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## **Effective Firm Planning Starts With a Budget**

Although very few smaller firms currently use them, detailed financial budgets can prove to be among a small firm's most effective planning tools. Many firms that resist the budgeting process do so because much of their business is transactional and, thus, sporadic in nature.

But even these firms can benefit from understanding how dependent they are on this work and planning accordingly.

### **The Benefits of Budgeting**

Essentially, budgeting is a mental exercise that coordinates several critical firm areas, including practice development, strategic planning, personnel, salary levels, support staff and capital needs. It allows a firm to make conscious, informed decisions, rather than reactive, frequently rushed, expenditures.

A budget provides the foundation for formulating revenue and staffing goals, and an opportunity to review expected expenses in advance. For example, seeing the firm's annual premium for malpractice insurance as a lump sum in a budget, as opposed to just the monthly statement, may prompt a firm to initiate a bidding process for its insurance business.

The budgeting process also can lead to an increased appreciation among firm leaders for the importance of business development exercises like marketing, referral networks and association memberships. Budgeting forces a firm to recognize how much of its revenue base depends on the unknown, particularly if its book is heavily transactional. This knowledge can motivate business generation and foster increased cooperation.

### **Budgeting Methods**

Two primary methods of budgeting are available to law firms. Some firms may be able to adopt both methods, using them to crosscheck each other. Regardless of the method applied, budgeting must be a firmwide process if buy-in is to be secured at all levels.

One method is to budget by attorney or paralegal, where each individual is viewed as a billing center. Annual billable hours are multiplied by hourly rates to determine each individual's expected revenue generation. This approach allows a firm to set individual annual revenue goals, while matching individuals with their salaries, benefits, insurance and other expenses to accurately estimate the costs of each.

Law firms also may estimate their revenues by practice area, which may prove more practical than by attorney. A firm begins by segregating its different practice niches; the individuals responsible for each practice area will determine its revenue. Again, revenue can then be matched up with the respective labor costs.

The nature of a particular law firm may make it more suited for one method than the other when it comes to accuracy of revenue predictions. Firms with substantial contingency fees, for example, may find it easier to estimate revenues by practice area because individual billable hours aren't tracked.

### **Drilling Down**

The budgeting process involves more than just a review of revenue and labor costs — the process continues down through a firm's various administrative support expenditures, such as staff salaries, rent, outside consultants, technology, marketing and insurance. Each of these areas will undergo a thorough examination, including looking for escalating costs, reviewing providers and coordinating expenditures with the firm's strategic plan.



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