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Strategic Planning for Law Firms: Learning the Financial Basics

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There are a lot of fancy definitions for the term "strategic planning." But at its core, all it means is to pinpoint a direction you want to go and then make decisions on how you plan on allocating your resources to get there. It is important to see the difference between strategic planning and marketing. And you may raise an eyebrow at that, but you'd be surprised how often people view these as the same thing. Strategic planning encompasses many operations of your business. Marketing is merely a piece of that coupled with things like your budgeting and reporting.

It is very important to note that strategic planning is not about grand ideas or mission statements. It is about where you want to be and how you're going to get there, all within a short and defined timeframe that is typically no longer than 5 years at a time.

Typically, smaller firms can respond more quickly to changing conditions than larger firms, and because of this, there is a temptation for the smaller firms to get lackadaisical in their planning. Larger firms know that it is significantly harder to pivot, so they prepare and they do not take their strategic planning lightly.

Key Elements to Strategic Planning

1. Top-down planning process

From a high level, strategic planning consists of what we call a top-down planning process. Your firm has to first set the overall goal and then create a realistic framework and path that will allow you to get there.

2. Measurable objectives

For instance, if you set a goal for your firm to have a family law practice area in two years, the next question you have to immediately start asking is how are you going to achieve that? Your goals must always be measurable. Period. There have to be measurable objectives, otherwise reaching that end target is going to be very difficult and you'll be more likely to set goals that are unrealistic in that proposed time period.

3. Resource analysis

Once you've set your goal and defined your measurable objectives, the next thing you need to do is analyze your resources. What skills do you already have within your law practice and if you're missing skills, what are you going to do to fill those gaps? Are you going to go out and learn them or are you going to hire people with those skills? When you begin analyzing your results, you need to also ask yourself, what do you need to get there? Sometimes firms will opt to hire an outside consultant to help guide them, others prefer to make those decisions on their own. Either way, you should figure out what assets you have and which assets you still need.

4. Regular status meetings

Schedules are busy, but it is essential that you and your team find time to pencil in status meetings into your calendar. Part of the reason you set measurable goals is so that you can measure them. These meetings don't have to be once a week, they could be bi-weekly or once a month, but they do need to happen, and you do need to communicate with your team and constantly be monitoring your progress. Time always moves faster than you think, don't let timelines and due dates sneak up on you.

5. Budget

Set a reasonable budget and adhere to it. You need to be asking yourself, what does your law firm's cash flow look like this year? How about your net income by year-end? Having a quality budget in place removes the guesswork and ensures you end up where you want to go. Additionally, ensure you have a good general ledger chart of accounts. If you are not familiar with the chart of accounts, it is simply a list of income and expense categories used to track your spending. Building a budget is a very crucial step in the process, if you're wavering on how to begin, check out our 4 tips on building a better budget.

How to Plan

Planning is not everyone’s strong suit and that’s okay! However, having the ability to plan is crucial when you begin targeting and mapping out your firm’s future. Fortunately, being a planner is a learned skill for most people. But they say you don’t know what you don’t know, so if you’re unsure if you fall into this category, there are plenty of personality tests that you can take that will give you an idea of what your strengths and weaknesses are. The Myers-Briggs Type Indicator® is a great resource if you’re curious! Additionally, check out seminars from the American Management Association and the Chamber of Commerce.

Financial Basics

Strategic planning sounds great, right? But what if you don’t have the financial background to adequately develop these plans? Don’t sweat it, you don’t need to have a degree in economics to know what you’re doing.

The key is to have a benchmark or expectation to see why your actual figures differ from expectations and take action based on what you find. The expectation in our financial management function is why we need a strategic plan and a sound budget. To start, use current and past budgets to create an expectation. Don’t make this part harder than it needs to be, take the information you already have and use it to build out the broader picture.

There are five basic financial statements you should be reviewing every month to help your strategic planning efforts:

- Balance Sheet
- Income Statement
- Statement of Cash Flow
- Owners’ Equity Statement
- Budget

The Balance Sheet

This shows the financial position of a company at a specific point in time. This is usually run or prepared the first week after the close of each month. So if you’re going to look at your March financials, for example, you’re going to run them the first week of April.

This is why it is so critical that you have all of the financial transactions posted to your chart of accounts on a timely basis. If you're at a larger firm and the accounting team starts putting pressure on you to get your timesheets in, this is why. If you haven't posted all your costs, advances, your time, and complete your billing, then your reports will not be accurate.

Remember this formula: Assets = Liabilities + Equity

Your balance sheet is somewhat customizable when you're comparing your designated points in time. You could choose to report on your current month, your activity year-to-date in a comparison against budget, or it could show you year-to-date in previous years. If you're using a practice management system, you should have the ability to generate such reports. It is important to note that not every software gives you the ability to customize your reports whenever you want them. Many vendors will only offer boxed, off-the-shelf reports, so be wary of this, as typically firms end up needing more flexibility in their reporting than they initially expect or anticipate.

Income Statement

This reports on a company's revenue and expenses over a period of time. Typically, the income statement is reported every month. Most law firms tend to lean towards cash basis accounting meaning that revenue is not earned until it has been received. Therefore, your income statement and balance sheet do not show accounts receivable or WIP. Those are separate, internal reports that you can run with your accounting software. Keep in mind that although these reports are run separately, they are crucial for your law practice.

We cannot express to you enough how essential it is to have a good chart of accounts so that your reports are meaningful. An issue that will make your accounting reports difficult to read is if there is not enough account detail in those chart of accounts. The chart of accounts should reflect the way your law firm is organized, for example (to name just a few) you could have reproduction expense, marketing expense, technology expense, partner compensation expense, etc. Doing this will make your reports more specific and meaningful to you.

Now, when you're looking at gross profit and net income, or net profit, an important test to conduct is to look at your top paying clients and add up what these people or groups are earning for your firm. Then take that number and look at it as a percentage of the gross revenue. This is a good indication of how flexible your law practice would be if you suddenly lost that work. An even more telling test would be to do that same calculation, take your most lucrative type of work, and view that as a percentage of your net income. For a lot of law practices, this can be quite scary because it will show that they have very little to no flexibility at all.

Statement of Cash Flow

This reconciles net income to the change in cash by showing sources and uses of the cash.

On cash flow statements, you'll typically see net income first, followed by adjustments in reconciled net income, cash from operating activities, and depreciation. Other line items you might have include cash flows from investing activities and financing activities.

Owner's Equity Statement

The owners' equity statement outlines the changes in the owners' equity accounts during the year.

In this statement, you will have members' equity at the beginning of the year, then any contributions added by those members, added net income (money before distributions), and then finally the members' equity at the end of the year following the dispersal of those distributions.

Putting it all Together

Now that we have taken a high-level look at these key statements, how do they all relate to each other? Are they even connected? Do they make a difference when you begin thinking about your strategic plan for the future of your firm? Let's see...

So let's look at the balance sheet, statement of owner's equity, the cash flow statement, and the income statement. If you look at your cash, this will be showing on your balance sheet and your cash flow statement. Your net income is also shown on your statement of owners' equity, the cash flow statement, and it is also shown on the income statement. Owners' equity is shown on the balance sheet, and of course on the statement of owners' equity as well.

So you can see why naturally, all the statements have to balance and agree with each other. They are all interconnected and work to provide checks and balances to your firm.

All of these statements will ensure that your books are balanced and in order. Without this information, you will not be able to strategically plan for your future. Finance is all about the details and monitoring the cash coming in and the cash coming out of your firm. You don't have to go at this alone, technology today has made it much easier to strategically plan and build out these reports the way you need them. If you're unsure of where to start, take a breath, think about the direction your firm wants to go, and slowly begin mapping out how you will get there.

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