

GOING THE DISTANCE
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Now I Get It! –Understanding Business Models and Financial Structures of Law Firms and Law Schools

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Why Is This Important?

Understanding the whole enables you to:

- Understand management decisions and their impact
- Effectively advocate for programs and resources
- Anticipate recruits' questions related to fiscal health and firm stability

The Big Picture: Law Firm Business Models and Financial Structures

- General partnerships
 - No filings to establish the business
- Limited liability partnerships
 - Protects personal assets from business debts and obligations
 - Except in cases of malpractice
- Swiss Verein
 - Becoming a preferred tax structure for cross border law firm combinations
- Solo practices
 - Obtain malpractice insurance

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Two-tier Partnerships

Equity

- Partners share in costs and profits of the business
- New partners contribute “capital”, often by loan
- Firm pays out shares of the profit each year
 - Salary vs. “units”

Non-Equity

- Title without financial responsibility
- Purpose varies by firm, or by practice within a firm

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Business Models and Financial Structures

- Gross Revenue
- Profits Per (Equity) Partner (PPP)
- Revenue Per Lawyer (RPL)
- Profitability: PPP/RPL

Firm Financing Options

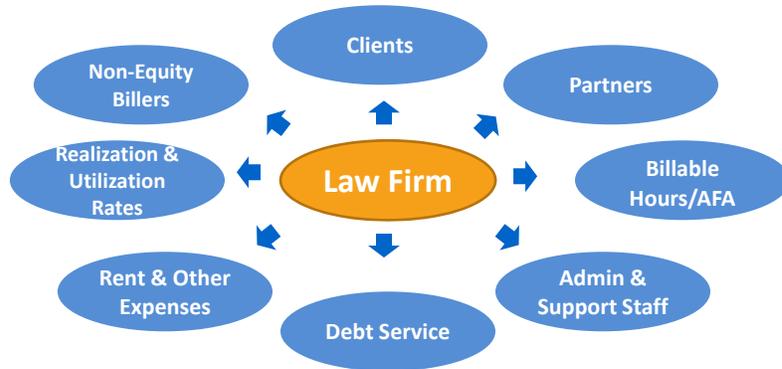
- Capital contributions
- Retained earnings
- Short-term lines of credit
- Long-term debt

The Basic Issues in Law Firm Microeconomics

A. Revenues

B. Expenses

C. Splitting Profits



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A. Revenues

- Revenue is a factor of:
 - Rates (\$\$/hour)
 - Hours billed (per timekeeper/year)
 - Realization
- Clients are the only source

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Changing Time Into Money

THE BILLABLE HOUR (Standard hourly rate)

- Timekeeper bills time
- Timekeeper records time
- Bill is generated, reviewed
- Bill is sent (A/R)
- Bill is paid (Collections)

Where Does Revenue Leak Out?

- Unbilled/Lost time
- Rate discounts
- Write offs
- Bill disputes/write downs
- Collections/non-payment

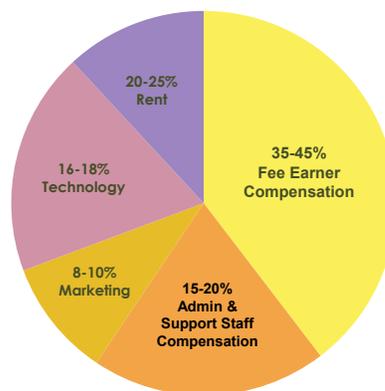
Alternative Billing

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

B. Expenses

Operating Expenses: Firm Level

Total = 77%-
100% of all
expenses



Operating Expenses

- Personnel costs (salaries, benefits, payroll taxes, etc.)
- Rent
- Recruiting Fees
- Technology
- Client Development
- Publications/Research
- Liability Insurance
- Office Expenses (e.g. Postage, Duplicating, Travel, Lexis/Westlaw, books, records, etc.)

Real Example: What Do Associates Cost?

1. My “compensation”
 - Salary, bonus, benefits, payroll taxes
 2. My direct costs
 - Bar fees, marketing, Smartphone
 3. My indirect costs
 - Share of rent/space, technology
- Cost per hour compared with others
 - (Sum of 1+2+3) / Hours expected

Economics of Junior Associate

Expense		Revenue
Salary	\$160,000	\$350/hr x 82% realization = \$287/hr
Benefits	\$50,000	
Assistant	\$20,000	x 1600 hours = \$459,200
Training	\$40,000	
Recruiting	\$25,000	x 1800 hours = \$516,600
Tech	\$5,000	
Space	\$20,000	x 2000 hours = \$574,000
TOTAL	\$320,000	

C. Profits

Keeping It Simple: Basic Net Income Equation

Gross Revenues

minus

Operating Expenses



equals

Debt Service

Net Income

Partner Compensation, 1

$$\text{Revenues} - \text{Expenses} = \text{Net Income}$$

- So far, Partners have not been paid
- *Net Income* is what the partners earn
- How do partners split the Net Income pie?
What are “draw” and “distribution”?

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Partner Compensation, 2 *Splitting the Pie*

100 Equity Partners	Lockstep	Incentive Based
	<i>often has</i>	<i>often has</i>
\$25 million net income	Tight Compression	Big Spread
PPP		
\$250,000	\$150,000 - \$450,000	\$50,000 - \$750,000
<i>*Few partners earn exactly \$250,000</i>	1:3	1:15

- *Partner compensation structure impacts firm culture*

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Adding Value

Assist firm in:

- Predicting revenue and ultimately profits
- Allocating resources
- Managing expenses
- Measuring performance
- Formulating financial plans/goals

Budget & Forecasting: Considerations

- Recruiting expenses on a school by school basis
- Summer associate event costs
- Lateral associate hiring
- High cost events
 - Retreats
 - Firm-wide training
 - Diversity events

Budget & Forecasting: Your Role

- Track & monitor
- Check accuracy of bills and invoices
- Process payments ASAP
- Communicate with recruits and vendors

The Big Picture: Law School Business Models and Financial Structures

- Law Schools NOT businesses
- Non-profit educational institutions
- Private (USC)
- Public (U of Michigan)
- Free Standing (New England Law/Boston)

Institutional & Financial Structure

- Responsibility Center Management
- Each unit responsible for itself
- Analogy: Subsidiary of a conglomerate
- Must follow University's rules

Revenue Source #1

- Tuition
 - Board of Trustees sets tuition levels
 - Tuition money comes to school – we manage
 - Fiduciary responsibility to students & alumni

Revenue Source #2

- Donations
 - Gifts – prescribed vs. flexible use
 - Endowments – cannot touch principle, only the interest

Revenue Source #3

- New or expanded degree programs
 - For lawyers
 - For other professionals
- Transfers
 - Domestic
 - International

Expenses

- Scholarships
- Salaries
- Current expenses
- Centralized (University) functions – obligation with benefits

Financial Factors & Pressures

- Applications down
- Scholarship demands up
- Increase fundraising pressures
- Manage/reduce expenses
- Maintain high quality student experience – high expectations

Law Schools vary, yet are similar.....Find Ways to add value

- Different schools have different models/approaches
- Universal/Shared factors
- Your role to add value:
 - Request tutorial from CFO/Budget Director
 - Expand your budget literacy
 - Support and explore cost savings
 - Build your case when additional resources are mission critical

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