

EdwinCoeLLP



**LPM Conference 2019**

Tim Nash, Chief Executive

# Are law firms in denial about their profitability?



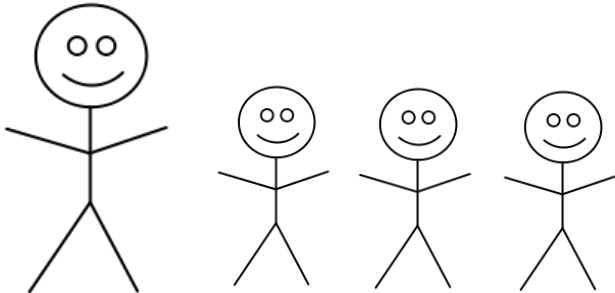
- The levers of profitability
  - Utilisation
  - Leverage
  - Rate (fees/hour)
  - Costs
  - Investments



# Are law firms in denial about their profitability?



- The levers of profitability

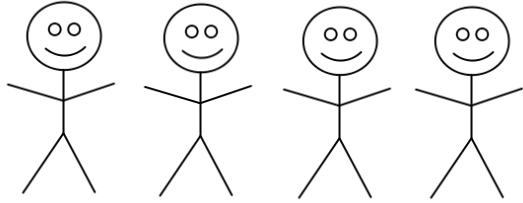
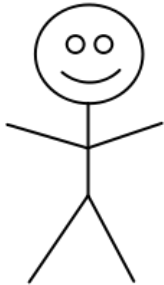


4 Leverage  
x  
1000 Hours  
x  
235 Rate  
=  
940,000 Revenue  
  
300,000 Salary  
330,000 Costs  
630,000 Total costs  
  
310,000 Profit  
33% Margin %



# Are law firms in denial about their profitability?

- The levers of profitability



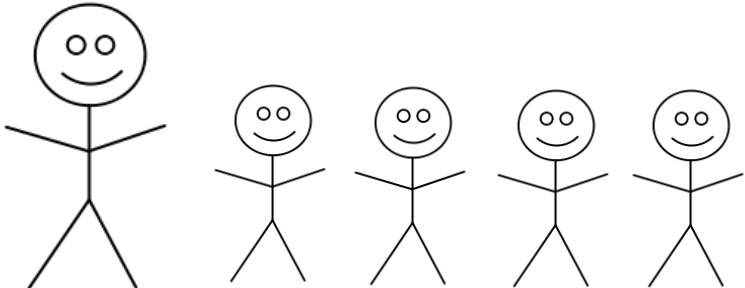
5 Leverage  
x  
1000 Hours  
x  
235 Rate  
=  
1,175,000 Revenue  
  
350,000 Salary  
330,000 Costs  
680,000 Total costs  
  
495,000 Profit  
42% Margin %



# Are law firms in denial about their profitability?



- The levers of profitability



4 Leverage  
x  
1100 Hours  
x  
235 Rate  
=  
1,034,000 Revenue

300,000 Salary  
330,000 Costs  
630,000 Total costs

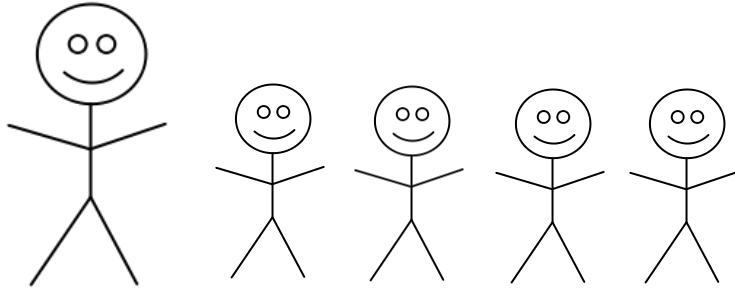
404,000 Profit  
39% Margin %



# Are law firms in denial about their profitability?



- The levers of profitability

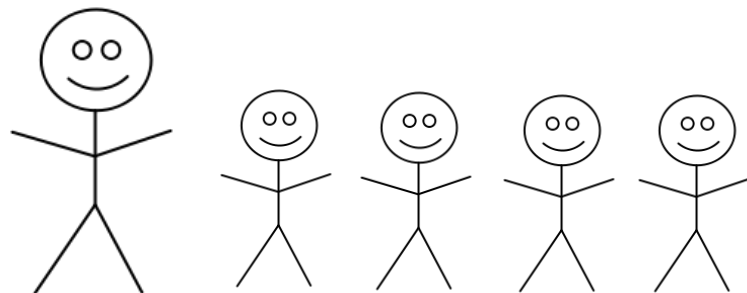


4 Leverage  
x  
1000 Hours  
x  
245 Rate  
=  
980,000 Revenue  
  
300,000 Salary  
330,000 Costs  
630,000 Total costs  
  
350,000 Profit  
36% Margin %



# Are law firms in denial about their profitability?

- The levers of profitability



4 Leverage  
x  
1000 Hours  
x  
235 Rate  
=  
940,000 Revenue

300,000 Salary  
280,000 Costs  
580,000 Total costs

360,000 Profit  
38% Margin %



# Are law firms in denial about their profitability?



- The levers of profitability
  - Utilisation
  - Leverage
  - Rate (fees/hour)
  - Costs
  - **Investments**
  
- Do firms appreciate the impact of these?
- Does profit equate to solvency?





# Are law firms in denial about their profitability?



- Vocation
- Traditional measures of performance
  - Hours ✓
  - Billing (essentially a valuation of hours) - a proxy for revenue
  - Costs
- Cash?
  - Cash collected



# Are law firms in denial about their profitability?



- Why aren't traditional measures aligned to profit?
- Time
- Billing
- The challenge of leakage
  - Pricing
  - Negotiation
  - Matter management
  - Billing
  - Collecting



# Are law firms in denial about their profitability?



- The effect of trends
- The firm model is geared to growth
  
- Therefore, no pressure on Working Capital, which itself becomes a lagging item for cash



# Are law firms in denial about their profitability?



- The effect of trends
- How does the firm model perform in times of revenue stagnation or shrinkage?
- Costs quickly exceed a falling revenue line
- Therefore, huge pressure on working capital to deliver cash
- Profit and cash can dissipate quickly



# Are law firms in denial about their profitability?



## Solutions

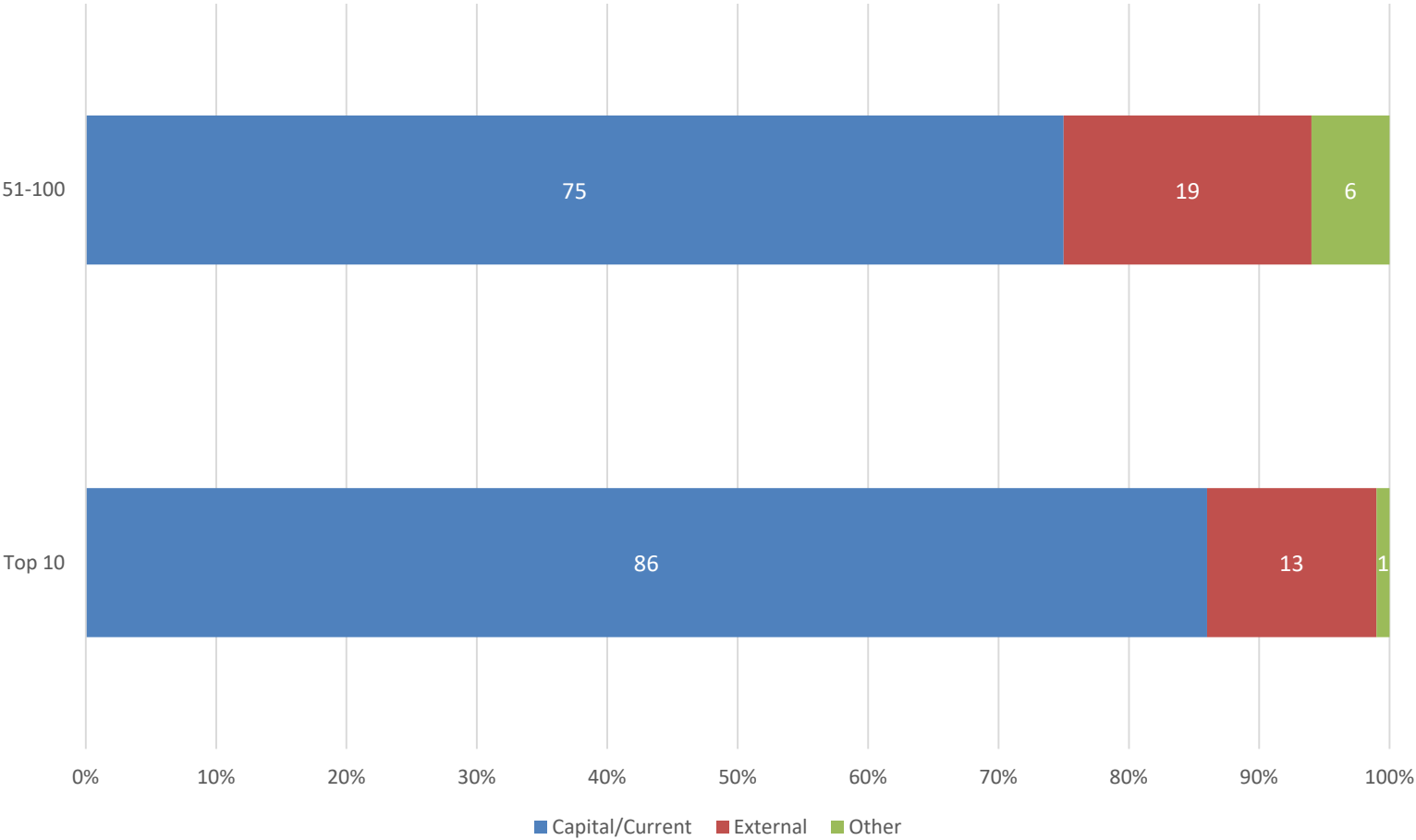
- 1. Long-term cashflow planning
  - 2-3 years
  - Robust model
  - Big payments
  - Sensitivities
  - Pinch points
- Where does law firm financing come from?



# Are law firms in denial about their profitability?



From PwC survey: sources of firm finance



# Are law firms in denial about their profitability?



## Solutions

- 2. Ring fence cash for future liabilities
  - Tax
  - VAT
  - Rent
  
- &/or put in place finance arrangements
  - PI
  - IT investments
  - Pinch points



# Are law firms in denial about their profitability?



## Solutions

- 3. Reduce leakage!
  - Pre-engagement
  - Scoping
  - Planning
  - Execution
  - Billing
  - Collection



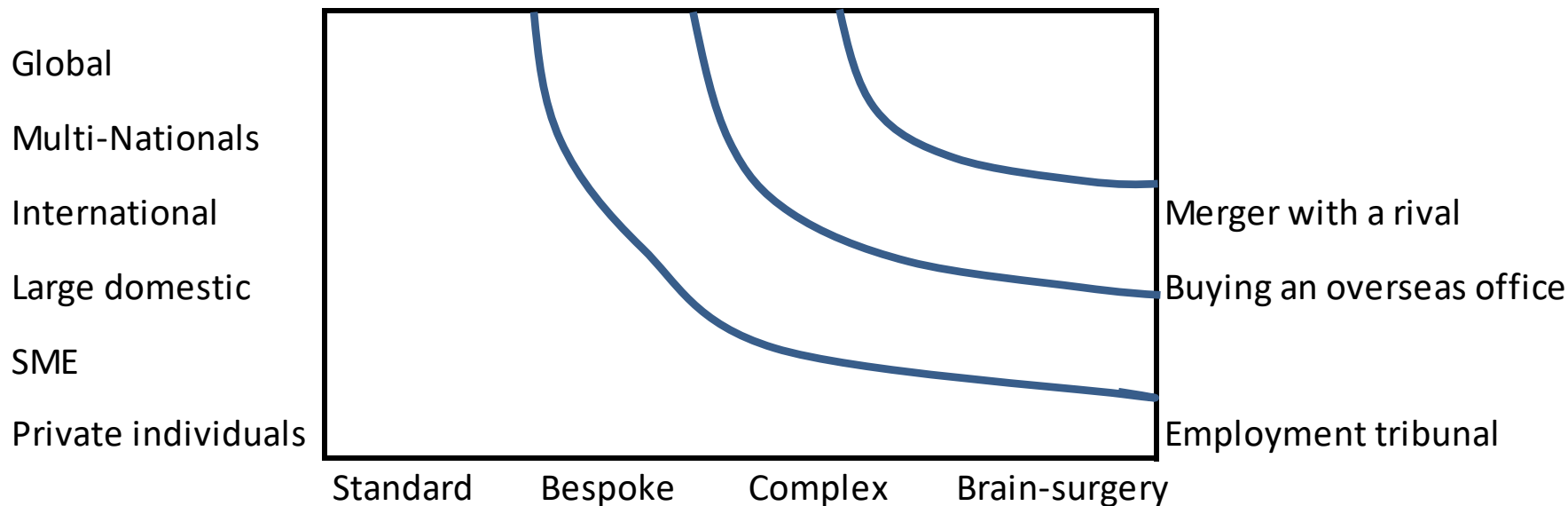


# Are law firms in denial about their profitability?



Scoping/planning pricing

## Segmentation of work: clients' perspective



# Are law firms in denial about their profitability?



## Solutions

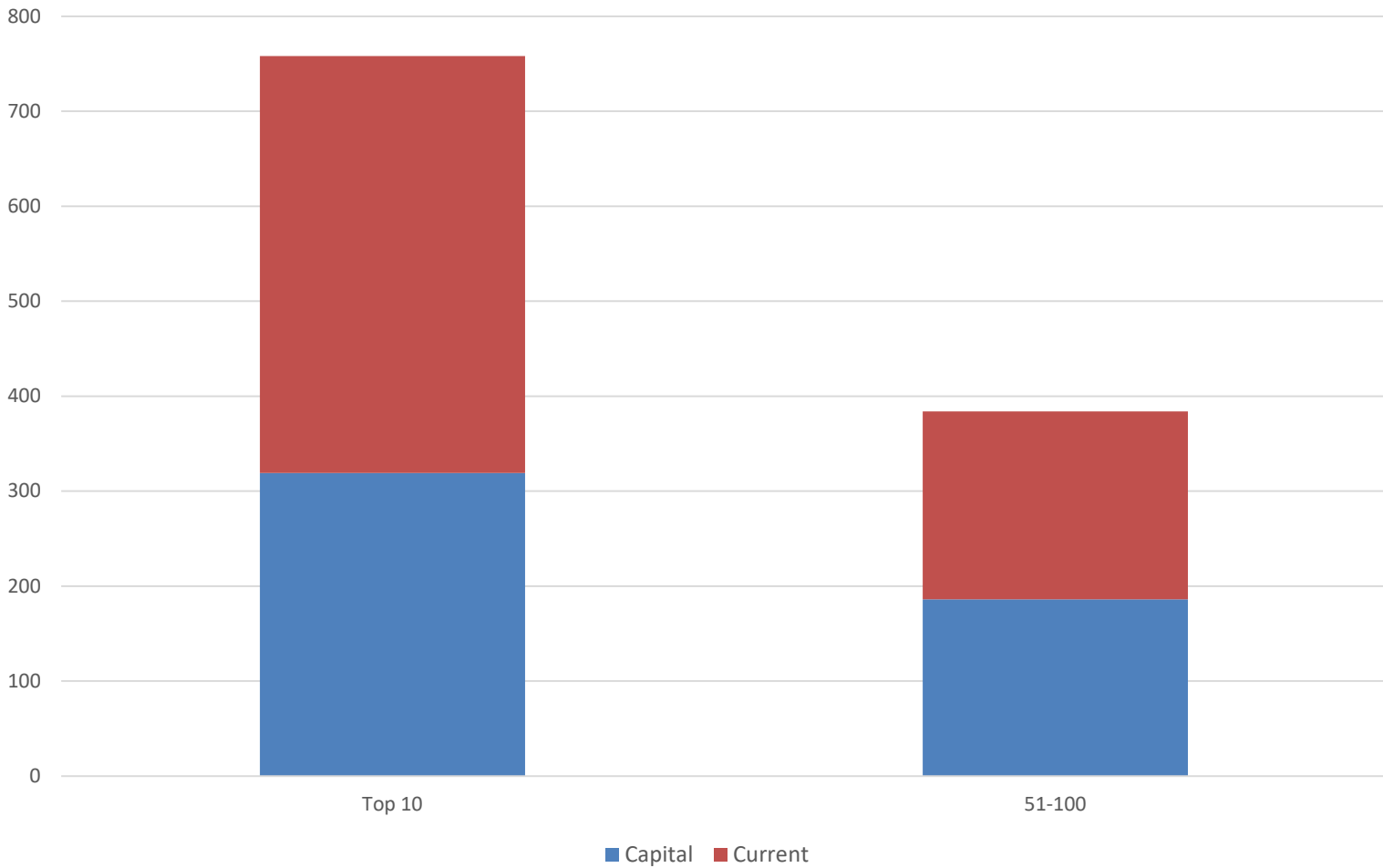
- 4. Reduce working capital
  - Speed of turnaround



# Are law firms in denial about their profitability?



Value of senior equity partner 'investment', PwC survey, £000s



# Are law firms in denial about their profitability?



- Remember
  - Revenue is vanity
  - Profit is sanity
  - Cash is reality



# Are law firms in denial about their profitability?



- Risks of relying on lockup

1. WIP is an illusion

- Speculative
- Loses its value very quickly

2. Debts less so

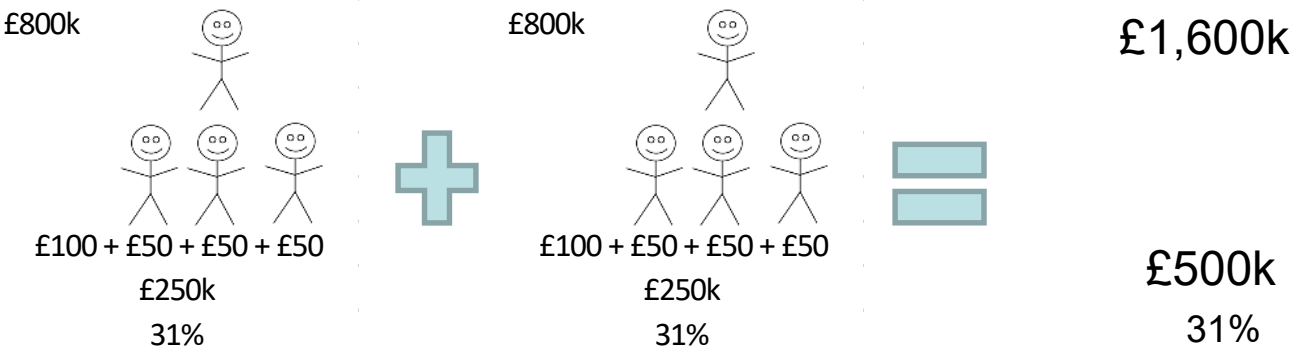
- Can invite complaints
- Fee earners instinctively want to liaise with their clients
- Need a process



# Are law firms in denial about their profitability?



- Risks of deal-making



# Are law firms in denial about their profitability?



- Mitigation options

1. Good relationships with external sources of finance
2. Board acceptance of fragility of profit
3. Coach matter managers and staff in essentials of profitable matter management
  - Prevents leakage
  - Speeds up working capital cycle
  - Creates certainty, or at least less uncertainty
  - Requires top-down sponsorship



# Conclusion



- Final thoughts
- Not in denial
- Lessons from outside law
- A lot of good things happening, but you can never, ever take your eye off the ball



# Contact



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