

EdwinCoeLLP



LPM Conference 2019

Tim Nash, Chief Executive

Are law firms in denial about their profitability?

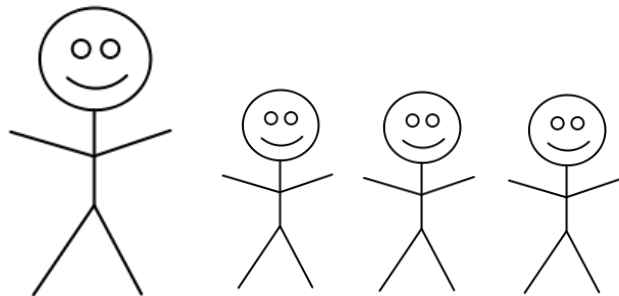


- The levers of profitability
 - Utilisation
 - Leverage
 - Rate (fees/hour)
 - Costs
 - Investments



Are law firms in denial about their profitability?

- The levers of profitability



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

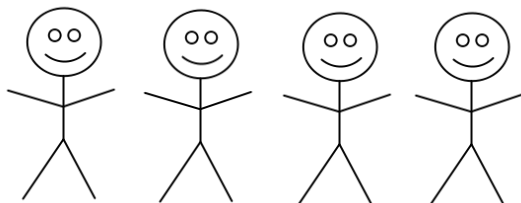
300,000 Salary
330,000 Costs
630,000 Total costs

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

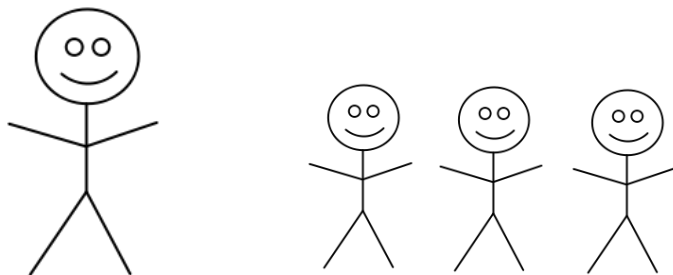
350,000 Salary
330,000 Costs
680,000 Total costs

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

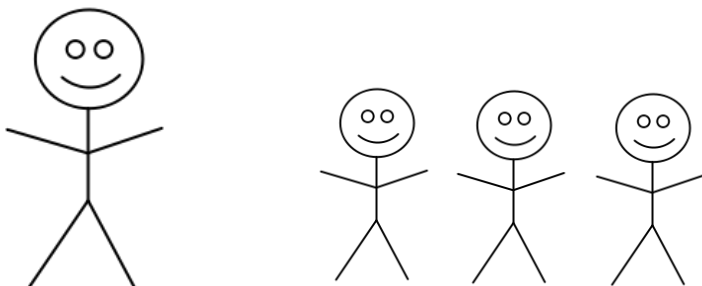
300,000 Salary
330,000 Costs
630,000 Total costs

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

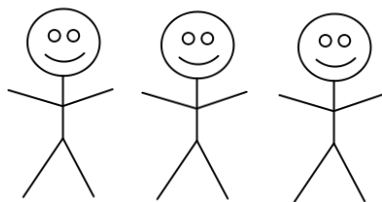
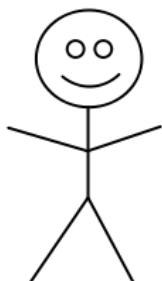
300,000 Salary
330,000 Costs
630,000 Total costs

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

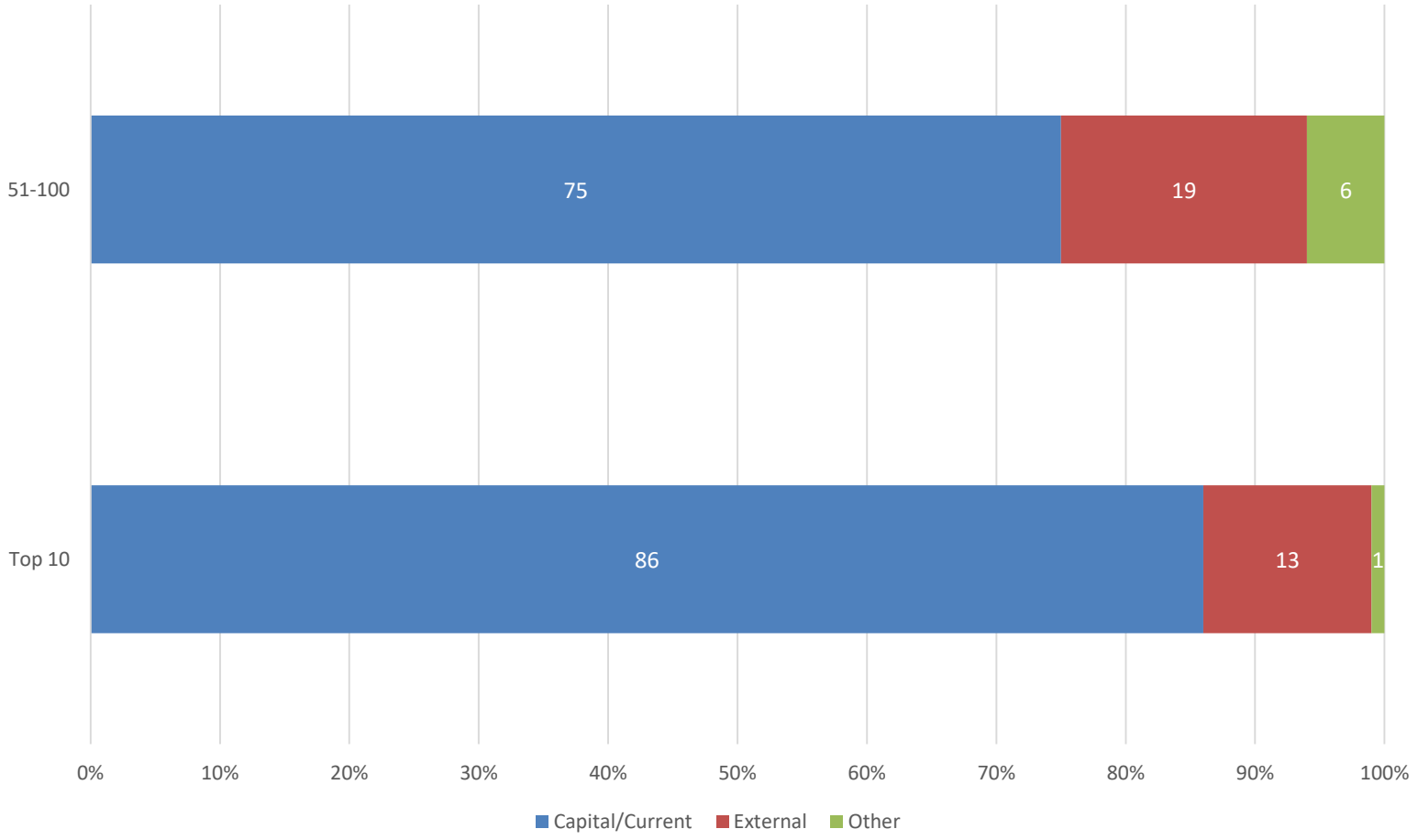
- 1. Long-term cashflow planning
 - 2-3 years
 - Robust model
 - Big payments
 - Sensitivities
 - Pinch points
- Where does law firm financing come from?



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

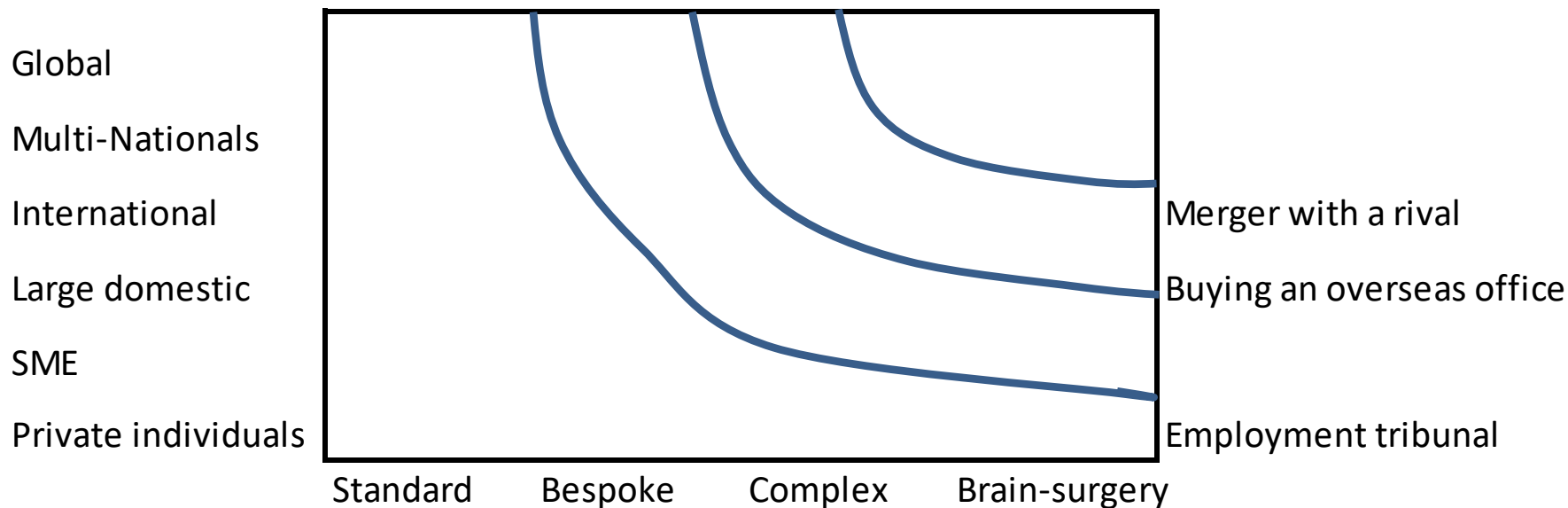


Are law firms in denial about their profitability?



Scoping/planning pricing

Segmentation of work: clients' perspective



Are law firms in denial about their profitability?



Solutions

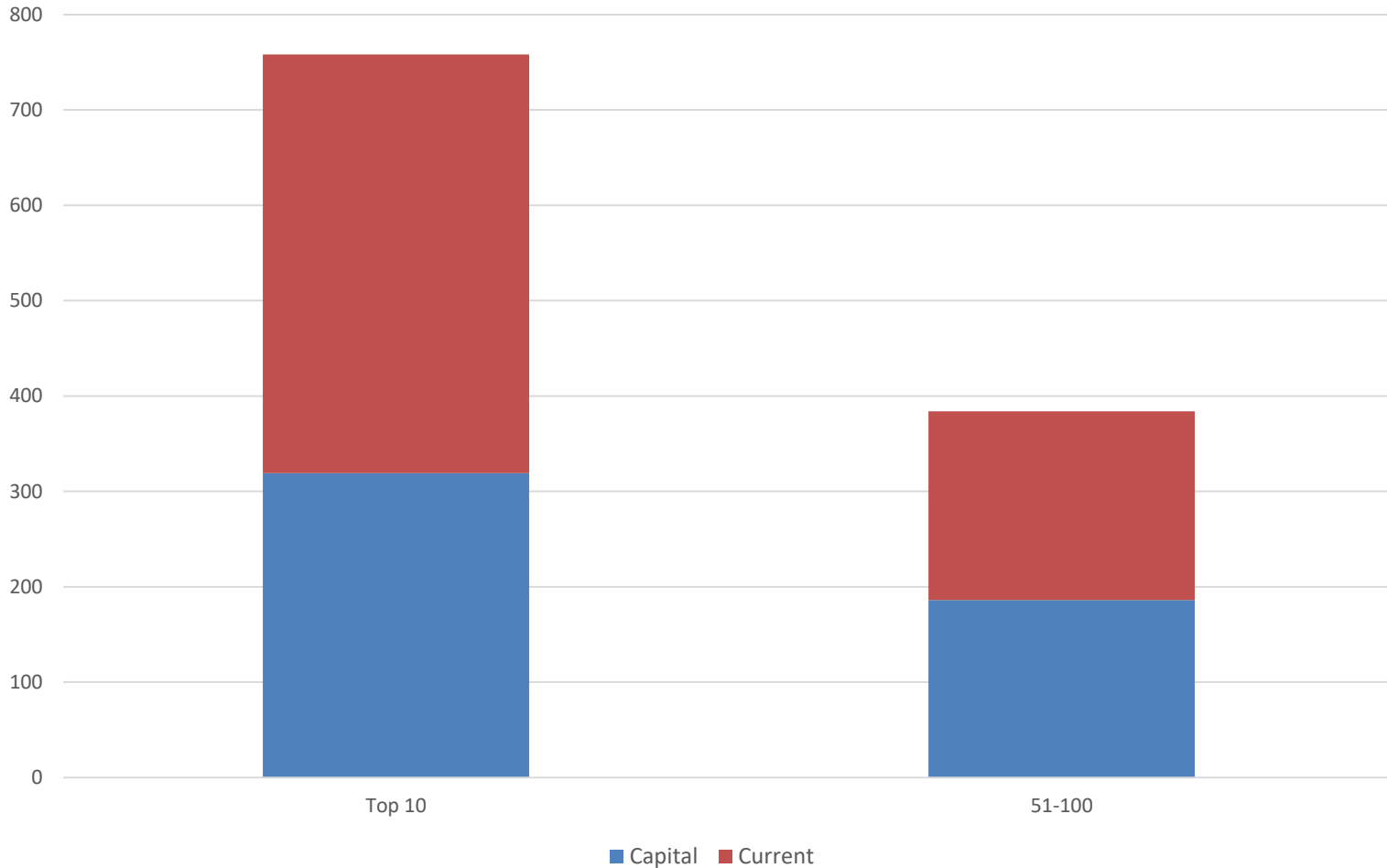
- 4. Reduce working capital
 - Speed of turnaround



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

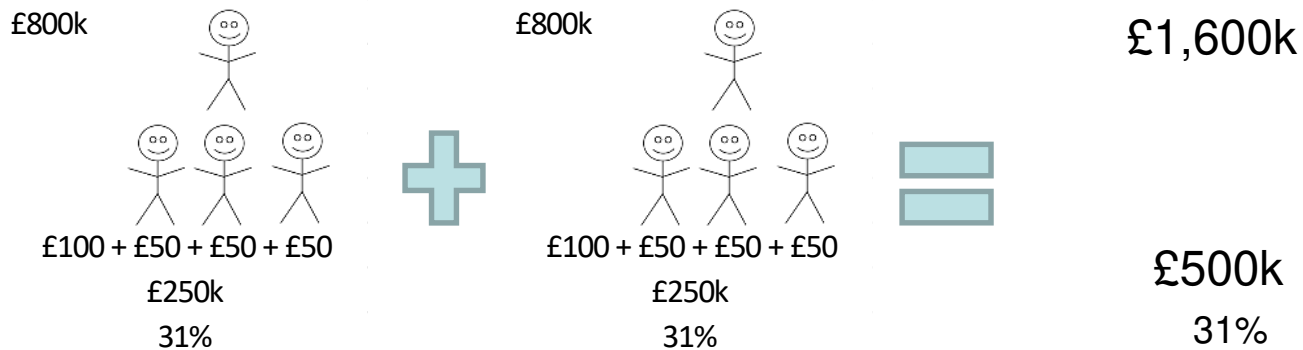
- Can invite complaints
- Fee earners instinctively want to liaise with their clients
- Need a process



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



Tim Nash

Chief Executive

t: +44 20 7691 4017

e: tim.nash@edwincoe.com



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Edwin Coe LLP | 2 Stone Buildings | Lincoln's Inn | London | WC2A 3TH

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