

Report to Legal Management

OUR 35TH YEAR

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New Survey Focuses on Law Firm Economics



William F. Brennan

By William F. Brennan

Editor's Note: This is the first of a two-part series summarizing the results of the 2008 Survey of Law Firm Economics. The second installment will appear in next month's issue.

The 2008 *Survey of Law Firm Economics* includes responses from 265 law firms and covers 15,953 lawyers. There are thousands of financial and operating statistics provided by this *Survey*, covering revenue, expenses, billings, realization, assets, liabilities, billing rates, billable hours, lawyer compensation, staff ratios and much more. Detailed information is provided by law firm size, geographic location, practice area specialty, population size, experience level of lawyers, and lawyer title. The following summary indicates some highlights from this year's *Survey* as well as a glimpse into the wealth of information it offers.

Average receipts per lawyer reported by participating firms was \$430,483 reflecting an increase of 4% over the prior year. Overhead expenses increased only 1.8% from the prior year to \$170,363 per lawyer which, when combined with revenue increases of 4%, had a net positive effect on law firm profitability.

Financials

Table 1 on page 9 illustrates the breakout of gross receipts and total expenses by law firm size. Receipts averaged \$367,330 per lawyer for law firms with between two and eight lawyers. The average remained relatively

flat for the next two law firm size categories, hovering between \$359,000 and \$377,000, but as firm size increased beyond 40 lawyers a clear relationship emerges between law firm size and receipts per lawyer: as firm size increases, so does receipts per lawyer. Law firm overhead expenses on the other hand are relatively flat for small and medium-sized firms, fluctuating within the range of \$144,000 to \$161,000 per lawyer, for law firms with up to 75 lawyers. Larger firms report much higher expenses per lawyer: \$174,000 for firms with 76 to 150 lawyers and \$197,500 for firms with over 150 lawyers. Expenses averaged about 43% of revenue for law firms with fewer than 21 lawyers, and between 38-40% for all larger firm size categories. Chart A on page 9 vividly illustrates this relationship.

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What are the largest expenses incurred by law firms? Table 2 below lists the detailed expenses that comprise the total overhead expenses of law firms, categorized by their practice areas of concentration. The percentage of each expense compared to the firm's revenue is indicated next to the aggregate amount on a per lawyer basis.

The relative magnitude of each individual expense is apparent from Chart B on page 10, which indicates that staff expense is clearly the largest single overhead expense item for all categories of law firms, followed by occupancy expense and then paralegal compensation (excluding the "other" category which is a catch-all expense comprised of malpractice insurance premiums and settlements, payments to retired partners and miscellaneous expenses). Note the significantly greater expense level reported by plaintiffs firms. These firms spend more on a

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Table 1. GROSS RECEIPTS, EXPENSES AND INCOME AVERAGE PER LAWYER

Breakout of Data		Firms	Average Gross Receipts \$	Average Total Expense \$	Average Total Expense %*	Average Firm Income \$	Average Firm Income %*
Size of Firm	2 to 8 Lawyers	22	367,330	160,664	43.7	206,666	56.3
	9 to 20 Lawyers	59	376,822	159,599	42.4	217,223	57.6
	21 to 40 Lawyers	67	359,724	144,078	40.1	215,647	59.9
	41 to 75 Lawyers	58	397,908	152,559	38.3	245,350	61.7
	76 to 150 Lawyers	43	448,166	174,373	38.9	273,793	61.1
	Over 150 Lawyers	12	488,456	197,522	40.4	290,934	59.6

*Percent of Gross Receipts

Chart A. AVERAGE PER LAWYER – BY LAW FIRM SIZE

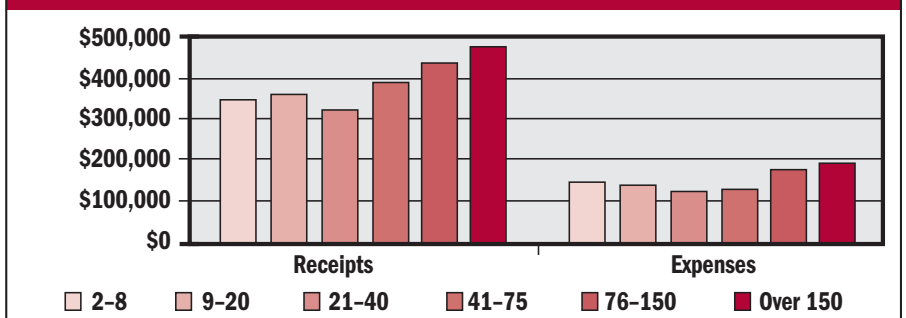


Table 2. DETAILED EXPENSES – AVERAGE PER LAWYER

Breakout of Data		Paralegal Expense \$	Paralegal Expense %*	Staff Expense \$	Staff Expense %*	Occupancy Expense \$	Occupancy Expense %*	Equipment Expense \$	Equipment Expense %*
Practice Area	Civil Trial Practice	14,216	4.6	51,720	16.6	22,822	7.3	6,586	2.1
	Insurance Defense Litigation	15,437	4.4	57,670	16.5	22,661	6.5	6,451	1.8
	Plaintiffs' Contingency Litigation	36,420	6.7	71,191	13.1	40,350	7.4	17,772	3.3
	Real Estate/Land Use	23,502	5.1	66,028	14.2	29,501	6.4	5,904	1.3
	General Law	17,242	4.0	60,971	14.0	27,122	6.2	9,510	2.2
	Other	18,634	4.0	61,898	13.1	29,129	6.2	10,640	2.3

*Percent of Gross Receipts

DETAILED EXPENSES – AVERAGE PER LAWYER

Breakout of Data		Reference Expense \$	Reference Expense %*	Promotional Expense \$	Promotional Expense %*	Other Expense** \$	Other Expense** %*	Total Expense \$	Total Expense %*
Practice Area	Civil Trial Practice	5,576	1.8	8,042	2.6	32,782	10.5	141,744	45.5
	Insurance Defense Litigation	2,888	.8	5,997	1.7	34,414	9.9	145,518	41.7
	Plaintiffs' Contingency Litigation	9,565	1.8	51,113	9.4	34,351	6.3	260,761	48.0
	Real Estate/Land Use	1,950	.4	7,298	1.6	34,591	7.5	168,773	36.4
	General Law	5,181	1.2	8,507	2.0	42,524	9.8	171,057	39.3
	Other	5,545	1.2	8,513	1.8	58,721	12.5	193,080	41.0

*Percent of Gross Receipts **Includes malpractice insurance premiums and settlements, payments to former partners, all other expenses not shown separately.

Survey... continued from page 9

Chart B. AVERAGE EXPENSE PER LAWYER – BY PRACTICE AREA

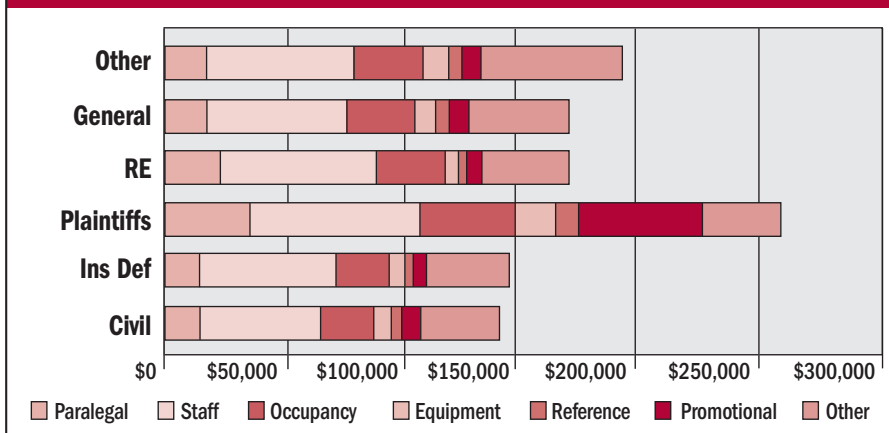


Table 3. VALUE OF UNBILLED TIME AT YEAR-END — NON-CONTINGENT FEE MATTERS ONLY — AVERAGE PER LAWYER

Breakout of Data		Firms	Average \$	Lower Quartile \$	Median \$	Upper Quartile \$	Ninth Decile \$
Size of Firm	2 to 8 Lawyers	13	50,066	20,572	36,973	76,498	113,721
	9 to 20 Lawyers	46	50,923	25,477	45,331	63,604	97,237
	21 to 40 Lawyers	62	51,047	34,772	45,445	63,912	77,752
	41 to 75 Lawyers	50	54,362	44,297	50,281	60,584	75,139
	76 to 150 Lawyers	41	69,367	43,490	58,148	74,527	89,793
	Over 150 Lawyers	12	54,854	44,462	53,986	70,031	79,585

per lawyer basis than all other categories of firms, and their increased level of spending applies to all expense items, but especially to paralegal, equipment, reference and promotional expenses. The total overhead expense per lawyer for plaintiff firms is \$260,761 which is a 53% premium over the average reported by all law firms in the Survey.

Billing and collecting receivables is an integral function of almost every law firm, and a firm's effectiveness and efficiency in performing these tasks is fundamental to the firm's financial success. One measure of a law firm's efficiency in this regard is the balance of unbilled time, or work in progress, the firm carries in inventory at any point in time. The larger the balance of unbilled time, as computed on a per lawyer basis, the less efficient the

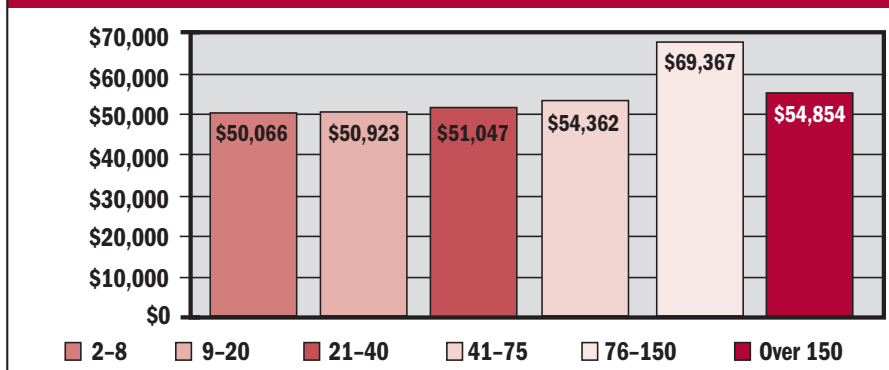
firm is in billing its clients. That is, the firm is taking longer to prepare its billings to clients, which slows down cash flow. Table 3 above provides selected statistics from the Survey about various categories of firms.

The average amount of unbilled time per lawyer fluctuates in a nar-

row range between \$50,000 and \$55,000, averaging slightly over \$52,000 for the group except for one category of firms: those with between 76 to 150 lawyers. For this category the average is over \$69,000 per lawyer, which is one-third larger than all the other categories. This category of firms reported the largest amount of unbilled time in the prior year also. What causes such a substantial increase for firms in this size category on a consistent basis? The answer to this question is not provided by the survey data. We surmise that it may be attributable to firms of this size needing more sophisticated business processes than smaller firms, which can rely upon informal controls and peer pressure to ensure that partners comply with their firm's billing policies, while firms with over 150 lawyers have developed and implemented formal business processes of this nature. Chart C below illustrates the relative magnitude of the increased investment made by law firms in the 76 to 150 lawyer size category.

Another means of measuring the efficiency and effectiveness of a law firm's revenue generating policies, systems and procedures entails the firm's realization statistic, which can be measured both in terms of billing and collecting. Table 4 on page 11 provides information on these measures for law firms of varying size categories.

Chart C. AVERAGE UNBILLED TIME PER LAWYER BY LAW FIRM SIZE



*Non-contingent fee matters only

Table 4. AVERAGE REALIZATION DATA USING ACTUAL RATES

Breakout of Data		Firms	Billing Realization %	Collection Realization %	Overall Realization %
Size of Firm	2 to 8 Lawyers	6	91.3	92.1	84.2
	9 to 20 Lawyers	35	97.2	96.8	94.0
	21 to 40 Lawyers	51	95.7	97.0	92.8
	41 to 75 Lawyers	49	95.4	96.9	92.5
	76 to 150 Lawyers	38	95.6	97.4	93.1
	Over 150 Lawyers	11	94.8	98.0	92.8

Chart D. REALIZATION BY LAW FIRM SIZE

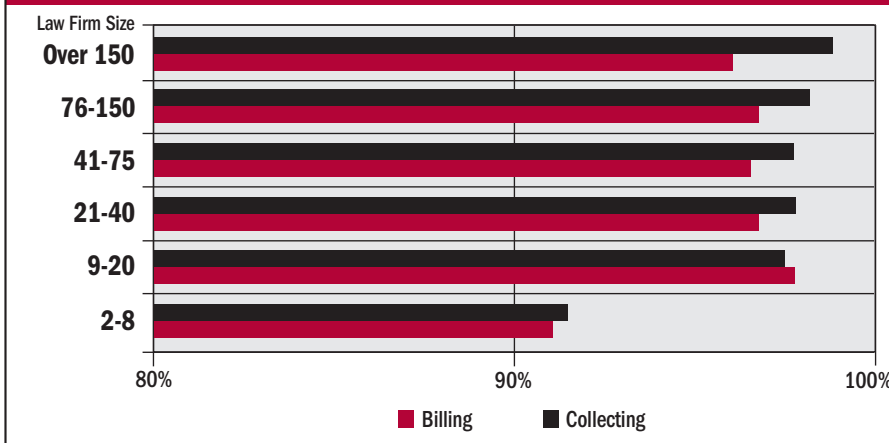


Chart D above provides a visual depiction of this data. Clearly all size firms are about the same in terms of converting their unbilled time into client billings and then such billings into receipts, except for the smallest size category. Firms in the 2 to 8 lawyer category are 4% less effective in terms of billing realization and another 5% less effective in converting those billings to receipts. As a result, these firms report an overall realization rate of only 84% compared to all other firms which have an overall realization rate of between 92% and 95%. If these small firms could improve their performance in this area it would substantially improve their revenue generating capacity and profitability in the year the changes are adopted.

It is interesting to note that firms in the 76 to 150 size category report billing and collecting realization sta-

tistics that are comparable to other sized firms. One might have expected lower realization statistics for firms in the 76 to 150 category because of the much larger balance of unbilled time carried by such firms, as noted above. An explanation of this anomaly might be that these firms have consistently carried relatively large balances of unbilled time, delaying how promptly they bill their clients, but when they ultimately get around to billing their clients they are just as effective in controlling the amount of write-downs of time and write-offs of receivables as are firms in other size categories, thereby yielding similar realization statistics. In contrast, as noted above, the smallest firms, write-down more time in the billing process and write-off a larger percentage of the bills they send out to clients than any other category of

firms, but they are just as prompt in sending out their billings to clients as are larger law firms.

In the second part of this article we'll look at what the *Survey* reveals about hourly rates, billable hours, compensation, and personnel ratios. ♦

The 2008 Survey of Law Firm Economics was conducted and published by Altman Weil Publications, Inc., a Division of Incisive Legal Intelligence. Readers can purchase a copy of the Survey by calling Incisive Legal Intelligence's survey group at (888) 782-7297 or online at www.lawcatalog.com.

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