



### **It's All In The Metrics**

With all these post-mortem horror stories in mind, accurate and applicable revenue metrics seem more critical than ever. Note that the key words here are *accurate* and *applicable*.

With that in mind, perhaps it's time to revisit some time-proven law firm metrics — and critically evaluate potential flaws in some of these long-accepted measurements.

#### **Some Problems With “The Standards”**

As you'll see, the two revenue metrics used most often to describe law firms' financial performance — *Gross Revenue* and *Revenue Per Lawyer* — are not always the best measures to describe a firm's operational and financial performance.

**Gross Revenue** — Merger mania is a major factor muddying the interpretation of Gross Revenue as a measure of financial performance, as some firms have seen dramatic increases in revenues from one year to the next, not because they performed “better” in any financial sense, but because they acquired other firms.

**Revenue Per Lawyer** — Misuse of the Revenue Per Lawyer (RPL) metric stems from the fact that leverage at law firms varies dramatically — during 2000, leverage ranged from 1.72 to 6.61 across Amlaw 100 and Amlaw 200 law firms. All else being equal, the more lower-billing associates a firm adds to its ranks, the more that firm will necessarily lower any calculation of its RPL.

## A Better Take On The Numbers

In 1984, David Maister published a now-classic model for law firm profitability, Net Income Per Partner (NIPP).

Maister's formula describing law firm profitability is:

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

**L** = Leverage (ratio of associates to partners)

**BR** = Blended hourly billing rate

**U** = Utilization (client hours recorded)

**R** = Realization (revenues divided by "standard value" of time recorded)

**M** = Margin (partners' profits divided by revenues)

This model has the advantage of describing fully:

- How leveraged a law firm is
- How busy that firm is
- How much that firm charges for its services
- How much of those fees that firm collects

It is true that there is not only "one way to skin a cat" or, for that matter, to operate a law firm. The variables in Maister's formula allow the analyst to focus on the revenue-related or cost-control related strategy(ies) that will be most effective in supporting the individual firm's philosophy while, at the same time, maximizing future profitability.

*Revenue metrics can be heady stuff indeed. But our firm has a dedicated team of accounting professionals who can help you with this analysis.*