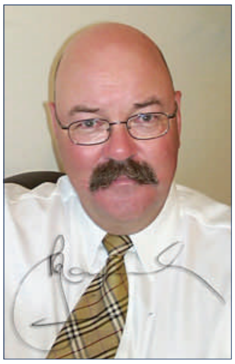

Editor: Rob Knowsley LL.B MIMC

KMS ProfitPower Tips for Lawyers™

Issue 34…June 2008

Increase Your Profit Results Dramatically! Reading Time… only 8 minutes

Robservations

Welcome to the June 2008 edition of **"KMS ProfitPower Tips for Lawyers"**… Issue 34

I trust that you enjoy the read, and find it both thought-provoking and useful to you in practice. Please feel free to e-mail me any feedback by clicking this link…

Editor@lawfirmprofit.com

Some time back I came across a comment from a partner in a KMS client firm in some meeting minutes which referred to me as a "numbers man". At the time I made a note to address this perception in this newsletter at a future date.

I simply want to make the point here that understanding the importance of the numbers has made possible two big shifts in firms I've assisted where management took on board the often small changes needed.

Firstly, getting some numbers right is the only difference between survival in business and closing your doors.

Second, getting some numbers right is the essential difference between just working for your bank, suppliers and employees, and actually having a business which truly makes it worthwhile working for yourself.

Law is in the main still a people business, and a manager who

Covered in This Issue…

manages simply by the numbers will not succeed. It takes real understanding of what people are capable of, what drives them, an ability to communicate well at all levels, and a willingness to confront and deal with "nonsense" wherever it exists.

If combining these abilities with a real understanding of the numbers helps to create a business which generates significant true profits for its owners after deducting all proper costs, a business which is truly worth something to an astute buyer, now that is a business really worth having.

How many small-medium legal practices actually fit this bill?

Common "Watch-Outs" in Practice Management…

Many errors made in firms ten years ago and longer are being repeated each month in 2008… causing much angst for partners and employees… not to say consultants!! I will try to deal with one or two each issue as a quick "heads-up".

TIP #1… Are you really making profits? A quick heads-up in light of recent marketplace activity…

The exact definition of "profit" seems to depend on which dictionary you open.

For our purposes here the simpler the better. "Excess of returns over outlay" seems a good starting point.

For "Profit margin"…how about "Profit after deduction of costs?"

Everyone seems to understand the basic concept of profit being after the break-even point.

However in my experience far too many firms still make the fundamental error of ignoring a proper salary for partners when calculating "outlays" or "costs",

The Editor, Rob Knowsley, is a lawyer, admitted 34 years, who practiced successfully with firms of all sizes – city, suburbs and country...in Australia and New Zealand. As KMS Senior Consultant, his insights are further based on the experience of twenty years of consultancy assignments, and telephone/e-mail support, for lawyers…in all areas of practice management and profit building. Many practices have quickly reaped the monetary benefits and enjoyed the feeling of being in more control of their business through his practical help…as multiple referees attest.

and so place the break-even point way too low.

The reality is of course that most partners work extensively in the practice… and to have had a non-partner do all that work properly there would have had to have been a labour cost… a remuneration in some form… usually a market salary!.

The introduction of much wider opportunity for law firms to incorporate has brought with it much commercial activity in acquiring practices. Some acquisitions have been reported freely in the general Press, and others in media with particular focus on the Profession. Figures for goodwill have often been openly disclosed.

What's very clear is that when looked at as a "real world", commercial, proposition, the goodwill of a legal business is worth to buyers something within a range calculated by application of a multiplier to the firm's "profit" after deduction of salaries at a proper market level. We do not need here to get into detail about the period over which the profit is averaged, or the multipliers typically used.

These salaries appear to fall in the range $250,000 to $300,000 for the majority of affected firms.

Some guidance can be obtained too from examination of the attitude of the taxation authorities who will not easily accept partner salaries below these sorts of levels in situations where they are trying to ensure that income is not being improperly diverted away from partners to other shareholders.

When you apply even the most modest salaries to partners, by far the majority of Australasian practices do not generate significant "true" profits at all.

This does not mean that law practice is inherently unprofitable. Rather it means that most are quite poorly operated.

Example… If you take a two-partner firm turning over $1M, with true outlays of $900,000 after including a mere $125,000 salary each… profit is $50,000 each. This amount often needs to be allocated partly towards an interest return on capital tied up, and some superannuation too. It's not much of a return.

If the firm used various simple techniques to increase turnover 10% to $1.1M, without a net increase in overheads, there is a further $50,000 per partner available. This represents a 100% increase in profit.

The irony is that increases of this sort are extremely easy to achieve in almost every practice.

The bottom line… because most law practices are badly run, and partners are usually very busy… too busy to realise just how badly run…the paradigm exists that law practices are in the main not capable of being very profitable unless you are "lucky" and have a large volume of highly profitable work.

Twenty years consulting following 14 years in practice has shown me that this is just a nonsense.

TIP #2… Some important things to watch out for on Work-in–Progress Realisation Rates…

- Realisation Rates are only useful to get an idea of likely recoveries into the future on work which has been billed. Where significant work is being done and will not be billed for some time there is no substitute for close supervision.
- Wild fluctuations in Realisation Rates can occur for a variety of reasons, including when a very small amount is billed in a period. Don't look at the RR in isolation in a short period. For example… 98% Realisation on a bill for $400 is of little value in assessing the performance of a fee-earner who may be heading towards a following month of 86% Realisation on bills of $45,000. In the later case we are talking apparent loss of Realisation in the order of $7325… in the first case just $8!
- Where fee-earners are allowed to operate in an environment where housekeeping is not done monthly, you need to be aware that there can be real hidden pain for you when Realisation Rates finally include all the relevant numbers. Spring cleaning of files and ledgers often produces tens of thousands of dollars of write-offs which were not previously taken into account at the time(s) those files were billed… meaning that the earlier realisation Rates were skewed upwards.
- Some practice management software does not take into account all relevant Work In Progress when calculating Realisation Rates. If you're not sure, run a simple test. Whether WIP is removed from the relevant ledgers by billing, by writing it down, or by writing it off outside of the billing process...however it happens in fact, it must be included in the relevant calculation to be fully accurate for your various purposes.
- Finally, Realisation Rates can be skewed by fee-earners failing to record Client file work in the first place. It is easy to keep your Realisation Rate around 98% if you omit to record activity you don't feel the client should pay for. Most fee-earners will not make the mistake of putting this activity into the system as

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KMSFirmTime as they are smart enough to realise that it is then too easily identifiable for what it is. They will simply not record it at all.

Work you have invested in ends up not being billed, and unfortunately the lost billing would almost always have been above the true break-even point…pure profit lost to you forever!

TIP #3… Eight great ways to make sure your firm quickly runs out of cash!

- Failing to ask enough clients up front for some cash on account…
- Write down Work in Progress habitually and usually quite unnecessarily…
- Send inane letters to debtors instead of ringing them up…
- Advance moneys for disbursements for clients from your Office account…
- Borrow too little…trying to operate a large business with small working capital…
- Paying people who you don't then manage to ensure they deliver a full day's work…
- Having too many files, especially if unbilled, so while you're working hard your file velocity and cash turnaround is poor…
- Drawing too much cash while also doing some or all of the above…

Your future KMSSuperProfit™ Seminars…

This new series in early 2008 was hugely successful… with some being sold out, and we plan to set dates to run these again in Sydney, Melbourne, Auckland, Wellington, Brisbane and Perth.

These are a great opportunity to get the MCLE/CPD points you need at the same time as getting the practical information you need to dramatically lift your profits…

Testimonials…

"Hi Rob, thanks for yesterday, the brief from my fellow partners was to attend your seminar and see if you had any new ideas to deal with old problems… you certainly delivered.

If you could forward your notes that would be much appreciated.

Till next time.

Cheers!"

Partner… Auckland firm 15+ partners

"For what its worth, I have had a very good result from implementing some of your suggestions, the improvement in the profits have been eye-opening.

Cheers,"

Partner… Queensland firm… regional city.

Having a strong indication of levels of interest speeds up our programming so to register your interest or to get a copy of the contents list for the seminar in this series, please click here to automatically generate an email to us…

seminarinterest@lawfirmprofit.com

De-bunking the single biggest myth in law firm management…

"There's no way I can average 6.5 (or 5.5 or whatever) hours Client Time per day…I'd need to be in the office 14 hours!!"

I've heard variations on this about once a week for the last twenty years, and if it wasn't so sad it would be funny. Sad because the people uttering this nonsense are trained lawyers who have spent a large slice of their lives in formal training, have a certain minimum level of intelligence, and in many cases have wasted tens or hundreds of thousands of dollars a year for most of their practising careers.

Sad also because, despite their intelligence and legal training, they can't see the fundamental flaws in their "argument".

The bottom line is that there are far too many lawyers who have no idea what an efficient person can achieve on an average day because they do not record their various activities accurately.

Most people who do not have solid evidence of what they do with their days waste phenomenal parts of most days.

The parts wasted are unfortunately for them the parts where proper profits are made by other lawyers.

A lawyer who works for seven hours in a day on Client files and one and a half hours a day on Firm work can manifestly record eight and a half hours of activity and certainly does not need to be in the office (or working for the business anywhere else) for fourteen hours.

A final tip… in my very long experience most employed lawyers do not need 1.5 hours for Firm Time each and every day...if they are assisted to have a healthy backlog of Client work they'd far rather be doing that.

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