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Editor

Managing for Superior Paralegal Profitability

More and more, paralegals are playing a prominent role in the delivery of legal services. As law firms increasingly rely on them, it is more important than ever to understand the drivers of paralegal profitability and whether your paralegals are being utilized effectively to that end. This column explores a formula for analyzing paralegal profitability, how to staff matters based on profitability factors, and includes tips on increasing profitability via effective utilization of paralegals in the delivery of legal services.

Legal Services Profitability Formula

For hourly-based legal services (still the predominant pricing method, by far), there is a useful formula for analyzing profitability:

$$\text{NIPP} = (1+L) (U) (R) (BR) (M)$$

The formula was devised by David Maister, a consultant to professional services firms, and it applies to individual timekeepers (i.e., lawyers and paralegals) and also to groups (practice groups, offices, entire firms, etc.). The formula's terms are as follows:

- **NIPP** stands for net income per partner (or shareholder), the most common definition of law firm profitability.
- **L** is leverage, the ratio of paralegals, associates and other non-owner fee earners to partners (or shareholders).
- **U** is utilization, the total number of billable hours worked and recorded by the partners, associates or paralegals in the firm.
- **R** is realization, the efficiency at which a firm converts billable time into fees collected, stated as a percentage.
- **BR** is the billing rate of the individual or the blended rate of a group.
- **M** is margin, the firm's net income, stated as a percentage.

As mentioned, the formula was based on research done by David Maister (when he was a Harvard Business School professor). The most important thing it shows is that there are five and only five factors that affect the profitability of hourly-based legal services. These are (from above): leverage, utilization, realization, billing rates and margin. The formula also shows that the factors are interdependent — that is, one of them typically cannot be changed without also affecting one or more of the other factors. For example, by looking at the above formula one can see that if the billing rate were doubled and nothing else changed, profitability would also double, by definition. Of course, if a firm were to double the billing rates of its timekeepers overnight, several other things would likely happen. Realization would suffer — how many of the firm's clients would pay their bills if the firm were to double its billing rates? Utilization would suffer as well, as clients would abandon the firm (thus driving down its billable hours) and seek services from competitors. If factors other than billing rate were changed, there could be similar effects on other of the factors as well.

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The lesson in all this is that if you want to analyze and improve the profitability of paralegals (the relevant time-keepers in this article), you need to analyze the five factors in the formula and determine which can be modified over either the short or long term to positively affect profitability. And although the formula actually can be used to calculate profitability of individual time-keepers or groups in a numerical sense, its higher value is to apply it analytically to the services being provided by your firm's paralegals (or lawyers, of course, for that matter).

Profitability and Paralegal Utilization

Aside from the five factors in the formula, nothing impacts the profitability of paralegals more than the degree to which they are utilized effectively. Stated another way, without the effective utilization of paralegals, their profitability will suffer. Effective utilization, however, significantly increases the likelihood of strong profitability.

Nearly two decades consulting to law firms about paralegals and paralegal programs has demonstrated to this author that, in those firms that really understand how to leverage work and profitability through paralegals, the following circumstances always exist:

- In terms of experience, education, title, job classification and compensation, paralegals do not look like legal secretaries, nor do they perform clerical work (keying the first draft of one's own documents is not considered clerical work, and of course, the high-volume, routine work performed by low-level paralegals in litigation matters might be considered to be an exception to this rule).
- Paralegals are provided with secretaries and other staff support, just as lawyers are.

- Paralegals are encouraged and allowed to participate in professional development and training activities, just as lawyers do.
- Paralegals are considered to be key members of the legal services delivery team or practice group, and they have input into the group's discussions, decisions and strategies.
- Paralegals are treated like professionals.
- The work assigned to paralegals is limited only by their abilities (and, of course, ethical considerations).

What to Do?

If you want to enhance the profitability of your firm's paralegals, use the formula provided above and analyze its five factors as they apply to your paralegals. Make adjustments to the factors where warranted. You should also attend to the effective utilization of paralegals and determine whether yours are under-utilized. If they are, train your lawyers to more effectively utilize the services of paralegals, and include paralegals in helping teach the training. Carefully consider and establish hiring and promotion criteria for your paralegals, including a determination of which credentials should be required of them (for example, bachelor's degree, two-year associate's degree, or paralegal certificate, etc.). Finally, in all respects, treat paralegals as professionals and engage them in discussions about how they can improve the profitability of the services they are delivering to your clients.

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