Key Performance Indicators Revisited

I have been told, and if recent inquiries are any indication, there has been a resurgence in the interest in Key Performance Indicators ("KPIs") among solo practitioners and small law firms.

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Any discussion of KPI should start with a word of caution – KPIs are simply tools – they are no substitute for common sense and good judgment when it comes to the management of your law firm.[1]

Successful firms constantly seek a balance between the business and people. By advocating the use of KPIs, I am not suggesting that all that counts in a law firm can be counted but rather what gets measured is what gets done.

Before exploring some simple but effective KPIs, it is important to understand what is required to make a particular calculation or ratio a KPI.

The number being measured should meet the following three criteria to qualify as a KPI:

1. It must reflect the firm's strategy and goals;
2. It must be key to their success; and
3. It has to be quantifiable.

As a result just because a firm utilizes KPIs that yours does not, doesn't mean that your firm is badly managed. The importance firms place on specific KPIs will change over time as they move along their individual evolutionary track.

Context is critical to the effective use of KPIs. For many firms, the only benchmark they have is their own past experience. Unfortunately, access to benchmarking data in the legal profession is limited. This is particularly true in Canada, especially for solo practitioners and small firms. As a result, in order to have some context they must overcome their reluctance to compare themselves to US firms of similar size.

The KPIs identified in the remainder of this article have been grouped into the following three categories:

- Business Development / Marketing
- Production
- Financial

The following sample is not meant to be all inclusive and is sensitive to the data readily available from accounting systems frequently used by small firms.

Business Development/Marketing

Typically KPIs have focused predominately on the productivity and financial aspects of law firms. Firms continue to explore business development/marketing KPIs to understand what will have the most meaning for them.

- ***Client Growth Rate*** – the ratio of the number of clients that the firm handled its first matter for in the past 12 months to the total number of active clients (active can be defined as having handled a matter for in each of the past 2 of 3 or 3 of 5 years);

- ***Average Fee per Client*** – the fee revenue for the year divided by the number of clients billed during the year;

- ***Average Fee per New Client*** – the related fee revenue for the year divided by the new clients (of clients that the firm handled its first matter for in the past 12 months);
- ***Marketing Budget Ratio*** – the ratio of the total marketing spend (including any salaries) to the total fees billed during the year;
- ***Business Development Ratio*** – the ratio of the business development spend for the year to the total fees billed during the year;
- ***Number of Matters per Client***– the ratio of number of matters billed to the number of clients billed;
- ***Average Fee per Matter*** – the fee revenue for the year divided by the number of matters billed during the year; and
- ***Average Fee per New Matter*** – the related fee revenue for the year divided by the number of matters billed for new clients (handled its first matter for in the past 12 months).

Production

To ensure the most accurate measurement possible, productivity KPIs utilizes the concept of fulltime equivalent (“FTE”). FTE reflects how many actual timekeepers or staff your firm had for the period being measured. For example, a lawyer who was with your firm for six of the past twelve months would be treated as one-half of an FTE in determining your lawyer count.

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- ***Leverage*** – the ratio of non-partner lawyers to Equity Partners;
- ***Percentage of Partners Hours*** – the ratio of Partners hours worked to the total hours worked by all timekeepers intended to measure whether Partners are working harder or smarter;
- ***Billable Hours per FTE Timekeeper*** (by category of timekeeper) – the gross number of billable hours worked by timekeepers in a category divided by the number of full-time equivalents in each category;
- ***Billings per FTE*** *(by category of timekeeper)* – the gross amount of fee billings by all timekeepers in a category divided by the number of full-time equivalents in each category;
- ***Average Worked Rate*** (by category of timekeeper) – the gross value of time worked for a timekeeping category as entered into work-in-progress divided by the related hours entered;
- ***Average Billed Rate*** (by category of timekeeper) – the gross value of time billed for a timekeeping category as divided by the related hours billed;
- ***Ratio of Averaged Billed to Average Worked Rate*** (by category of timekeeper) – the ratio of the average billed hourly rate to the average worked hourly rate for a timekeeping category. This can assist in extrapolating what the likely impact will be on billed fees of potential rate increases; and
- ***Billable Hours per Legal Assistant*** – the ratio of the total billable hours for all timekeepers to the number of Legal Assistants.

Financial

Financial KPIs are evolving as the fundamental economics of firms change. This is resulting in differing views of what is critical to both tracking and measuring your firm's financial success. I direct you back to two of the criteria required to make a calculation/ratio be a KPI - it must reflect the firm's strategy and goals, and it must be key to their success. Using these two criteria will enable you to focus on the relevant financial KPIs.

Financial KPIs are evolving as the fundamental economics of firms change.

- ***Unbilled Days*** – the ratio of the fee portion of unbilled work-in-progress to the average fee billings for the past 12 months; measures the length of time it takes you to bill the work you do;
- ***Uncollected Days*** – the ratio of the fee portion of accounts receivable to the average fee billings for the past 12 months; measures the length of time it takes to collect your accounts after they are rendered;
- ***Revenue per Square Foot*** – the gross amount of fees billed by all timekeepers divided by the total square footage of office space leased by the firm;
- ***Charge Off Percentage*** – the ratio of the fee billings written off as uncollectible as a percentage of the fees billed for the year; - *Net Income Ratio* – the ratio of the Firm's net income (income prior to any distributions to partners) divided by the total fee billings of all timekeepers;
- ***Average Net Overhead*** – the net expenses (total expense minus billings of all non-equity partner timekeepers) divided by the number of Equity Partner FTEs. This is the net cost that each Equity Partner must cover before any profits are generated;
- ***Average Daily Cash Requirements*** – This is the cash receipts required to fund all cash payments (expenses, loan principal repayments, etc.) on an annual basis divided by the number of business days your firm is open for business; and
- ***Average Daily Cash Collections*** – Rolling 12 months average of cash receipts divided by the number of business days your firm is open for business.

Conclusion

The manner in which KPIs are presented is critical to the effectiveness of the KPIs. No matter what KPIs you track, reams and reams of paper or screens usually only serve to lessen the impact that the KPIs can have on your practice or firm's decision making.

KPIs are like any effective tool used to manage your practice or firm, in Albert Einstein's words *“if you cannot explain it simply, you don't understand it well enough”*. One final note of caution - no one KPI tells the full story, but rather they must be viewed collectively to achieve the best informed decision making results.

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1. The word firm in this context is interchangeable with a “solo law practice”

Stephen Mabey is a CPA, CA and the Managing Director of Applied Strategies, Inc. Stephen's focus is on law firms in general and on small to medium size law firms in particular. He has written about and advised on, a wide range of issues including - leadership, business development, marketing, key performance indicators, strategic planning, mergers, practice acquisitions, competitive intelligence, finance, mergers, practice transitioning, compensation, organizational structures, succession and transition planning, partnership arrangements and firm retreats. In 2013, Stephen was inducted as a Fellow of the College of Law Practice Management in recognition of his sustained commitment to the highest standards of professionalism in law practice management. For more information, visit ***appliedstrategies.ca*** *or connect with* ***Stephen Mabey on LinkedIn****.*

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