

The Business of Law – Why It Should Matter to You

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Before We Plunge In

- Who are we?



- Who are you?



Agenda

- Why Is This Important?
- Law Firm Business Fundamentals
- The Business of Law
- Understanding Key Profitability Drivers
- Applications to Your Role
- Questions/Comments/Additional Discussion

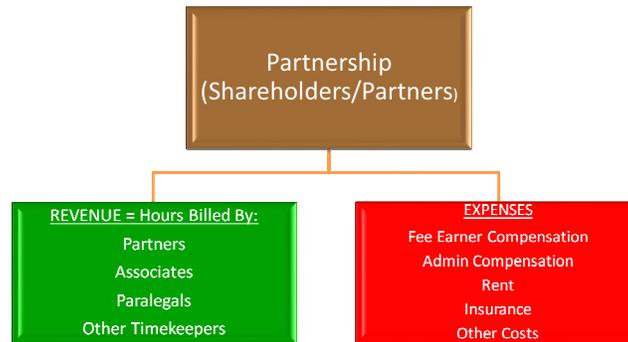
Why Is This Important?

- \$ It Matters to Clients!
- \$ It Matters to Firm Leadership
- \$ It Matters to the Bottom Line
- \$ Students Need to Understand Employer's Business
- \$ Dealing with Challenges in the Current Environment
- \$ It Matters to Us!



Law Firm Business Fundamentals

- Law Firm Business Model



Revenue – Expenses = Net Income = Distribution to Partners

Law Firm Business Fundamentals

Cash v. Accrual Accounting



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What Drives Revenue?

- Revenue is a factor of:
 - Rates (\$\$/hour)
 - Hours billed (per attorney per year)
 - Realization (Adjustments at billing and receivables)



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What Comprises Expenses?

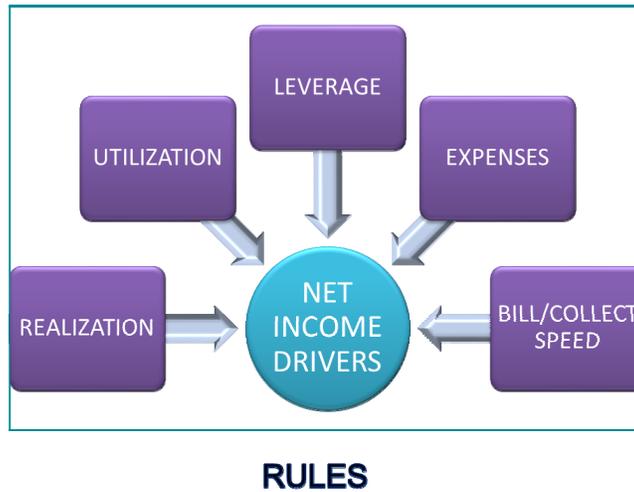
- People – 65%
- Rent – 26%
- Everything Else – 9%

AmLaw 100 data



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Drivers of Law Firm Profitability



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Realization

- Impacted by discounts, write-offs, collection issues
- Declining since the late 1990's, and is at its lowest level now – avg. 83%
- Reflects increasing client demands for discounts and resistance to rate increases

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Utilization (Billable Hours)

- This is a measurement of billing efficiency
- Nothing more than actual Hours Billed ÷ Hours Target
- Has been declining

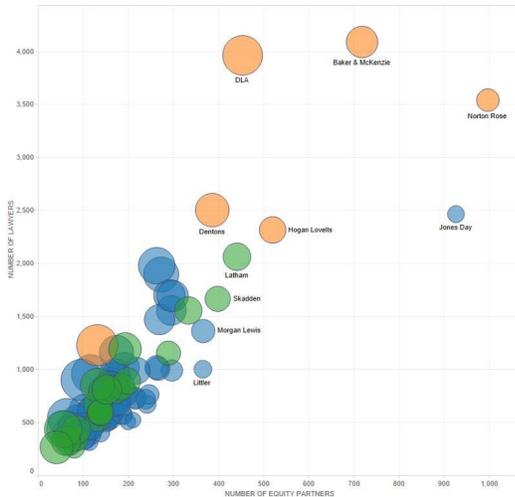


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Leverage

- Lawyers other than Equity Partners ÷ Equity Partners
- When high utilization is maintained, higher leverage typically results in higher profits
- Highly leveraged firms may not offer as many “hands-on” opportunities for junior lawyers





LEVERAGE is the ratio of total head count (minus equity partners) to equity partners.

It is expressed here as a whole number and represented by bubble size.

Source: Am Law 100 2014

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Expenses

- Compensation, rent, technology and admin costs
- Although law firms cut expenses significantly a few years back, these have been creeping back up
- Space and technology costs keep driving expenses up



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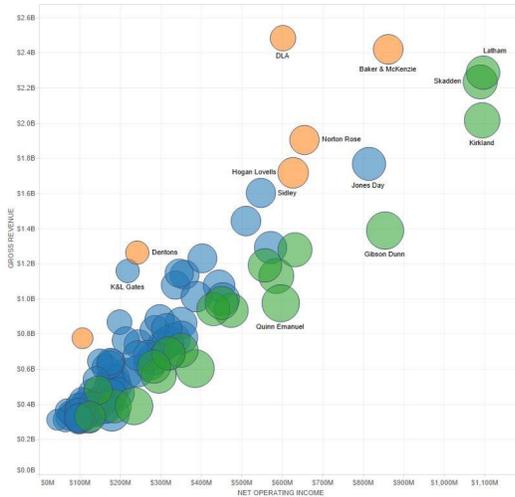
Bill/Collect Speed

- Direct correlation between speed by which bills are sent out and percentage of bill ultimately collected
- Daily time entry paramount in order to accomplish
 - Additional benefits result

Understanding Key Profitability Drivers

Margin Impact

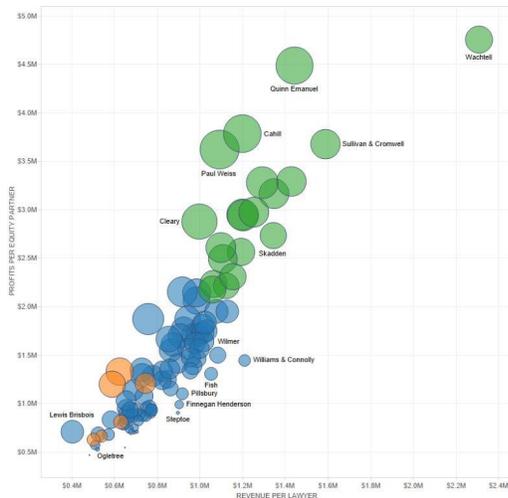
- Time Value Billed (hours worked x standard billing rate)
- Price discounts
- Write downs
- Write-offs
- Bill Speed
- Collect Speed



PROFIT MARGIN is the percentage of gross revenue that is devoted to net income.

It is expressed here as a whole number and represented by bubble size.

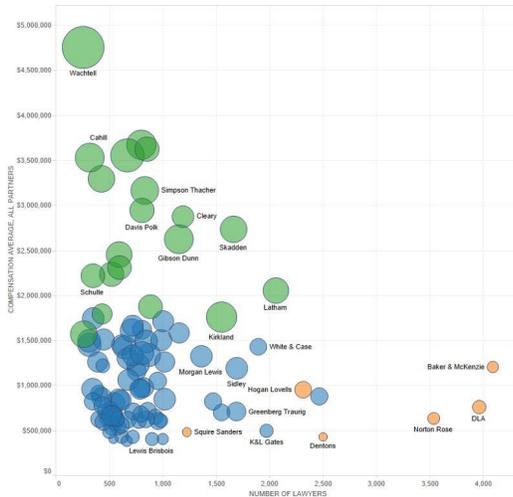
Source: Am Law 100 2014



The **PROFITABILITY INDEX** measures which firms best balance leverage and profit margin for the highest possible profits per partner.

It is calculated by dividing profits per partner by revenue per lawyer and represented by bubble size.

Source: Am Law 100 2014



VALUE PER LAWYER measures how much money, on average, each of a firm's lawyers contributes to overall partner compensation.

It is represented by bubble size.

Source: Am Law 100 2014

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Understanding Key Profitability Drivers

Calculating Costs (by timekeeper)

- Timekeeper's compensation (salary, bonus, benefits, payroll taxes, etc.)
- Direct costs attributed to timekeeper (bar expenses, marketing expenses, etc.)
- Indirect costs attributed to timekeeper (share of office overhead, share of firm overhead, etc.)
- Total costs can be divided by hours expectation to compare "apples to apples" cost per hour

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Comparing Firm Performance

- Firm X
- \$411 Mill. Gross Revenue
- PPP: \$615,000

- Firm Y
- \$408 Mill. Gross Revenue
- PPP: \$1.4 Million

Why the difference?

- 735 Lawyers
- 181 equity partners
- RPL \$560,000
- PM 27% = \$111 M
- Leverage $554/181 = 3.1$
- Expense/Lawyer \$408,000
- Hours 2,000 worked

- 498 Lawyers
- 92 equity partners
- RPL \$820,000
- PM 33% = \$133 M
- Leverage $406/92 = 4.4$
- Expense/Lawyer \$552,000
- Hours 2,291 worked

How Well Is Your Firm Operating In The New Normal?

- Propensity to discount price
- Volume (work more)
- Efficiency at delivering services
 - Reduced expenses (including personnel)
 - Efficiency
 - Creativity
- Time taken to bill a client
- Time taken to collect

Applications to Your Role

- Training
- Staffing
- Hiring
- Performance Management
- Diversity
- Student Counseling

Applications to Your Role (Training)

- Incorporate business principles, including understanding of law firm economics into training curriculum
- Ensure that opportunities exist for less experienced lawyers to observe matter intake negotiations

Applications to Your Role (Staffing)

- Gain a detailed understanding of the client needs on each matter
 - Experience level requirements
 - Cost containment requirements
 - Jurisdictional limitations
- Goal of balancing capabilities and capacity with fully meeting client needs on each matter

Applications to Your Role (Hiring)

- Identify opportunities for cross office or cross practice staffing, rather than adding a new hire
- Ensure an environment where interoffice and interpractice transfers are possible

Applications to Your Role (Performance Management)

- Identify potential efficiency issues before they show up in evaluations
- Identify commonalities among matters where inefficiencies exist and target training accordingly
- Analyze trajectories of relationship, originating, and responsible lawyer statistics to assess advancement potential

Applications to Your Role (Diversity)

- Compare metrics from a diversity perspective
- Implement systems so that diverse staffing can be measured and monitored

Applications to Your Role (Student Counseling)

- Student understanding of employer business
- Differentiation of choices for student decisions

Recommended Reading

- *Your firm's news/financials/reports/results*
- *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*
- *NALP-industry news Digest*
- *ABA (Journal, Law Practice Management Section)*
- *Reports from the banks and consultants*
- *PinHawk Legal Administrator Daily*

Questions/Comments/ Additional Discussion



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