is the starting point. Only look at firms that broadly conform to your own in terms of client/work 'mix'. Firm size is NOT relevant.
- Be careful not to compare with a firm that is approaching its year end as most firms speed up WIP conversion and chase debtors hard in the last few weeks.

- For firms that derive 90%+ of their fees from transactional work for limited companies WIP of 30 days or fewer is good and achievable.
- The same firms should be able to operate debtors at no more than 60 days and operate within a target of WIP + debtors of 90 days – at all times of the year.
- Firms with a predominantly private client base should keep WIP within 45 days and debtors at no more than 60.
- Set a target for WIP + debtors and hold partners, fee earners and management staff accountable for achieving it.

All the above can become somewhat meaningless if the volume of time sold remains static or below best practice norms. For NZ and Australia the minimum figures to achieve are 1200 hours a year per assistant at full selling price. Another way to consider this is to divide total annual fees by the number of partners in your firm to arrive at a figure of \$s per partner per year. If you are operating below \$475K per partner there is 'room for improvement'. If this surprises any reader consider the following: the NZ profession is geared at 1 partner to 1 assistant overall. Therefore, for each partner/assistant combination there are 2250 hours per year ( $\$475K \div 2250 = \$211$  per hour). Then ask the question "Am I worth more or less than \$211 per hour?"

**N.B. The fiscal calculations are based on New Zealand performance for the 'typical' solicitor. Weighting would have to be applied for metropolitan based commercial practices. For separate Australian figures please email: [co-jones.pmf@clear.net.nz](mailto:co-jones.pmf@clear.net.nz)**

If there is anyone still reading at this point – now comes the interesting part: what is the impact of increasing the volume of time sold?

If each 'typical' partner and solicitor charged one additional 6 minute unit a day or \$21 each the increase in income per partner would be 220 (working days per annum) x 2 x \$21 or \$9240. This only works if the time is actually charged for, the bill sent and collected! It is in all firms' interests to control costs and use sound billing systems. Time recording may be a tedious task but at present there is no better way to record productivity. As more legal services become commoditised, record keeping and performance benchmarks will grow in importance.

In Europe and the US the banking fraternity is on to the mathematics that underpins all financial performance data and expects to be included in the management reporting distribution list as a consequence of providing finance. Many banks have developed their own service industry performance models and have started to apply them. When the application of these models becomes commonplace here in Australia and New Zealand it won't only be the managing partner who gets on your case, it will be the bank manager as well!

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