

The Future of Profitability Models and Analysis for Law Firms



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Executive summary

The convergence of changes in the legal landscape – wider economic pressures, the growing implementation of legal technologies, the disrupting influence of alternative service providers and their competitive pricing offerings – means that the corporatization of the law firm is well underway. The “business of law” is now more of a priority than ever before, with procurement and pricing professionals playing increasingly significant roles within firms, and a growing focus towards the measurement and analysis of profit, rather than simply its generation, becoming apparent. With this becoming common practice, it is now essential for those at the helm of their firm’s profitability to take a deep dive into its real fundamentals. *The Future of Profitability Models and Analysis for Law Firms* is the latest publication to provide this kind of comprehensive exploration into the recent and revolutionary approaches firms are adopting in their pursuit of greater returns in this current period of renaissance for the law. Featuring contributions from field experts and thought leaders – including pricing directors, chief financial officers, and management consultants – *The Future of Profitability Models and Analysis for Law Firms* combines trendspotting, exploratory intelligence with case studies and real-world examples of best practice to act as a launchpad for application and instruction.

Law firms increasingly require attorneys to scope, plan, and budget matters on the front end, especially matters billed as an alternative fee arrangement. These plans and budgets are often used to set the price and project the profitability of matters, thereby controlling or mitigating the financial risk to the firm. Much attention is paid to getting the “right price” and packaging the value of the engagement so that the client recognizes the price as not only acceptable but completely justified. Getting the “right price” is hard, but executing the plan within the budget can be even harder. Monitoring performance to the budget on a regular basis for conformity and to reduce inefficiencies or working out of scope, will, in turn, reduce write-downs and write-offs. This approach is an essential

– if often overlooked – step to executing within budget, particularly on fixed and capped fee matters. In chapter one, Dwight Floyd – director of pricing and value at Eversheds Sutherland – delves into this underappreciated but essential management tool, demonstrating how monitoring can promote awareness and communication at every stage of a matter.

The profession has come a long way since David Maister's 1984 article in *The American Lawyer*, where he set forth the logic for his net income per partner calculation. However, many law firms still utilize the classic metrics of personal productivity (fees collected off one's own work) and book of business (fees collected off one's own clients) to evaluate partner performance and billable hours for associates. It is important for firms to have a deeper understanding of what it costs to deliver its services and the profit contribution clients and practices make to the overall success of the firm. Chapter two, by James D Cotterman – principal at Altman Weil – provides an easily implemented framework to get started, which follows the cost-per-hour model that still dominates the profession. This chapter will also look into how profits are lost in the revenue cycle through pricing discounts, efficiency write-offs, and client valued write-downs.

The surprising truth about law firm profitability is that it is often not what you think. In chapter three, Eugenia Frenzel – director of pricing and practice management economics at Perkins Coie – discusses the need to shift focus from revenue to profitability in law firms of different sizes, and highlights emerging ways to accomplish that and go beyond. Even when profitability is fully embraced at a law firm, lawyers naturally and often purposefully gravitate toward lower net profit margins; at the same time, when it comes to the bottom line, law firms are notorious for keeping profitability as a back-office, behind-the-scenes metric. Moving profitability closer to center stage will reveal a paradigm shift and highlight the next challenge facing business operations in law firms.

In chapter four, Timothy Corcoran – former CEO turned management consultant – outlines the way in which law firms can leverage current market opportunities: understanding and embracing “traditional” profit measures, establishing the cost of an hour in an hourly billing world, and appreciating that profitability must include a far wider set of circumstances in a landscape where the continued prevalence of non-hourly fees and clients' relentless drive for efficiency means a profit model based on billing high rates and high hours is inherently limiting. Utilizing his expertise and insights from his practice, Timothy will delve into the disadvantages of idolizing one approach to profit and present a more multifaceted and comprehensive alternative.

Profitability reporting is essential for all law firms; however, it needs to move beyond a mandatory exercise to something that can proactively contribute to a firm's overall performance. In chapter five, Peter Lane Secor – chief pricing officer at Pepper Hamilton LLP – lays out his roadmap to effective profitability reporting, taking in its different aspects and incorporating them together into one cohesive strategy. Readers will learn new approaches to access and visibility, partner compensation statistics, and the importance of clear communication with key stakeholders.

Now that your firm has a matter and client profitability model, including revenue recognition and cost allocation methodologies, there is one more aspect to evaluate and address – partner compensation. Allocate too much as a matter cost and even minimal partner involvement can have a significant negative impact on performance; allocate too little and matters with the most partner involvement will see the highest margins. Partner involvement on its own should not be the driving factor for client or matter performance. Finding the right balance while being fair to partners and clients is a critical step to discerning accurate conclusions and incentivizing the right behaviors in your decision makers. What are other firms doing in this space? What are the strengths and blind-spots of the various approaches? These are questions that Ron Paquette – director of pricing at Akerman LLP – addresses in chapter six, providing vital guidance for those looking to learn from their competition in this space.

Companies consistently face challenges and opportunities to enhance their business models and provide value to their customers, workforce, and owners. Not surprisingly, law firms are no different. Chapter seven, by Thomas Van Der Moere – chief financial officer at Neal, Gerber & Eisenburg – focuses on a firm's opportunity to scrutinize existing and potential business using client and product profitability analysis, shifting the focus away from billable hours and time-measured revenue and providing insight that will allow a firm to direct its resources to areas where return can be maximized.

When the support of management has been achieved and a profit mythology established, what is to be done with the results? This is an issue delved into by Eddie Raychaudhuri – chief pricing and LPM officer at Berger Singerman – in chapter eight, as he utilizes his decade-long experience of launching and implementing law firm pricing initiatives to outline strategic approaches to improve firm financials. This will include setting goal metrics across differing practice groups, coaching partners

on analyzing their books, and identifying which clients are tangibly beneficial for your firm's business.

Gathering data on a firm's profitability is a vital first step. The real value of this information, however, is when it contributes to an actionable strategy to improve revenue. In the final chapter, Madhav Srinivasan and Jim Foley – chief financial officer and pricing and legal project management director at Hunton Andrews Kurth LLP – delve into methods for leveraging profitability for action and results. This includes utilizing insights to realign timekeepers towards higher margin work, reorganizing staffing models that are linked to quality and financial results, and providing data and tools to partners to leverage in their practice.

About the authors

Timothy B Corcoran is a keynote speaker, consultant, author, and legal commentator. With deep experience spanning two decades as a corporate executive, he guides law firm and law department leaders through the profitable disruption of outdated business models. As a change agent, Tim's focus is on helping law firms operationalize their strategy, profiting from experience through project management and process improvement. Between customized talks and strategic collaborations with other industry experts, including the Legal Lean Sigma Institute and The Tilt Institute, Tim offers a full suite of advisory services. His accolades include serving as 2014 President of the Legal Marketing Association, a fellow and trustee at the College of Law Practice Management, committee chair of the Association of Legal Administrators, and sought-after speaker and writer on topics related to the changing business of law. Tim also authors the widely-read *Corcoran's Business of Law* blog.

James D Cotterman is a principal with Altman Weil, Inc. He advises law firms on compensation, capital structure, and other economic issues, governance, management, and law firm merger assessments. Before joining Altman Weil in 1988, Mr Cotterman was manager of acquisitions for a public company in the healthcare industry, where he developed, evaluated, negotiated and integrated merger opportunities. Mr Cotterman is the author of *Cotterman on Compensation*, a blog on lawyer compensation and law firm finance. He is the lead author of the ABA book *Compensation Plans for Law Firms*, and is a member of the Board of Editors of *Accounting and Financial Planning for Law Firms*. He has been the supervising author for Matthew Bender's loose-leaf text *How to Manage Your Law Office*. His writings have appeared in *The American Lawyer*, *The National Law Journal*, ABA's *Law Practice*, *International Law Firm Management* and many other publications. Mr Cotterman is a frequent speaker and lecturer, including presentations for annual and regional conferences of the American Bar Association and

the Association of Legal Administrators, as well as numerous state and local Bar and ALA meetings. He is a fellow of the College of Law Practice Management.

Dwight Floyd is the chief pricing and value officer at Eversheds Sutherland (US) LLP. Dwight and his team work with Eversheds Sutherland attorneys and clients to provide superior value by developing and implementing creative pricing and service delivery strategies. Dwight is a former litigation partner and a biologist who brings a different approach to common challenges in the legal market. As in our natural ecosystem, he recognizes that everything in the legal ecosystem is connected to everything else. His challenge is discovering and revealing to attorneys and clients how those connections can benefit and sustain everyone involved while still conserving resources. Dwight is rated AV by Martindale-Hubbell and is an Accredited Legal Pricing Professional (ALPP) by the True Value Partnering Institute. He received his JD from the University of Virginia School of Law, his MS from Colorado State University, and his BS from Clemson University.

Jim Foley is the pricing and legal project management director at Hunton Andrews Kurth LLP, where he oversees the pricing, legal project management, matter analytics, business intake and conflicts areas. He has extensive experience in alternative fee arrangements (AFAs), legal project management (LPM), matter budgeting, law firm financial management, and financial analysis, and is a catalyst for change within the firm.

Eugenia Frenzel is the director of pricing and practice management economics at Perkins Coie LLP, focusing on forging and strengthening lasting client relationships through tailored pricing, effective matter management, and synergistic collaboration. She strives to deliver innovative business solutions to internal and external clients. With over 15 years of legal operations expertise at three AmLaw 50 firms, Eugenia is passionate about ensuring organizational strategic agility in today's fast paced and often volatile environment. Eugenia is an accredited legal pricing professional, a regular speaker at industry conferences, and a volunteer with ILTA. She is a licensed attorney and received her JD from Quinnipiac University School of Law; Eugenia received both her MS in Organizational Leadership and BS in Business from Mercy College.

Peter Lane Secor is the chief pricing officer at Pepper Hamilton LLP. Peter concentrates on legal project management with a focus on improving efficiencies through shared management responsibilities, strengthening communication, and making value transparent. His expertise includes client/matter profit analysis and providing partners with performance evaluations from a financial perspective.

Ron Paquette is the director of pricing at Akerman LLP, an Amlaw 100 firm with over 700 lawyers and professionals across 24 offices in the US. He has over 13 years of legal finance and client/matter profitability experience with prior roles as both a vendor/consultant and in-house at two other large law firms. His four years with Redwood Analytics were primarily spent focused on new analytic methodologies for the industry, exposing him to a wide array of approaches to client/matter profitability and their underlying strengths and weaknesses. He took this experience in-house, where he has implemented or improved profitability models in each firm. In his current role, Ron is rolling out profitability with the Akerman partnership while also implementing the required processes and disciplines for a robust and proactive pricing organization.

Eddie Raychaudhuri has over a decade of experience launching and implementing pricing and LPM initiatives at law firms, which has incorporates process improvement, practice innovation, alternative staffing, client fee negotiations, establishing profit methodologies, and developing fee arrangements and monitoring fee deals. Eddie has a proven track record of working with practice groups to optimize practice platforms, business performance, client relationships, and operations to achieve increased profitability and reduce institutional risks while maximizing client value. Eddie earned his JD/MBA from Case Western Reserve University School of Law and American University's Kogod School of Business.

Madhav Srinivasan is the chief financial officer at Hunton Andrews Kurth LLP, leading the global finance and pricing competencies. Madhav is an ALM Intelligence Fellow and also an adjunct faculty at Columbia Law School in New York and University of Texas at Austin School of Law.

Thomas Van Der Moere is the chief financial officer at Neal, Gerber & Eisenberg LLP, a Chicago-based law firm with over 140 lawyers, where he oversees the financial operations of the firm including the areas of

About the authors

accounting, treasury management, planning/analytics/business intelligence, practice economics and strategic pricing, financial systems, and new business acceptance and risk management. Tom has expertise in professional service firm administrative and financial management, performance and compensation analysis, financial and operational analysis and modeling, strategic planning, process development and re-engineering, firm/project profitability and risk management, and business intelligence. He also has significant financial experience with public and private companies in professional services, energy, and manufacturing industries. Tom has an MBA from the University of Chicago Booth School of Business and an MS in Accounting and Business Management from the University of Tulsa.