

# How does the business of law work?

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**PerformLaw**  
Do Law Firm Management Right!

A dark, semi-transparent background image showing a business meeting. Several people in business attire are gathered around a table, looking at various financial documents, charts, and a calculator. The scene is dimly lit, with the primary light source coming from the documents and the calculator. The overall mood is professional and focused.

# FINANCIAL

# STATEMENTS



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# Basic Financial Statements



## **Income Statements**

Client Fees less costs to operate = net income



## **Balance Sheets**

Assets. Liabilities, Equities (what a firm owns less what it owes)



## **Capital Accounts**

Each equity owner's share of the firm's worth



## **General Ledgers**

Detailed lists of transactions in each financial statement account



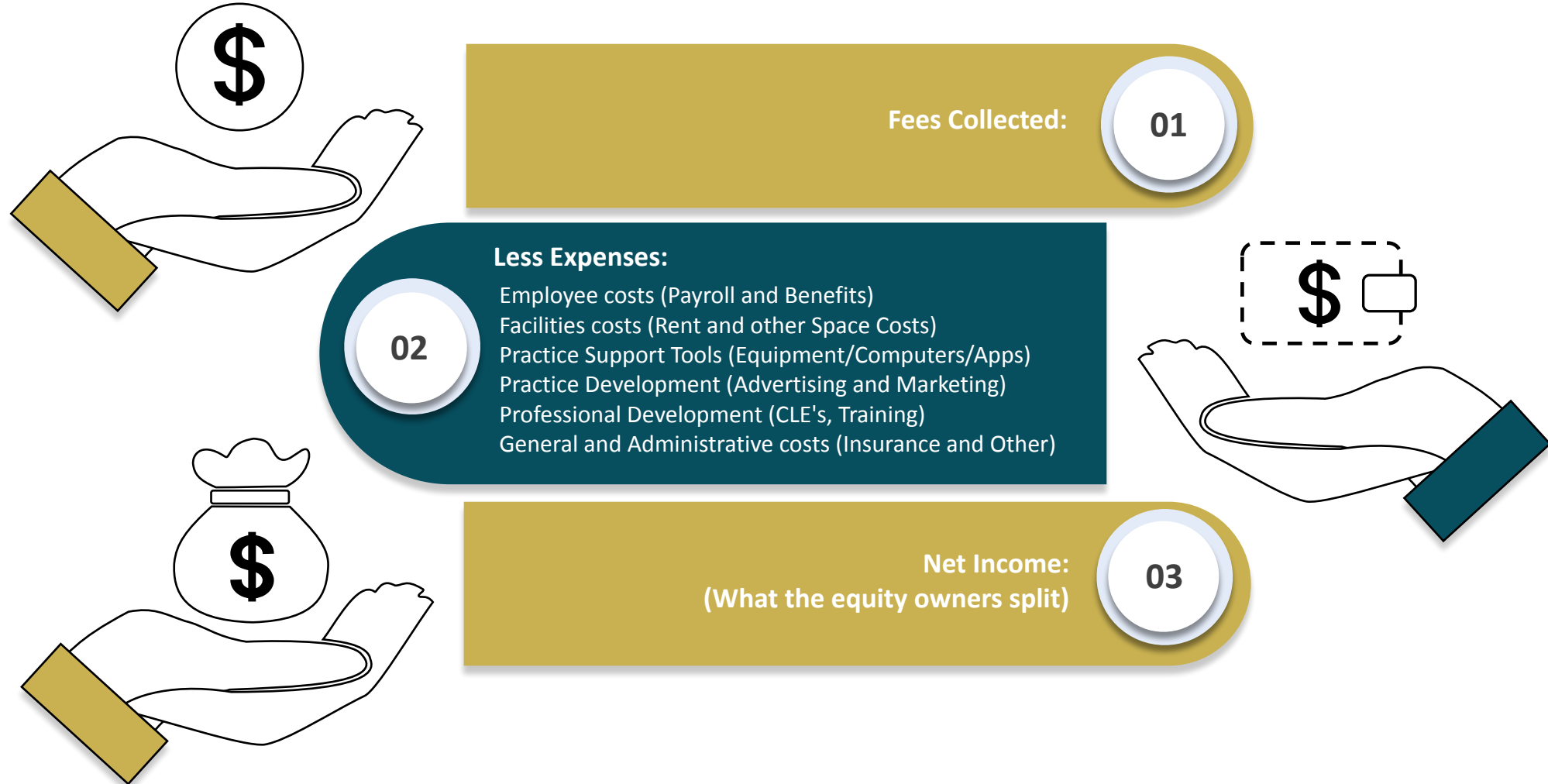
## **Sub Ledgers**

More detail on certain account balances (who owes you money, trust accounts, payables)



# Law Firm Income Statement

How much a law firm takes in less what it costs to produce the income and operate the firm.



# The Books and Records

Balance Sheets, Capital Accounts and Ledgers

## BALANCE SHEETS

- > **ASSETS:**  
Cash AR  
(Accounts Receivable)  
Property Owned
- > **LIABILITIES:**  
AP (Payables)  
Bank Debt  
Notes/Leases
- > **EQUITY:**  
Asset - Liabilities

## CAPITAL ACCOUNTS

- > **INCREASES:**  
Net Income Share  
Other Gains
- > **DECREASES:**  
Monthly Draws  
Profit Distributions  
Other Payments  
Other Losses
- > **INVESTED:**  
Income- decreases=  
amount invested in  
the firm

## COMMON LEDGERS

- > **GENERAL LEDGER:**  
Transaction lists of Asset,  
Liability, Equity,  
Income and  
Expense Accounts
- > **SUB-LEDGERS:**  
WIP (Unbilled Time), AR  
(Accounts Receivable), AP  
(Accounts Payable), Trust  
Ledger (Trust Balance by  
Client)



A dark, dimly lit photograph of a business meeting. Several people in business attire are gathered around a table, looking at various financial documents, charts, and a calculator. The scene is overlaid with a semi-transparent dark layer. Two horizontal bars, one yellow and one teal, are positioned over the right side of the image, containing the main title text.

**PROFITABILITY**

**AND INCOME**



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# How Law Firms Make Money

Timekeeper Profits

## Revenue Drivers

**Billable Hours**  
**Rates**  
**Billing Realization**  
**Collected Realization**

## Examples (Annual)

Billable Hours	2,000
Hourly Rate	\$200
<b>Billable Value</b>	<b>\$400,000</b>
Billing Realization %	98%
<b>Amount Billed to Clients</b>	<b>\$392,000</b>
Collected Realization %	97%
<b>Cash in the Door</b>	<b>\$380,240</b>
Effective Collection %	95.06%



# How Law Firms Make Money

## Timekeeper Profits

### Cost Drivers

#### Direct Costs:

Timekeeper Salary & Benefits

Direct Support Costs  
(Secretary and other direct support costs)

#### Overhead Costs:

Facilities, Practice Support,  
Practice Development,  
Professional Development and  
General and Administrative

### Example of Total Cost Per Lawyer

Lawyer Salary	\$125,000
Benefit Costs (15%)	\$18,750
<b>Total Payroll Cost</b>	<b>\$143,750</b>
Secretary Pay	\$65,000
Benefit Costs (20%)	\$13,000
Total Secretary Cost	\$78,000
Attorney's Share	33%
<b>Costs Assessed</b>	<b>\$25,997</b>
<b>Total Direct Costs</b>	<b>\$169,747</b>
Allocated Overhead	\$100,000
<b>Total Cost (Breakeven)</b>	<b>\$269,747</b>

### Profit Per Lawyer

<b>Fee Collections</b>	<b>\$380,240</b>
<b>Less:</b>	
<b>Direct Costs</b>	<b>\$169,747</b>
<b>Allocated Costs</b>	<b>\$100,000</b>
<b>Net Profit</b>	<b>\$110,493</b>





# Capacity Analysis and Planning

## PRACTICE PLAN HOURS DISTRIBUTION

Name Experience Management Level	PARTNERS		INCOME PARTNERS	ASSOCIATES		PARA-LEGAL S	TOTALS	
	Partner 1	Partner 2	IP 1	Associate 1	Associate 2	Paralegal 1	Total	% Scheduled Hours
	30	20	12	7	1	5		
Section Head								
<b>HOURS</b>								
Scheduled*	2,400	2,400	2,400	2,400	2,200	1,800	13,600	
Billable	1,639	1,771	2,010	2,005	1,745	1,600	10,770	79%
Non-Billable	761	629	390	395	455	200	2,830	21%

Non-Billable Detail – Hours

Practice Support/Overhead/Charitable

Administrative**	266	169	125	125	125	125	935	7%
Skill Development and CLE ***	25	25	25	25	225	15	340	3%
Bar, Professional Civic (Non-Marketing)	100	125	50	75	20	10	380	3%
Pro bono	25	25	35	50	50		185	1%
Recruiting	5	10	5	20	10		50	0%
Training Others	40	75	100	50			265	2%
	461	429	340	345	430	150	2,155	16%
Marketing/Marketing Support***	300	200	50	50	25	50	675	5%
<b>TOTAL</b>	<b>761</b>	<b>629</b>	<b>390</b>	<b>395</b>	<b>455</b>	<b>200</b>	<b>2,830</b>	<b>21%</b>

\* Scheduled hours are the total billable and non-billable hours planned for the year. These example hours are lower for the typical partner.

\*\* Based on management requirements and 30/45 minutes per day for admin overhead (timesheets, billing, miscellaneous, meetings, NB Case admin etc.)

\*\*\* Supported by detailed practice and marketing plans also includes bar, professional and civic contribution with a potential marketing benefit.



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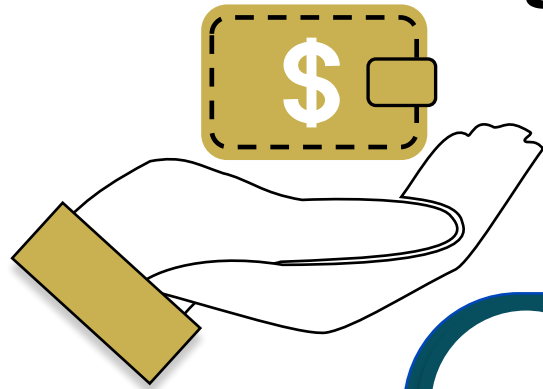
# CONTRIBUTIONS

# AND REWARDS



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# Building Value and Contributing Income



## Building Long Term Value

- More salary emphasis
- Less bonus recognition
- Equal advancement weight

SUBJECTIVE

OBJECTIVE

## Contributing To Profits

- Less salary emphasis
- More bonus recognition
- Equal advancement weight



## Building Long Term Value

- Quality of professional work
- Client relationships and service
  - Personal development
- Business development competence
  - Training contributions
  - Professional recognition
  - Firm reputation buildup

SUBJECTIVE

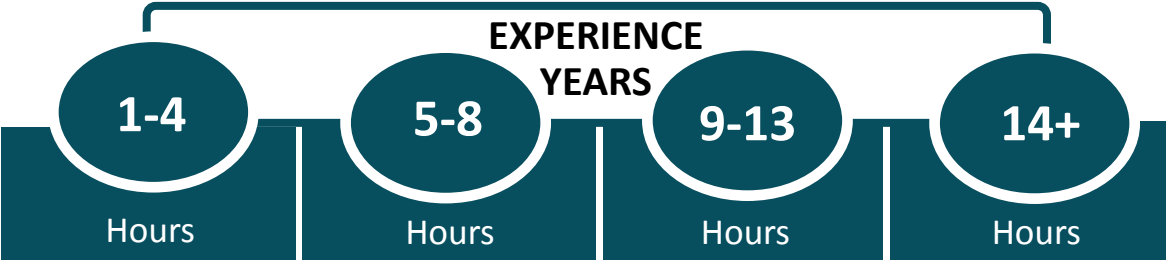
OBJECTIVE

## Contributing To Profits

- Personal profitability
- Client profitability
- Profitability of others (leverage & supervision)
- Recruitment of profitable lawyers
- Training contributions



# LAW FIRM CONTRIBUTION MODELS: By the Hours



CONTRIBUTION	Description	1-4 Hours	5-8 Hours	9-13 Hours	14+ Hours
Billable	Needed to meet client demand (will vary by firm and practice type)	2,100	2,100	2,000	2,000
<b>Non-Billable Hours</b>					
Skill Development	CLE and formal training programs	30	25	25	25
Training Others	Time spent training and helping others learn and grow	0	25	50	75
Marketing and Related	Traditional marketing activities, content contribution, brand building	10	25	100	125
Bar, Professional, Civic (BPC)	Leadership and participation in BPC organizations (often a supplement to marketing and individual brand building)	10	35	50	85
Recruiting	Interviewing, on campus, clerk programs, firm functions	2	5	15	15
Pro Bono	Some firms count toward billable goals. Depends on firm policy and state bar rules.	TBD	TBD	TBD	TBD
Administrative	Time, accounting, billing and non-billable overhead time (HR, Tech, Finance, Firm Management, Vendor Contracts)	20	20	120	175
<b>Sub-total Non-Billable Hours</b>	Mostly an investment in building your career	<b>72</b>	<b>135</b>	<b>360</b>	<b>500</b>
<b>Total Hours Contributed</b>		<b>2,172</b>	<b>2,235</b>	<b>2,360</b>	<b>2,500</b>



# Compensation

Typical equity member compensation approaches

## Formula Based

Gross Fee Credits or Profit Splits for Collected Origination \$

Billing Attorney \$

Working Attorney \$

Compensation not tied to ownership %

**Example:** Profit pools split based on shares of totals.

E.g. Total originations= \$2,000,000  
your originations= \$500,000, you get 20% of the origination pool

## Percent of Ownership

Percent of profit is tied to ownership percentage

**Example:**

Firm Profit = \$2,000,000

Ownership Percent 10%

Income Share \$200,000

(\$2,000,000\*10%)

## Hybrid

Formula based objective portion

Subjective and Equity Pools

**Example:**

**Tier 1:** Timekeeper pay

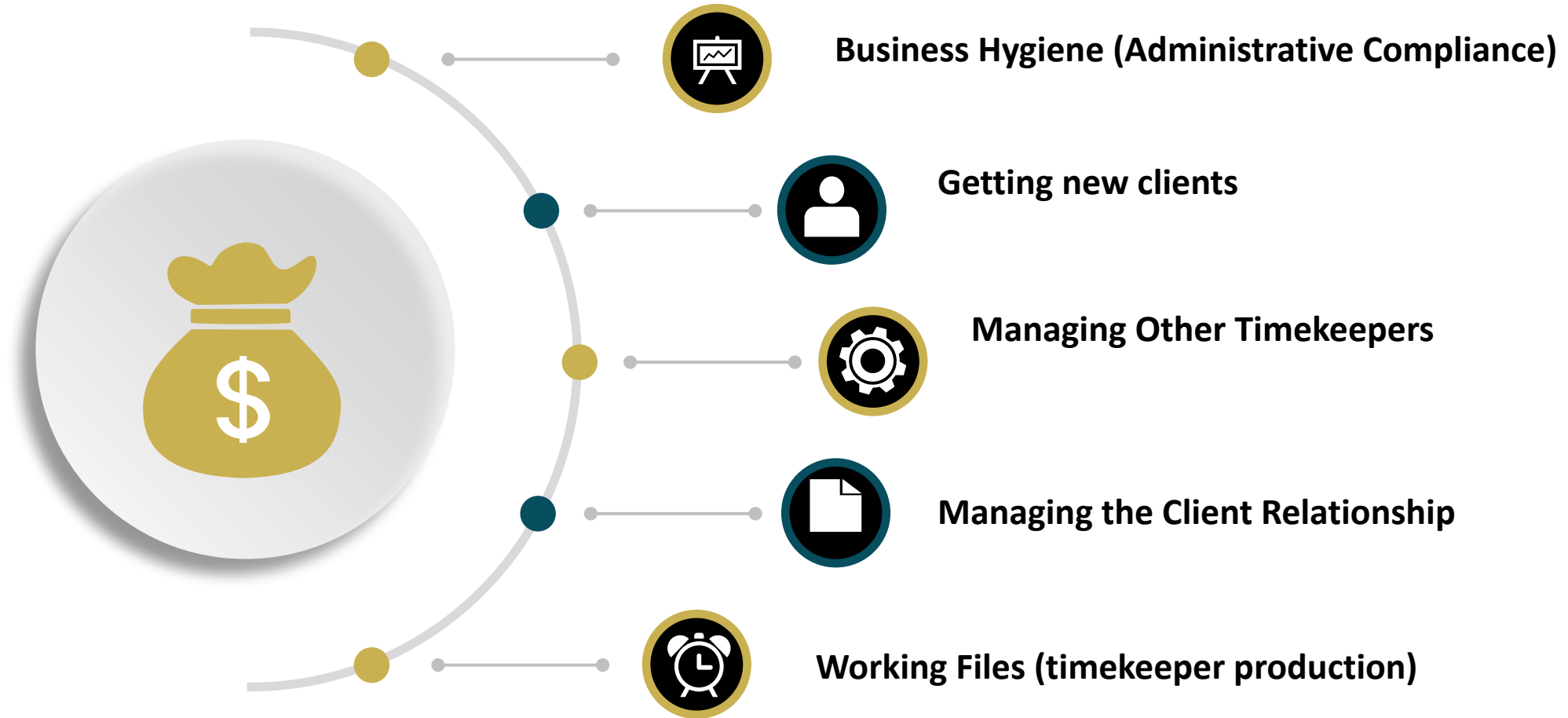
**Tier 2:** Origination pay

**Tier 3:** Subjective

**Tier 4:** Ownership



# Financial Performance Factors



# Subjective Criteria

Wealth creation factors and sub-factors



## Recruiting

Search Interviewing, Peer Recruiting, Law School Activities, Committee Service



## Branding and Marketing

Reputation, Strategy and Plans, Content Contributions, Referral Network, Team Development



## Attorney Training and Development

Training Plans, Practice Plans, Evaluation and Feedback, Progression Metrics, Mentoring



## Systems and Intellectual Property

MAS/CRM, Case Management, Legal Content, Protocols, Policy Support

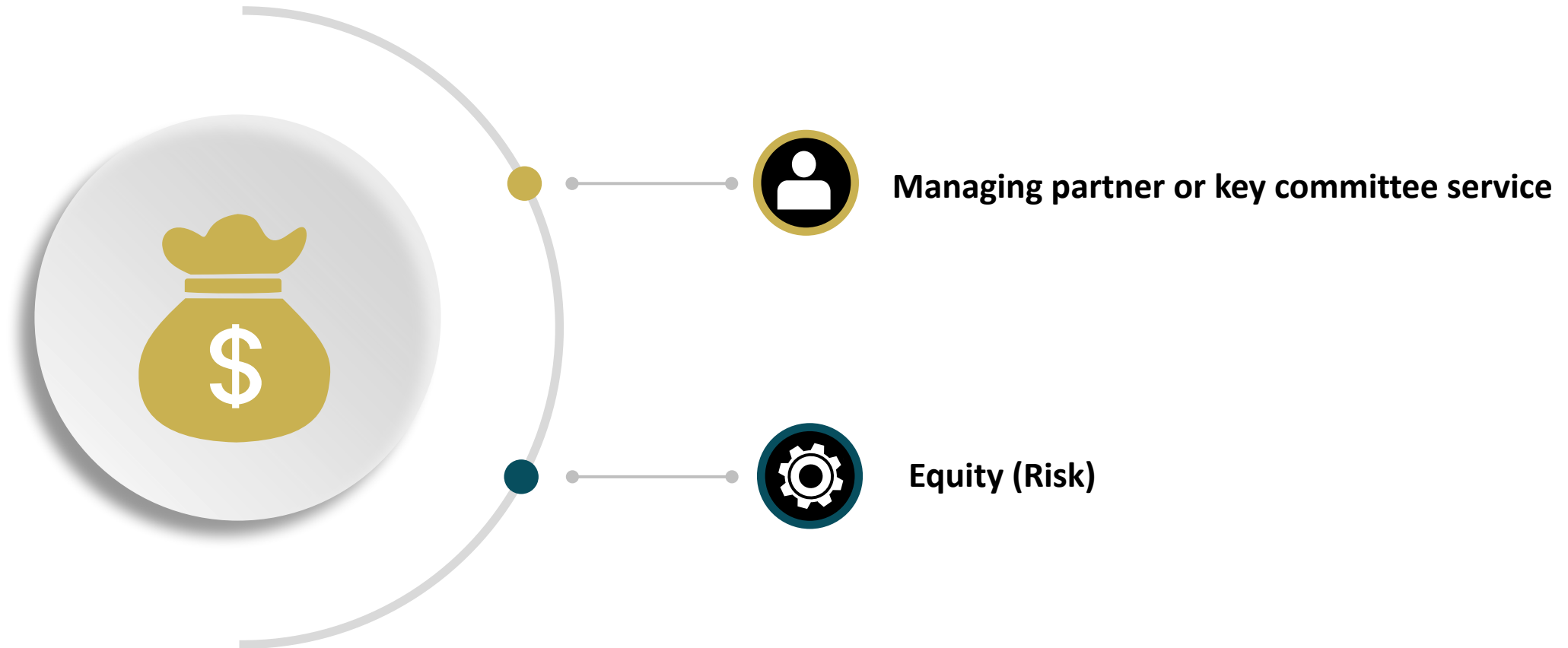


## Cultural Development

Citizenship Fairness  
Collaboration, Team Building, Stewardship



# Management and Investing







**Admitting**

**New Partners**



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# Benefits of Partnership (Equity)

**01**

Participate in the leverage profit

**02**

Keep more of your own profit

**03**

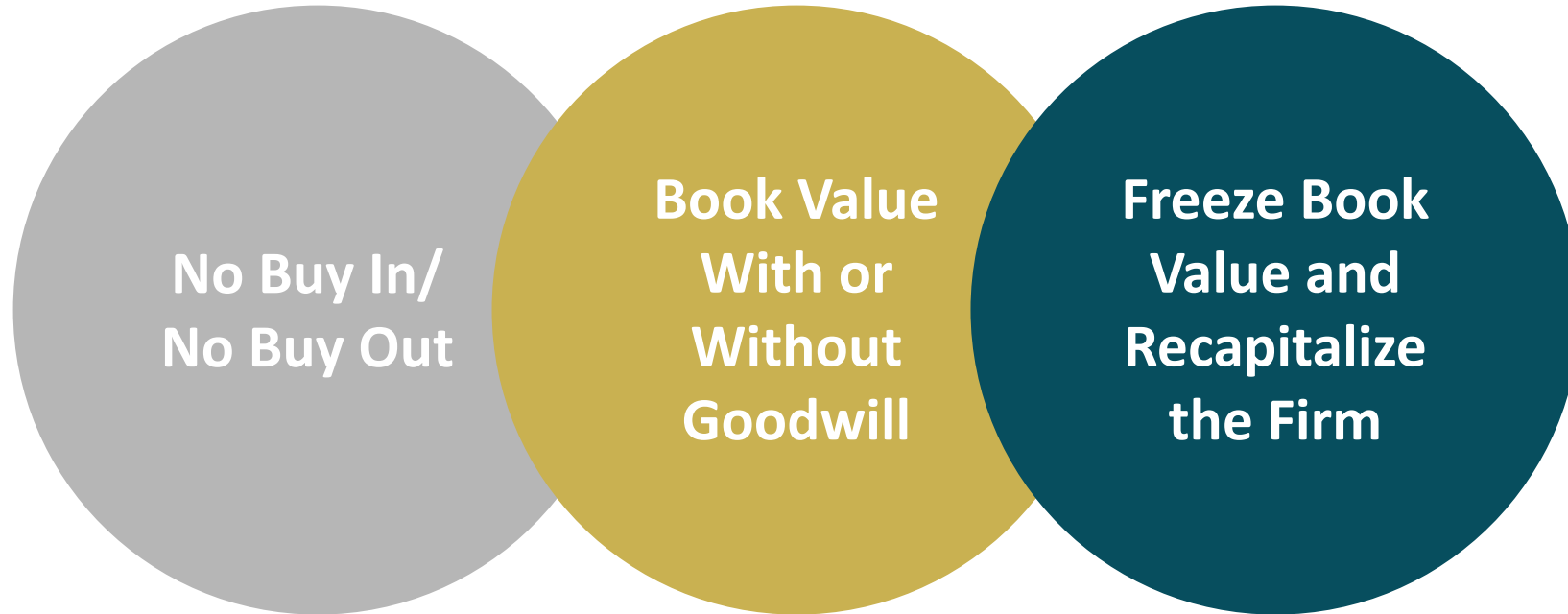
Enhanced marketing opportunities

**04**

Self determination



# Main Ways to Admit New Partners



# 1. No Buy In / No Buyout



**More Prevalent In Larger Firms**



**Required Capital Contributions**



**Refundable**



## 2. Book Value Without Goodwill

Assets Minus Liabilities



Include AR and WIP



Example:  
A law firm has \$500k in assets including AR and WIP and owes \$200K to the bank, book value is \$300K. Assuming 100 shares, each share is worth \$3K.

## Book Value With Goodwill

Assets Minus Liabilities



Include AR and WIP



Something Extra for the Value of the Going Concern

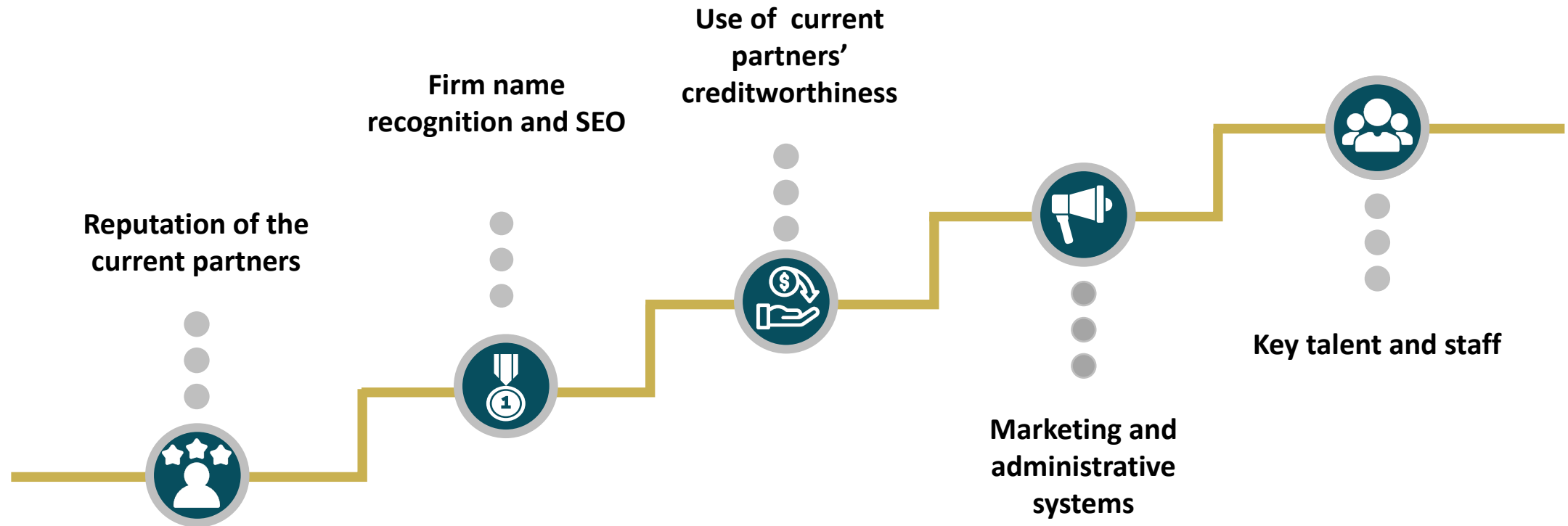


Example:

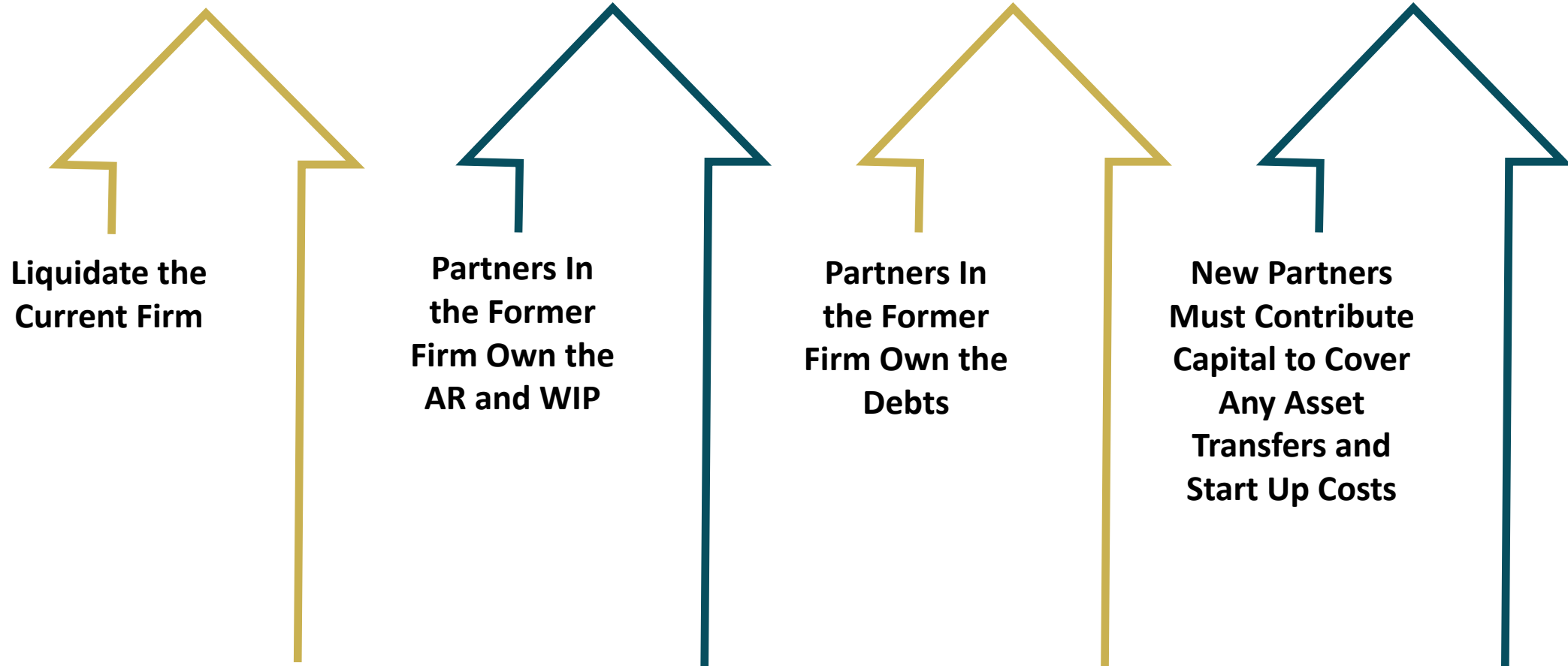
A law firm has \$500K in assets including AR and WIP and owes \$200K to the bank, book value is \$300K. Assume partners agree to a going concern value of \$50K, each share is worth \$3.5K.



# Examples of Goodwill



### 3. Freeze Book Value and Recapitalize the Firm



## W 2

**Gross Pay and Bonuses + Employer Share (FICA/MC) 7.65%  
+ Health Insurance and Other Benefit Subsidies + 401 K  
Contributions (Employer Match)**

**Benefits are typically worth 15-20% of base pay Taxes are  
withheld and remitted each pay day**

## Equity Member Pay K 1

### Capital Account

**Gross Income Allocation (Share of the firm's profit)**

**Less Draws and Profit Distributions Less Benefit Payments  
Less 401 K Contributions (All)**

### Ending Capital (Net Due)

**Taxes are paid directly by the member Quarterly Jan, April,  
June and September Member is responsible for the  
employer share payroll taxes (7.65%)**

**K1 COMPENSATION OF \$175,000 IS WORTH ABOUT \$150K  
W2 INCOME - ACTUAL VALUE DEPENDS ON BENEFITS**

# W2 versus K1 (member) compensation

How will my comp change when  
I become an equity partner





**THANK YOU**



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