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How to Increase Law Firm Profitability

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For five quarters in a row, law firm profitability has fallen, according to the [2023 Report on the State of the Legal Market](#), a study conducted by the Thomson Reuters Institute and Georgetown. (Data are based on reported results from 170 US-based law firms, including 46 AmLaw 100 firms, 47 AmLaw 200 firms, and 77 midsize law firms.) Profits per equity partner are down for the first time since 2009. [Client payments and realization rates are down](#) too.

Demand has also dropped for everyone except midsize firms, where clients are flocking because they want quality legal services without the major firm price tag.

So, how can small and medium-sized law firms capitalize on this demand and optimize their profitability? That's what we'll cover in this article.

Why does profitability matter for law firms?

Law firms should focus on profitability for a number of reasons. First, being profitable ensures that the firm can sustain its operations and provide quality legal services to clients. Having a profit allows firms to comfortably cover their operating expenses, such as rent, salaries, technology, research materials, and marketing, and establish contingency funds and reserves for unexpected expenses or downturns in business, such as a global pandemic, potential lawsuit, or market uncertainties.

It's also important for law firms to have sufficient funds to invest in resources and infrastructure to stay competitive and deliver efficient services. To stay ahead of the curve, firms should make investments in technology, legal research tools, [document management systems](#), communication tools and [client portals](#), [matter management systems](#), and training. The more profitable a firm is,

the better it can enhance its capabilities and client service through investments like these. And the more investments a firm makes, the better able it is to attract, engage, and retain attorneys and staff members — not to mention pay them competitively.

Finally, profitable law firms are positioned to pursue growth opportunities and expand their practice areas or geographic reach. They can invest in client and business development strategies that attract new clients and increase their market share.

Why do law firms miss their profitability goals?

The baseline profitability goal for a law firm is 50 percent. If your firm isn't hitting that mark, it may be because your expenses are too high or you aren't earning enough revenue. Or maybe you are too heavily staffed, which can drain your law firm's financial resources. The key is to figure out what is causing the problem.

Many firms look at their profit and loss statements, but these statements don't tell you the whole story. The typical law firm [P&L report](#) isn't granular enough to help you determine the true source of revenue and expenses. You may have a timekeeper who brings in a lot of revenue but not enough to cover their incredibly high expenses, for example. Or you may have a million-dollar client, but what you shell out to keep that client and maintain their business is so high that you're essentially paying the client to remain on your roster. But you likely can't tell that from your current financials.

The problem stems from too many law firms not running their firms like a business. Law firms that lack accountants don't fully understand the concepts of what makes firms profitable. If your firm's office manager or paralegals are managing your accounting, they are certainly capable of handling billing, checks, and cash receipts, but they won't be able to focus on your [law firm's bigger financial picture](#).

The bottom line is that if you're focusing just on revenue and expenses, you're [missing important details](#). Many law firms overreact when expenses look high and look for ways to make cuts. But if you're focused on reducing spending, you're also contracting your business, and the revenue will follow, as will employee morale and output.

And if you aren't yet using [law firm accounting software](#), you're just planning your law firm's future based on guesswork. That wouldn't pass muster for your clients, and it shouldn't pass muster for your shareholders, either.

What is the best way to monitor law firm profitability?

The key is to study profitability by timekeeper. This way, you can discern which attorneys are in the clear and which need help. To get the full picture of expenses and profits for every timekeeper, you need to monitor direct expenses, indirect expenses, plus overhead. But most law firm billing platforms can't deliver this information without running reports from hundreds of [general ledger accounts](#).

Centerbase is here to fill the gap. Our new Profitability Reporting tool delivers the data that your partners need to drive smarter business decisions. Our tool goes beyond showing more than just data on what's been billed and collected. Our platform helps you track revenue, expenses, and profit margins at the firm, practice group, and individual levels, so you can optimize your firm's profitability and improve its financial performance. You can also analyze key metrics such as billable hours and realization rates so you can set profitable billing rates and pricing and create accurate budgets. With our platform, you can determine which timekeepers are most valuable to your firm, what practice areas to expand, and which matters are contributing to — and hurting — your bottom line.

Centerbase puts real-time accounting tools in the hands of everyone in your law firm. It's like having your own personal accountant on call. [Contact us for a free demo](#) and learn how our profitability reporting can help you kick-start your law firm's growth.

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