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The Ultimate Guide to Increasing Law Firm Profitability

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You want your law firm to thrive, not just survive. Profitability management is the best way to ensure that your firm stays at the top of its game both in the short- and long-term.

But increasing profitability is no small task. It requires a complete understanding of your law firm's current performance in all of its functions with an eye toward the future. Profitability fine-tuning will help your law firm figure out how to bring the most effective combination of resources together to address clients' needs and to do it at the right price.

In this blog, we'll cover how you can raise your firm's bottom line, including steps you can take and how technology can lend you a hand. But first, let's review the basic concepts behind law firm profitability.

Where does profit come from, and what is law firm profitability?

Profit and revenue are different. You know this, and we know this. Yet the terms are always conflated when it comes to law firms. While boosting your firm's revenue through things like [lead generation](#) is great for short-term growth and can lead to an increased profit over time, increasing your firm's net profit is the only sure way to be successful in the long term.

Think about law firm profitability in simple terms. Revenue is the money your firm receives from clients for legal services rendered. The matter cost is just that: the cost to your law firm in connection with a matter, including attorney and staff time and client costs paid. You subtract matter costs from revenue to get your firm's gross profit.

Revenue – Matter Cost = Gross Profit

But we're not done yet! To figure out your law firm's net profit, you must also subtract overhead costs such as office space, supplies, attorney bar fees, and the like.

Gross Profit – Overhead = Net Profit

If your law firm is increasing revenue without increasing net profit, it means you have room for improvement. For example, your firm might acquire new clients and thus have increased monthly revenue. But if your firm also needs to hire new lawyers and paralegals to deliver client service and expand office space to house them, your profit margin might not be as high as you expected. The

key to increasing net profit is a balancing act: maximizing revenue and minimizing unnecessary costs.

What financial statements and key metrics are useful for measuring profitability?

Measuring profitability requires taking full stock of your law firm: the good, the bad, and the unprofitable. As Covid-19 continues to loom and the market remains unstable, measuring profitability and setting a clear path forward is more important than ever. Your firm needs to measure in order to manage. Below are some key metrics for your firm to track and consider.

Billable hours: Utilization and realization rates

You already know the virtues of monitoring your law firm's key performance indicators (KPIs). KPIs reflect your firm's success in achieving certain goals with forward-thinking data collection used to analyze productivity. Monitoring KPIs keeps your firm accountable to itself. This valuable information allows your firm's management to make informed decisions on hourly rates, hiring, and expansion.

When it comes directly to profitability, tracking certain KPIs like utilization and realization rates is important. You calculate utilization by dividing the total billable hours of a timekeeper by their total working hours. This percentage is subject to fluctuation throughout the year based on workload. While monthly tracking is a best practice, yearly tracking might prove a more useful metric for employment and bonus considerations.

You calculate realization by dividing the total number of billable hours invoiced by the number of billable hours worked. Essentially, realization rates measure the difference between recorded time and the percentage of that time paid by clients. This measure is an accurate indicator of your law firm's profitability. For example, if you billed a client for 20 hours of work and the client only paid for 10 hours, your work realization was only 50% (and it's probably time to set up a call with this client to discuss payment).

While tracking KPIs is important to making informed decisions, manual tracking is time-consuming and subject to human error. Instead, we suggest using [the wonders of tech](#) and reporting tools to give your firm the metrics it needs and to help your legal professionals [track their billable time](#).

Nonbillable hours

A simple and direct way to boost profitability is to limit your attorneys' nonbillable hours. Some non-billable time is unavoidable, but much of it can be outsourced and given to non-attorney staff as part of their normal workload.

Delegation is a key management skill. Encouraging your junior lawyers to delegate their nonbillable tasks is a great way to help them build their skills so that they can focus their time, energy, and efforts on billable legal work. Having your timekeepers focus on high-value work will benefit your firm's profitability.

Cash flow

Positive cash flow is important to keep your firm afloat. Thankfully, [it can be managed with forethought and planning](#). Assessing your law firm's financial health is the first step. Consider your firm's overhead costs like fixed expenses (e.g., rent and utilities) and fluctuating costs (e.g., payroll) and determine any opportunities to reduce those expenses.

It's also important to project your firm's expected client revenue in both the short- and long-term. These steps should be followed by establishing a data-driven cash flow forecast. With the right practice management software, you'll quickly [generate billing and accounting reports](#) so you can understand your incoming receivables, study where you're making and losing money, and compare your firm's cash flow over time.

Collections

Another way to increase profitability is to get paid. But it's not that simple, right? We all know that billing and collections are often among the most dreaded aspects of operating a law firm.

One way to ease the frustration is to make it easier for clients to pay you by setting up a system that accepts different payment options, including online payments, to streamline your firm's [invoicing and collection processes](#). Following up on unpaid invoices is also necessary. Your firm did the work and deserves to be compensated properly for it. By improving your firm's [collections process](#), you'll also boost profitability.

How can my law firm increase profitability?

This article's central question is how to increase your law firm's profitability. There are many ways to start the process, but the best way is to do so intelligently. The most profitable firms in the legal industry are the ones that keep tabs on their key metrics and use data to drive their decision-making. Here are a few things to think about and ways to get started with maximizing your firm's profitability.

Reducing expenses

Reducing expenses is a simple place to start. Begin with reviewing your law firm's spending over the last quarter. Are there things (e.g., subscriptions or online services) your firm is paying for that you aren't using or that you could live without? With the increase in work-from-home arrangements, it might be that your firm can give up some office space, and hopefully, your firm is also using [the right integrations and tech](#) to free up cabinet space. Another way to reduce monthly expenses is to require clients to pay filing fees in advance. This frees up cash for you and means less waiting to get reimbursed. By reducing overhead, your firm will directly increase net profit.

Productivity reporting

We discussed KPIs above, but there is much more to [financial and productivity reports](#) for legal practices. With the right reporting tools, you can drill into how your attorneys and staff use their time and predict future billing based on historical data. Your law firm should generate and review attorney productivity reports a few times a year and certainly in connection with performance evaluations. Regular monitoring of this information will allow your firm's management to identify problems along the way rather than waiting until the end of the year or when the issue boils over.

Monthly productivity reporting is also helpful for tracking matter timelines. With this information

at your fingertips, your firm can identify matters that have been sitting stagnant in every practice area, address the causes of the delay, and rectify the issue while also strengthening the client relationship.

Increased timekeeper efficiency and billing

Your lawyers are your firm's biggest asset. The more efficiently they bill, the higher your firm's profitability. [Removing any hurdles to billing and promoting best billing practices will serve your firm's bottom line.](#) Concurrent timekeeping is key. Your law firm should encourage its attorneys and staff to enter time daily and release monthly or as otherwise required. At the end of a billing cycle, your law firm should review its billing processes to evaluate the timeliness of entries and submission of the bill to the client. With regular evaluations, your administrators can fine-tune your firm's billing procedures to maximize the timely receipt of payments, increasing client satisfaction and reducing the risk of write-offs.

How can legal technology help increase firm profitability?

Using tools and legal tech can transform a law practice's net profitability. Tech can help keep costs low through workflow and document [automation](#), which frees up your lawyers and staff to work on billable matters to bring in more revenue. The right legal tech will help your firm simplify nonbillable tasks like [client intake](#), [practice management](#), [billing and collections](#), and [time tracking](#).

With more time for billable work, your firm can raise its revenues. And with the right tech that [offers a streamlined experience](#) and integrations, your firm will minimize its use of subscription services and administrative time and thus minimize your overhead costs. The result is the perfect recipe for increased profitability.

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