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Analyze This

Use profitability analyses, but be sure to look behind the numbers.

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In theory, profitability analyses hold tremendous allure. In practice, they can often fall short.

The idea is simple: Establish a defined set of performance metrics that accurately judge each practice group and its attorneys' contribution to the firm's success. But there are challenges.

First, while the idea is to develop a set of objective standards that measure everyone equally, the fact is that such metrics are based on assumptions, the choice of which can be biased, e.g., whether or not a firm gives origination credits to an attorney who doesn't work on the new matter.

Second, metrics that measure performance well in one type of practice may be unsuitable to another.

Third, profitability analyses can lead to a rigid practice management mind-set that is overly focused on objective criteria, and loses sight of vital, but hard to measure, subjective factors that also contribute to a firm's success.

Consider this example. At one firm I counseled several years ago, a senior partner came to me with his analysis of the firm's trade association practice group. Trade association work is generally done at lower billing rates than other corporate work, and the complaining partner had the facts and figures--billing rates, billable hours, collections--to show that the group was not very profitable. He was convinced that the partner in charge of the group was significantly overcompensated. Based on the metrics he was using, the senior partner was absolutely right.

The partner in charge of the trade association practice didn't dispute any of the metrics. The core of the practice was certainly not the firm's most profitable. But the senior partner overlooked that fact that the practice generated one or two seven-figure antitrust litigation matters each year that were billed at full standard rates.

Under the senior partner's profitability analysis, data from the litigation department, which actually did the work on those seven-figure matters, was not considered. However, without the trade association practice, the firm wouldn't have those matters. Faulty assumptions, faulty results.

This situation also illustrates another potential shortfall in overly rigid, billables-driven profitability analyses. The "unprofitable" work was also steady, predictable, and rarely required senior-partner-level skill sets. Through this work, the firm was able to level out spikes in demand and many associates and young partners were able to generate billable hours when otherwise they

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may have been idle.

Some of the "unglamorous" types of work that often suffer in billable-driven profitability analyses--such as real estate leasing work, minute-book reviews, low-profile employment, and insurance defense litigation--can provide intangible benefits: Attorneys can continue to generate billables; and such work provides steady contact with counsel at large clients, so that your firm is top-of-mind for more attractive matters come.

If a firm implements a profitability analysis that fails to recognize those intangible values, then attorneys will not be encouraged to develop and maintain those relationships--or will be motivated to take those relationships to another firm where they are valued.

Consider, too, the skills necessary to manage the client relationships associated with high-volume, low-rate work. The supervising attorney needs to understand when senior-level skills are required, yet still be able to meet the client's economic expectations. That partner also has to have the client relationship and practice development skills to ensure that the firm receives more profitable work from that client. Such skills don't fit easily into profitability analysis metrics, but often are more important than billable hours.

Another area that firms often overlook is firm citizenship. Is there a young partner who is a natural leader? That leadership isn't billable, but it's very valuable.

Does this mean that profitability analyses are a bad idea? No. It means that careful thought must go into their limitations. It also means that they should be a management tool, not the management tool. Good managers are the ones that get behind the numbers to find the real story of a firm's success.

One final point: Firms should consider restricting access to profitability analyses. Lawyers are trained advocates but often have limited financial acumen, and may misuse analyses. In addition, lawyers end up keeping score. This can lead to internal dissension or even the loss of good, productive lawyers from your firm. The people who should be looking at this information are only those--such as the managing partner, management committee or CFO--who need to use the information to make business decisions.

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