

Firms should examine their realization rates

Focus on Ensuring adequate cash flow is critical

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Jasmine Daya says it is crucial for lawyers to run a 'financially sound' firm.

In moving from partner to principal of Fireman Daya & Co., Jasmine Daya wanted to be able to better gauge the financial health of the firm.

The task included examining current approaches and introducing new ones.

In addition to the regular monthly statements, she employs a spreadsheet that provides her with a picture of the firm's numbers.

"I can't stress enough the importance of a very healthy, financially sound firm," she says, pointing to the many obligations of running a firm, including paying staff.

"If I'm worrying about how am I going to fund my staff, how am I going to fund the disbursements on my file, then how am I able to focus on providing proper quality service to my clients as a lawyer?"

As a personal injury lawyer in Toronto, Daya might have to carry a file for two to five years, with upfront costs, before seeing payment.

So ensuring there is adequate cash flow is crucial.

The need to stay on top of the fiscal side of a legal business has firms of all sizes and practice areas looking beyond the traditional hourly billing rate to judge the firm's success and keying in on numbers that can offer them insight quickly.

Figuring out the realization rate and comparing that month to month provides a clear and quick view on how well the firm is performing and whether there ought to be any adjustments, says Mark Dormer, president of Cosgrove Associates Inc. in Toronto, which advises law firms on profitability.

"It can affect a law firm's profitability and it could help a law firm look at any inefficiencies and adapt faster to the low rates," says Dormer.

"We think they're very important metrics for law firms and a lot of law firms don't really look at this as closely as we would like."

The realization rate measures the percentage of the posted hourly billing rate that is actually paid by the client, with the discounts and write-offs subtracted.

Any realization rate below 80 per cent demands some analyzation to determine what can be improved, says Dormer, although many firms shoot for a rate of 90 per cent or higher.

The rate reflects the firm's revenue, and a small change can have a big impact on its profit.

"We try to find ways to improve them. For example, if the lawyer has a low realization rate on a client or a file, is there a way that we can automate the work to help with the realization rate? Should we be raising our prices?" says Dormer.

"Sometimes, there's not too much we can do about it, because we have to remain competitive. But at least you have that information and you can act on it."

In its 2018 Report on the State of the Legal Market, Georgetown Law and Thomson Reuters Legal Executive Institute reported that "dynamic" law firms in the United States offered fewer discounts on standard rates to win business and they engaged in fewer pre-bill write-downs, suggesting they had better upfront communications about their pricing with their clients.

While law firms have introduced modest rate increases since 2008, there has been pushback from clients, resulting in a somewhat downward or flat realization over the past decade, the report notes.

The result is that firms need to maximize on their existing billings.

While determining the realization is effective for projections of revenues and cash flow, it is also a reflection of the firm's ability to maximize profit on the work already being done.

“If my associates are all resulting at 85%, that means . . . there is a 15% difference between what I have them set up to bill and what they actually bill at,” says Stephen Mabey, the Nova Scotia-based principal of Applied Strategies Inc., which advises law firms.

By determining the rate, the firm can explore the reasons behind that 15-per-cent difference and perhaps expose larger problems.

It may be that the firm’s rates are too high or it might simply be an issue related to just one associate or practice area.

Or it may well be that partners are having a difficult time putting together a total bill on a particular file and have decided to write down the associates’ time.

Whatever the issues, he says, the realization rate provides the starting point to examining the firm’s operations and heading off any problems that may be developing.

The key is to focus on the bottom line and how to bring more money into the firm without necessarily having to put in more work, simply by focusing on collecting for the work that is already being done.

“I think realization is critical, because if you tell me your rates are \$500 an hour, but if you are really only billing out at \$400 and collecting \$375, there’s an issue here some place.

Either you should never be at \$500 or clients aren’t prepared to pay it,” says Mabey.

“We might be better off taking you off that client and giving you client work that you can get the full \$500 for.”

Measuring that rate from month to month can also provide some early indication of any problems or issues, says Marc McAree, managing partner at Willms & Shier Environmental Lawyers LLP.

“You create more revenue by either billing more hours and/or doing so at a higher or lower effective hourly rate,” he says.

“If it’s falling off, then we have to ask ourselves the question, ‘Why is that? Does it mean that we are writing down and writing off client accounts more so than we normally do?’”

Bruce Baron likes to keep a close eye on how the firm is doing.

As founding and managing partner of Gaertner Baron PC in Toronto, he uses some key metrics regularly.

“I know exactly what my monthly cash flow is,” he says.

“I know what my cash flow out every month is and I know what it is in every month. So I try to bill out about 150 per cent of what I know my expenses out every month is.”

Keeping an eye on the real earnings of the firm helps him keep it on solid financial footing.

Instead of reacting to that, keeping a close eye on that performance indicator confirms that the firm with five lawyers and three support staff are heading in the right direction.

The firm's overall approach to the business of law allows for efficient service through the maximum use of support staff, keeping client costs down, resulting in a higher collection ratio, he says.

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