



Précis Paper

Costs, Billing and Profitability

Rob Knowsley is one of the most experienced advisors on practice management in Australia and New Zealand. This discussion outlines the importance of costs, billing & profitability.

Discussion Includes

- Revenue and production budgets
- Pricing and profit margins
- Communication with fee earners
- Costs disclosure and billing
- Fixed, conditional and contingent fees
- Activity capture
- Increasing profitability

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1. In this edition of BenchTV, Rob Knowsley, the principal consultant of Knowsley Management Services, is interviewed by Louise Blase on the topic of revenue budgeting, setting fee targets, pricing and the modern billable hour in contemporary Australian law firms.
2. In the course of their discussion, the presenters comment on the ways in which a law firm can identify issues when it comes to profitability, the main causes of these issues, and the approaches a firm can take to improve the profitability of the legal practice.
3. Mr Knowsley uses his 40 years of experience in the legal industry as both a lawyer and consultant to firms in order to provide valuable insights into the ways in which a legal practice can identify its shortcomings and improve its overall profitability.

How can a firm identify issues when it comes to profitability?

4. Mr Knowsley recommends that a firm steer well away from comparing averages when identifying issues with profitability in a legal practice. Instead, he recommends bringing in an independent consultant, such as himself, to analyse all of the firm's expenses, revenues and other reported data in order to determine the cause of inadequate gaps between revenues and expenses. Moreover, the consultant can help formulate and initiate a plan to go about fixing any gaps by increasing margins over expenses, and improving the overall profitability of the firm.
5. One of the benefits of outsourcing is that a consultant can take a look at the firm with an independent view, using their past experience to spell out the issues clearly with a plan of how to fix them. It is not uncommon to see firms that are able to identify a problem affecting firm profitability but they are either unable to develop an appropriate solution or agree on the right approach to take.
6. Mr Knowsley acknowledges that it is very hard for legal practitioners to know they are being unprofitable. According to Mr Knowsley, firms are generally too slow to recognise that they are off track as they only analyse the financial data a month or more later. In order to be able to fix a problem, it is important to look at this information as soon as possible. Furthermore, it is useful to determine what the working potential of the people already employed at the practice would be if they provided reasonable effort and efficiency for sensible fees. If this potential is not met, this may signal an issue in the firm.

What are the main causes of unprofitability in a law firm?

7. There are several reasons why a particular firm might not be as profitable as it could be. One reason proposed by Mr Knowsley is that work might be improperly distributed throughout the firm, such that some employees are expected to generate too much revenue, while others are not expected to generate enough and thus given too little work. This improper distribution leads to the former set of employees becoming overworked, stressed and unable to complete their work to the best standard, while the latter set of employees might become anxious that they are not doing enough work to improve their skill sets and advance their careers. Mr Knowsley notes that it is very possible to have a situation where people are very good at what they do but they are simply not given enough of that particular type of work in order for them to create a profitable margin.
8. Alternatively, employees might not be working productively or efficiently at the tasks they are allocated. Mr Knowsley stresses the importance of encouraging workers to be their most productive every day. He notes that once the various types of leave (annual, sick, compassionate etc.) and public holidays are taken account of, there are close to 231 working days in the year for a law firm, which is not a lot of days to generate enough revenue to cover ongoing expenses such as rent, which are year-round. Moreover, if it is the case that employees are only working 7.5 hour days and not working productively for the majority of that time, Mr Knowsley believes that the firm has almost no chance of making revenues exceed expenses when principle salaries are taken into account. This issue is exacerbated by workers working part-time and in months where employees attend firm-planning retreats or work at alternate locations, for example a country practitioner working in the CBD for a week.
9. Another reason for low profits might be inadequate management. Often firm management tends to be done by the lawyers whose real skills do not lie in that area. These lawyers are usually busy dealing with the problems their clients have presented them with and are thus not able to devote proper time to adequate management of the firm. A manager should be able to encourage their employees to achieve what they are capable of on a consistent basis. Oftentimes this is not the case, and managers tend to put up with less than optimal performance.
10. Other reasons that Mr Knowsley lists which hinder profitability include firms not collecting revenue quickly enough or not actually billing it at all, firms not completing work quickly enough to be able to bill, as well as firms not having enough work through inadequate marketing. Mr Knowsley identifies four steps to work out a rough figure for the number of files that need to be opened per business day by a person to sustain optimum production – 1. Identify what a person and their support team should be producing in one month, 2. Identify what type of work they are doing, for example property law settlements, 3. Identify

what an average fee would be for that work, and 4. Divide the monthly total they are expecting a person to produce in a month by the average fee.

11. Some practices are able to bill much more closely to the work while others cannot, and this can cause issues with profitability. For example, the typical conveyancing matter takes about 6 weeks to complete and bill while medical negligence matters generally require a lot of research and mediation so can take years to complete and bill. It is important in the latter scenario that employees are monitored to ensure their productivity. Otherwise a significant amount of money could be lost for the firm.
12. Finally, Mr Knowsley mentions that the rising prevalence of technology such as computers and software in the work place has led to an overall increase in costs to firms, despite the reduction in costs of individual technology components over time. On the other hand, overall worker productivity has tended not to increase proportionately, which results in profits falling in many practices.

What approach should be taken to improve the profitability of a legal practice?

13. Having spent well over 30 years successfully improving his own practices and those of his clients, Mr Knowsley's approach for improving the profitability of a legal practice involves looking in depth at the firm's current functioning and identifying what he would do differently as a manager to achieve a significantly better outcome. This involves analyzing the business and seeing if their goals are attainable.
14. It is important to identify the revenue gaps in the firm and set out a plan for fixing each of the gaps in order of priority and as soon as possible. This will allow the firm to get into a position where it is able to be optimally productive. Mr Knowsley does not believe in getting rid of people from a workplace, instead he believes the key to restoring profitability is through "improving the marketing of the firm, getting the work coming in at the right levels, and getting people working productively".
15. One way a legal practice might improve its profitability is through an adjustment in pricing of its legal services. A fairly small increase in the price point, which would not be objected to by the firm's clients, could improve the profitability of a firm's transactions by close to 50 percent. These opportunities are usually missed by firms that are frightened of losing work.
16. A firm generally does not need to be reinvented but rather fine-tuned. It is common for firms to develop habits which are not very smart such that they miss important opportunities to increase revenue, for example use of the internet to reach out to clients internationally or inter-state. If the managers are able to step back and re-energise the practice, this can lead to a significant improvement in profits.

17. It is ever important that clients receive excellent service and are billed correctly when they come to a firm. This increases the satisfaction of clients and increases the referral work that comes from them. A firm should keep aware of where their clients come from and who they are by keeping track of referrals and client details. In addition, a firm should establish and enforce billing policies, for example the payment of healthy deposits or retainers by clients.
18. Finally, it is important to properly manage the staff at the firm such that they each have enough work to do and clearly know what is expected of them.
19. Once a firm establishes the right level of productivity for their present resources with the right cash flow from ongoing revenues over expenses, it is possible to move to the next step which may be expansion of the firm.

BIOGRAPHY

Rob Knowsley

Legal Practice Management Consultant – Australia

Rob Knowsley has provided legal practice management advice and solutions to over 1,300 legal firms in Australasia over 42 years. He provides practical advice to address fundamental problems, and to develop successful legal firms.

Louise Blase

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