**Good Economics Enables Law Firms**

- Enables firm to command a premium
- Supports Rate Structure
- First Class Talent
  - Enables firm to pay top dollar in order to attract and retain first class talent
- Law Firm Growth Cycle
- High Value – Added Legal Work
  - Enables firm to attract high value-added legal work
- Depth & Breadth of Experience
  - Enables firm to build and maintain depth and breadth of experience
Good Economics Enables Lawyers’ Careers

- **Lawyer Career Growth Cycle**
  - **Strong Firm Economics**: Enables firm to attract high value-added legal work and clientele.
  - **First Class Talent**: Enables firm to attract and retain first class talent.
  - **Training, Experience**: Enables firm to provide professional development opportunities.
  - **Pro Bono and Charitable Work**: Enables firm to play leading role in community.

- **Enables firm to**
  - provide professional development opportunities
  - attract and retain first class talent
  - play leading role in community
  - attract high value-added legal work and clientele
Topics

- How Firms Make Money
- Equity/Non-Equity Partners
- The Economics of Associates
- Risk Factors
- Trends
- Discussion
How Firms Make Money: Revenue

\[
Revenue = \text{Hours Billed} \times \text{Effective Rate After Discounts} - \text{Write-Offs} - \text{Uncollectible Amounts}
\]

- **Alternative Billing is Growing Rapidly**
  - Fixed fees (transactions, large portfolio of cases, retainers)
  - Blended rates for associates and partners
  - Contingency/ success fees/ attorney fee awards

**Usually measured against hourly rates x hours billed**
How Firms Make Money: Costs

- Real Estate (5-10 year horizon)
- Technology (2 years)
- Associate Comp (9-24 months)
- Staff Comp (3-6 months)
- Debt service (1-20 years)
- Marketing, Recruiting, Training, Charity, Bar Dues, Retreats, Library (immediate)
How Firms Make Money: Debt

- Cash Flow is uneven
  - Lowest in Q1; highest in Q4
  - Attention to A/R is critical
  - Time saves clients money
  - While firm pays fixed costs

- Capital obtained from equity partners

- Long-term debt
  - Usually for office expansions, IT, or real estate

- Revolving debt
  - For ups and downs in cash-flow
Equity/Non-Equity Partners

- **AmLaw: Not about ownership**
  - Equity Partner has >50% income variable
  - Non-Equity Partner has <50% income variable

- **PPP = Profits/Equity Partner**
  - Firms can “adjust” the number of equity partners to improve PPP

- **Revenue per Lawyer (RPL)**

- **Profitability: PPP/RPL**
The Economics of Junior Associates

Expense:  
- Salary $160,000**  
- Benefits 52,800  
- Sec’y 30,000  
- Training 40,000  

Recruiting $25,000  
Computers 5,000  
Space 15,000  

TOTAL: $327,800

Revenue: $325/hr x 80% realization = $260/hr  
- x 1200 hrs = $312,000  
- x 1500 hrs = $390,000  
- x 1800 hrs = $468,000

Realization

- Billing Realization % = billable value of work (billable hours $ billed rate) divided by standard value of work (billable hours $ standard rate)

Example:

100 hours @ $500/hour $50,000

Less:
5% negotiated discount (2,500)
5 hours written off (before billing) (2,500)

Amount Billed $ 45,000

Billing Realization % = 45,000/50,000 or 90%

Collection Realization % = 43,000/45,000 or 96%

Amount Collected $ 43,000

Overall Realization % = 43,000/50,000 or 86%
Risk Factors

- **Rainmaker departures**
  - Not always bad – depends on who is leaving and why
  - Larger firms usually can better withstand departures
  - Departing rainmakers leave money behind (A/R)
  - Can reach a tipping point

- **Failure to adjust**
  - Market changes, for example:
    - SF litigation firms used to get East Coast referrals
    - Employment counseling done in-house
  - Succession planning
    - Management/rainmakers aging
    - Clients merge; client contacts change
Risk Factors (continued)

- **Over-concentration of clients**
  - Percent of revenue from top 1, 2, 5, or 10 clients
  - Exposure to market/industry fluctuations
    - Tech bust of 2001
    - Capital markets bust of 2008

- **Mergers**
  - Can be distracting, sometimes forced
  - Can greatly strengthen firms
  - Some disruption from departures (desired vs. regretted)

- **Expansion**
  - High fixed costs -- hard to adjust quickly
Trends: Looking Backward

- Law as a Business
- Billing rate increases
- Consolidation/mega-mergers
- International expansion
- Segmentation of firms
  - Geography
  - Billing rates
- Specialization of practice areas
- In-house legal departments
  - Concentrated number of firms (“convergence”)
- Increased spread in partner compensation
Trends: Looking Forward

- Billing rate pressures
- Alternative billing
- Outsourcing/contract lawyers
- Virtual firms
- Further specialization
- More senior lawyers not on partner track
- Decoupling associate compensation from seniority
- Less hiring; more retention
- Accounting firm/consulting firm models
- Associate involvement in business development
Discussion