The concept of measuring law firm profitability has been popular for long enough that most are familiar with it, but when it comes to using it in everyday practice, views and approach range greatly. The goal behind measuring your firm’s profitability is to increase it, not just to know what it is. This article suggests the importance of using this information, at least monthly, and provides examples of business decisions which could be improved, suggestions for displaying profitability data in your existing reports and steps to make it easier to incorporate that data in your decision-making.

The Foundation: “Having” a Profitability Measurement Tool

If your firm has started down the path of better understanding your profitability, you are moving in a financially healthy direction. It takes significant effort to build what I will call, for this article, your Profitability Measurement Tool (PMT). PMT includes your database needed to run reports that display your profit, the key metrics you use to calculate and understand profit and procedures by which you apply the information in making business decisions. If you have this, you have a very solid foundation. This is what I call, “having” a PMT. It is, however, just the start of the process to reap significantly greater benefits from the foundation you’ve built.

You may be like most firms who begin with a once-a-year look to know what your firm’s profitability is, to compare it to the previous year, or to check the relative profit of your practice areas. Also, firms review annually to calculate an associate or contract partner’s profitability as a factor in determining their compensation and bonus. All of these are valuable uses of profitability data, but you can, and should, demand more from your PMT investment.

Maximizing Your Investment: “Using” a Profitability Measurement Tool

What follows are suggestions for ways to use your PMT more frequently and incorporate it into your business decision making, which could lead to increased profit.

• **Business Decision Application:** When negotiating a billing arrangement, knowing the amount you can discount billing rates and blended rates without taking a loss. **Tool:** Create a list of each attorney and paralegal’s breakeven billing rate and update it twice a year. **Benefit:** This would let you know whether you would still make a profit on a given quote, or how much you would lose per timekeeper if you decided to go below some breakeven rates. (Breakeven rates are the billing rate below which a timekeeper is working at a loss.)

• **Business Decision Application:** When hiring a lateral attorney with business, analyzing the probable effect on firm profit, cash flow and the lateral’s compensation. **Tool:** Create a spreadsheet to simulate the expected monthly costs and revenue (work, billing and collection) for the first 12 months (startup) and second 12 months. The spreadsheet could be a template with key firm PMT data and the option to input the variable data for each new situation. **Benefit:** Simulate the cash flow effect, the profit to the firm, and the compensation to the lateral under various scenarios.

• **Business Decision Application:** Identifying working attorneys whose performance is below your preferred profit, taking actions to increase the profit and tracking the results of the actions. **Tool:** Create a spreadsheet using your PMT to list the budgeted profit for each timekeeper and compare it to the actual performance every three months. **Benefit:** The profit of each attorney is your basic building block. You will increase firm profit if you eliminate low-profit situations by increasing those attorneys’ billing rate, work hours, or decreasing their compensation.

• **Business Decision Application:** Assessing and improving the profit of key groups such as practice areas, branch offices, each originating attorneys’ clients and individual clients. **Tool:** The tool to use would be similar to the one described above for working attorneys, just with different groups included in the data. **Benefit:** Increase profit by identifying the groups performing below your preferred profit level compared to those performing well above the profit level. Analyze what makes the very profitable groups so profitable, identify actions to increase profit in the less profitable groups and track progress every three months.

• **Business Decision Application:** Increasing your billing attorneys’ clients’ billing realization and collection realization. **Tool:** Include in your monthly financial reports a report of
the past three years’ annual billing realization rates, collection realization rates and the current year-to-date rates. Present at the firm level and by billing attorney. **Benefit:** Increased realization rates result in increased partner compensation with no additional legal work.

- **Business Decision Application:** Publishing your overhead per attorney amount to your partners when it is calculated each year and explain the year-over-year changes. This amount should be used for many of your profitability calculations. **Tool:** Overhead per attorney. **Benefit:** It is useful for partners to be aware of this amount and how it is changing every year with developments in the firm.

This article lists just a few ideas of working your PMT into business decisions on a regular basis. It doesn’t take long for partners to gain a deeper understanding of ways in which they can contribute to an increase in the firm’s profit, especially as they begin to see and use this information more frequently. The more you use your PMT, the better your skills with it will become. In using applications like those described in this article, be selective at first. Begin with two or three topics that your interested partners would find most relevant, and don’t get bogged down trying to do too many at once. As you become more comfortable with your PMT, incorporating more topics will become more seamless.