Your Financial Dashboard

AT THE OUTSET, it's important to establish some context for the subjects we cover in this article to maximize what you learn and minimize any stress brought on by the topics of performance analytics.

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A financial dashboard for a law firm works on the exact same principle as the one in your vehicle. You don't drive your vehicle by watching it alone; rather, it helps you know how you are progressing in getting to your desired destination.

Law firm financial dashboards should focus management and partners on those key performance indicators (KPIs) that are critical to the success of the firm. Because we tend not to use that which we don't understand, the presentation of the information must be in a style—that combination of words, numbers and graphs/charts—that is most meaningful to the audience. As with a car dashboard, too many gauges simply distract and lessen their value—and warning lights may be ignored until it's too late.

Converting indicators to KPIs

When a group of lawyers get together, it's not uncommon to hear them talk about indicators, some of which your firm may track and some you likely have no earthly idea what they are talking about. This is no cause for panic. No firm will use all of the potential analytical measurements of law firm performance, no matter how large or small the firm. One of the key reasons for this is the importance firms place on specific KPIs, which will change over time as the firm changes and evolves.

So the question is, what makes one or more of the various performance indicators change from being "that's nice" to a key performance indicator for your firm? An indicator should meet the following three criteria to qualify as a KPI for your firm:

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

"An indicator should meet the following three criteria to qualify as a KPI for your firm..."

The nature of your firm's practice will also affect its selection of KPIs. For example:

- Transaction-focused firms will undoubtedly have different KPIs than relationship-focused firms.
- Billable-hour-driven firms will have different KPIs than tariff-driven firms.
- Firms at a growth stage in their life cycle will have different KPIs than firms at a succession or mature stage.

This is not to suggest that all that matters in a law firm can be counted, but rather that what gets measured is what gets done. Therefore, if an indicator is not quantifiable, it is not likely that it will be incorporated into your firm's decision-making process—which may, in fact, cause underlying issues to go unaddressed and not enable you to achieve maximum financial performance.

Leading or lagging indicators

Continuing the car dashboard analogy a little longer, some of the gauges are important to understanding potential issues down the road, such as the fuel gauge, the temperature gauge, the tire pressure gauge and so on. And some are meant to tell you how you are progressing to your original destination: the speedometer, the odometer, the fuel gauge and so on.

KPIs that make you consider issues that may be just over the horizon are referred to as “leading” indicators, and those that measure the results at a particular point in the firm's evolution are referred to as “lagging” indicators. As you can see from this example, a KPI can be both leading and lagging based upon what you are using it to measure.

Ian Gotts, in a March 2009 **BPTrends article** on leading versus lagging indicators, coined the question, “Are your managers operating as company doctors or coroners?” His premise is that “things can start to go wrong in a business well before the performance measure turns the traffic light on” a financial dashboard that is focused on lagging indicators.

"Are your managers operating as company doctors or coroners?"

To translate this point into meaningful terms to law firms, the following chart divides a sample of common KPIs in law firms into the two categories:

LAGGING KPIs	**LEADING KPIs**
Fees billing in a month	Number of matters opened
Hours billed	Hours worked
Cash receipts	Number of average days billing in lockup*
Revenue per lawyer	Number of matters per client; number of lawyers billed per client; number of types of matters billed to clients
Effective hourly rate	Average fee per matter; average fee per new matter; ratio of average billed to average worked rate (realization

*This is the sum of the unbilled work in progress and accounts receivable divided by the average fees billed on a daily basis for the past 12 months on a rolling basis (the most recent 365 days, not a fixed year).

Do-It-Yourself Financial Dashboards

Due to the stage at which the legal profession finds itself regarding its usage of KPIs, much of the accounting software suitably priced for solo practitioners and midsized firms does not make the tracking of leading indicators an easy exercise. In fact, only in recent years have the large law firm software packages offered “dashboard modules”—and they are still of questionable sophistication, with many firms developing their own internal remedies for mining the required data.

Table 1: Business Development KPIs

WHAT	WHY	HOW
Client Growth Rate	This is a simple measurement to quickly determine if your practice's client base is growing, or whether growth in revenue has all come from existing clients. This helps firms to focus their business development spend accordingly.	This is the ratio of the number of clients that the firm handled its first matter in the past 12 months to the total number of active clients (active can be defined as having handled a matter for in two of the past three years).
Average Fee per Client	You would track this to see if your client legal spend with you is growing, flat or declining. It allows you to think about whether the change is rate-driven, client-driven, etc., and then you can respond accordingly.	This is the fee revenue for the year divided by the number of clients billed during the year.
Average Fee per New Client	Firms use this indicator to measure whether the clients being added are contributing to the overall revenue growth as it is, compared to the same ratio for existing clients, from a cost-of-doing-business perspective; in the long term, firms want to generate more revenue from fewer clients.	This is the related fee revenue for the year divided by the number of new clients (clients that the firm handled its first matter for in the past 12 months).*
Number of Matters per Client	Firms use this as another indicator of growth, because of the focus on existing clients and the ease and lower cost of generating work from them, compared with searching for and landing new clients.	This is the ratio of number of matters billed to the number of clients billed and is calculated by dividing the former by the latter.
	Again, firms use this as another indicator of the health of the practice, because of the focus on	This is the ratio of number of clients billed in the last 12 months to the same clients that had been

Client Retention	existing clients and the ease and lower cost of generating work from them, compared with searching for and landing new clients.	billed in the 12 months before that.
Growth in Top Clients	Firms, while growing the business, also want to make sure they don't become over dependent on any one or small group of clients that could adversely impact the firm's finances if those clients left. Also, firms want to understand where the bulk of their fees are coming from and where they should focus the bulk of their business development efforts.	This is the ratio of fees billed to top 100 clients (number can be adjusted to size of firm) in the past 12 months to the fees billed to the top 100 clients in the 12 months prior to that.
Dormant Client Percentage	Clients that you once had are the easiest ones to pursue for new work, so this is important for that reason and also as an early warning sign of whether you have a quality-ofservice issue to follow up on.	This is the ratio of the number of clients that the firm has not handled a matter for in two of the past three years to the number of total clients.

The 2012 *Legal Technology Survey Report*, produced by the ABA Legal Technology Resource Center (LTRC), reported that, of the firms that responded, the top brands for time and billing software were:

- Timeslips (18 percent)
- QuickBooks (13.5 percent)
- Tabs3 (10.2 percent)
- Elite (10.2 percent)

In a cursory review of the websites of those firms, only Elite (including its ProLaw module) raises the specifics of financial dashboards that can be used to quickly mine for KPIs. This does not mean that small to midsized firms using the other software packages should not use a financial dashboard, but rather, accept that there may be no “push one button” reports, and it may require some data manipulation to quantify the KPIs.

Table 2: Productive KPIs

WHAT	WHY	HOW
Percentage of Partners' Hours	Firms track this to see who is doing the work in their firms, to address potential issues such as work delegation, complement imbalance, etc. It is seen to be an overall barometer to determine whether partners are working harder or smarter.	This is the ratio of partners' hours worked to the total hours worked by all timekeepers.

Billable Hours per Full-Time Equivalent Timekeeper	This measure is more relevant than just measuring change in gross billable hours, as the total hours can increase as a result of more timekeepers, but the actual workload per lawyer could be shrinking, resulting in firms facing a situation of more lawyers than work and an imbalance in their complement.	This is calculated by taking the gross number of billable hours worked by paralegals, associates and partners and dividing by the number of full-time equivalents in each category.
Ratio of Average Billed to Average Standard Rate	Firms use this for a variety of reasons, including extrapolating what the likely impact will be on billed fees of potential rate increases, as an early warning flag of possible quality issues depending on the magnitude of the gap between billed and standard, and to see if there is a billing issue.	This is the ratio of the average billed hourly rate for a timekeeping category—which is calculated by dividing fees actually billed by the hours billed—to the average standard hourly rate for the category of timekeeper— which is the value carried in work in progress of the hours that were billed.
Billings per Full- Time Equivalent	Some firms look at this in conjunction with their average overhead to ensure profitability is being achieved, to identify potentially underperforming timekeeper groups, to balance complements, and to determine appropriate levels of compensation.	This is calculated by dividing the gross amount of fee billings by paralegals, associates and partners by the number of full-time equivalents in their respective categories.
Billable Hours per Legal Assistant	Firms use this as a basis for targeting staff levels and increasing or reducing existing complement on a basis that most lawyers understand—the billable hour.	This is calculated by dividing the total billable hours for all timekeepers by the number of legal assistants.
Number of Matters Opened	Firms, particularly those not driven by billable hours, use this as another measurement of workload, often in conjunction with the Average Fee per Matter.	This is calculated by totaling up the number of new matters opened in the past 12-month period and comparing it to similar totals from prior years.

However, this is not an insurmountable problem at all for solo practitioners and midsized firms when you remember the simple fact that law firm accounting is not rocket science—and don't let anyone make it so!

Historically, KPIs used by law firms have focused on the productivity and financial aspects of law firms, but increasingly, management is developing and tracking KPIs for the business development side of firms. Tables 1 through 3 lay out for you KPIs used at various firms of all sizes, why firms are possibly using them and how they can be calculated in straightforward terms. These are not meant to be exhaustive lists, but rather just a sampling.

However, we would offer a couple of cautionary notes, with the most important being that KPIs should serve as a guide and not a hitching post. KPIs are simply a tool; they are no substitute for the use of common sense and good judgment when it comes to the management of your law firm.

Table 3: Financial KPIs

WHAT	WHY	HOW
Net Income Ratio	Firms use this for a variety of reasons, including the direction their overhead is going, as a benchmark of profitability that is not subject to the manipulations of how many partners one has today, and as a comparative for compensation.	This is 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	This is the net cost that each partner must cover before any profits are generated by his or her billings. It is a handy tool for putting relativity into compensation levels.	This is calculated by taking the total expenses of the firm before any distributions or salaries are paid to partners minus the billings of all nonpartner timekeepers. This number is then divided by the number of partner full-time equivalents (equity and nonequity.
Unbilled Days	Firms use this KPI to measure the length of time it takes to bill the work they do.	This is calculated by dividing the fee portion of unbilled work in progress by average billings per day (which is calculated by dividing the firm's total fee billings for the past 12 months by 365 days).
Uncollected Days	Firms use this KPI to track the length of time it takes to collect their accounts after they are rendered.	This is calculated by dividing the fee portion of accounts receivable by average billings per day (which is calculated by dividing the firm's total fee billings for the past 12 months by 365 days).
Charge-Off Percentage	Firms use this to track how much of their accounts receivable are actually going uncollected.	This is simply the amount of billings written off as uncollectible divided by the fees billed for the year.

Five Common KPIs

Approaching the list of KPIs enumerated in Tables 1 through 3 is similar to the challenge of a buffet: There's a desire to sample everything, but if you are not careful, you will miss out on the "good stuff."

Given the breadth of experience of the readers of *Law Practice*, we have selected five KPIs that most firms, irrespective of the type of work or clients they focus on, are likely to track because of both their ease of calculation and practicality.

Context is critical to the effective use of a KPI. Too many firms only benchmark against their own past experience rather than comparing their KPI metric to the same KPI of other law firms. In part, this is because access to benchmarking data in the legal profession is limited. However, we have managed to obtain benchmarking data for these five KPIs for 2012 and 2011, which is presented in the chart after each KPI description. The source of the benchmark information is Lexis Firm Insight, which is an online solution that provides information ranging from billing rates to collection days and is updated quarterly.

Our brief analysis of the five KPIs follows.

1. Lockup measures the combined time it takes to bill and collect a firm's accounts. This is critical to projecting cash flow and projecting when you might need to borrow against your bank credit facility. It is the sum of the Unbilled and Uncollected Days, which is calculated by dividing the unbilled fee portion of a firm's work in progress and the fee portion of the receivables by the average billings per day. This latter calculation is derived by dividing the Fees Billed for the 12 previous months by 365 days.

Table 1

LOCKOUT/YEAR	TOP 25%	MEDIUM	BOTTOM 25%
Unbilled Days 2012	50	63	87
Unbilled Days 2011	51	62	81
Uncollected Days 2012	67	76	80
Uncollected Days 2011	68	78	89
Total Lockup 2012	117	139	173
Total Lockup 2011	119	140	170

2. Billable Hours per Full-Time Equivalent Timekeeper measures the number of hours worked by paralegals, associates and partners. This is more relevant than just measuring change in gross billable hours, as the total hours can increase as a result of more timekeepers, but the actual workload per lawyer could be shrinking, resulting in firms facing a situation of having more lawyers than work and an imbalance in their complement. This KPI is calculated by dividing the gross number of billable hours worked by paralegals, associates and partners by the respective number of full-time equivalents in each category. Note that a full-time equivalent reflects how many actual timekeepers your firm had for the

period in question. For example, a lawyer who was with the firm for six of the past 12 months would be treated as one-half of a full-time equivalent in determining your lawyer count.

Table 2

BILLABLE HOURS / YEAR	TOP 25%	MEDIUM	BOTTOM 25%
Equity Partners 2012	1,676	1,526	1,440
Equity Partners 2011	1,646	1,559	1,482
Non-Equity Partners 2012	1,584	1,438	1,311
Non-Equity Partners 2011	1,727	1,504	1,383
Associates 2012	1,740	1,647	1,518
Associates 2011	1,736	1,642	1,544
Paralegals 2012	1,418	1,274	1,151
Paralegals 2011	1,395	1,298	1,172

3. Average Billed Rate measures the effective rate actually billed by the timekeepers (which will frequently differ from their standard or work rate by anywhere from 5 to 11 percent) and is key to monitoring and raising flags as to whether it is potentially client discounting, lawyer discounting or work quality issues. This KPI is calculated by the gross value of time billed for a timekeeping category divided by the related hours billed.

Table 3

AVG. BILLED RATE / YEAR	TOP 25%	MEDIUM	BOTTOM 25%
Equity Partners 2012	$512	$401	$322
Equity Partners 2011	$514	$390	$315
Non-Equity Partners 2012	$393	$334	$285
Non-Equity Partners 2011	$378	$334	$271
Associates 2012	$283	$243	$213
Associates 2011	$306	$238	$200

Paralegals 2012	$174	$156	$122
Paralegals 2011	$174	$150	$126

4. Leverage measures the ratio of associates to partners. This measurement is still thought be a critical driver of law firm profitability through the leveraging of a high ratio of associates to partners. (Note that in 2013 and beyond, this should be broadened to include all nonpartner timekeepers ratio to partners.) It is calculated by dividing the associate full-time equivalents by the partner full-time equivalents.

Table 4

LEVERAGE / YEAR	TOP 25%	MEDIUM	BOTTOM 25%
2012	.98	.78	.56
2011	1.06	.71	.51

5. Billings per Full-Time Equivalents measures the revenue generation by each timekeeper type, which is important to both budgeting for the future and historical analysis with the intent of not repeating past mistakes, which has included losing overachieving partners due to impact on the firm's overall profitability. It is calculated by taking the gross amount of fee billings by paralegals, associates and partners and dividing it by the respective number of full-time equivalents in each category.

Table 5

BILLINGS / YEAR	TOP 25%	MEDIUM	BOTTOM 25%
Equity Partners 2012	$693,391	$532,146	$405,765
Equity Partners 2011	$699,782	$541,316	$430,595
Non-Equity Partners 2012	$478,845	$427,130	$339,679
Non-Equity Partners 2011	$568,266	$466,581	$333,892
Associates 2012	$449,470	$345,489	$281,084
Associates 2011	$416,833	$346,501	$269,524
Paralegals 2012	$210,135	$171,979	$140,737
Paralegals 2011	$195,793	$167,368	$119,950

Another, but less timely, source of benchmarking data is ALM's annual *Survey of Law Firm*

Economics. However, it does have the benefit of providing data both by geographical region and firm size.

Before moving on to our conclusion, one note of caution: No single KPI tells the full story. Rather, they must be viewed collectively to achieve the best-informed decision-making results.

Conclusion

The messages that we hope you take away from this article can be summarized as follows:

- Determine what is required for your firm to successfully execute its strategy and then select the KPIs that help you know how you are progressing toward these goals.
- Ensure you have a balance of leading KPIs and lagging KPIs, so they enable your firm to act in a preventive mode as well as measuring progress.
- No single KPI will provide all the answers firms seek but rather, collective vision is required.
- KPIs are not that complicated to calculate, but you do need to be able to mine the data in your systems in order to have the proper input.

KPIs are simply a tool. They are no substitute for the use of common sense and good judgment when it comes to the management of your firm.

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Comments or Questions?

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