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Profitability & Business Management

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LEGAL PRACTICE MANAGEMENT WORKSHOP 18 - 20 JUNE 2024

Roadmap

- ✓ Guide to starting a business
- ✓ Business Structure
- ✓ Business Plan
- ✓ Market Research
- ✓ Accounting Package
- ✓ What is Profit?
- ✓ Setting Targets & Charge Rates
- ✓ A Financial Plan
- ✓ Impact of Structure on Profitability & Charge Rates
- ✓ Recording Time
- ✓ Monitoring KPIs
- ✓ Reading Financial Statements
- ✓ Can you trust your Financial Statements?
- ✓ Managing Cash Flows
- ✓ Marketing (Group Discussion)



Guide to starting a business

Before you start

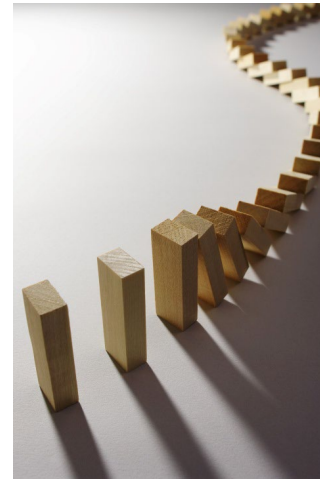
- Check if you are ready?
- Review your business idea
- Do you have a business plan?



Guide to starting a business

Business structure

- What type of structure to choose?
 - Sole trader
 - Partnership
 - Trust
 - Company
- Can you change your business structure?



Guide to starting a business

Business Plan

- What is a business plan?
 - For example - one page business plan
- Business idea
- Target market & competition
- Funding
- Resourcing



Guide to starting a business

Market Research

- Client analysis
- Competitor analysis
- Create a client profile



Guide to starting a business

Accounting package

- Keeping records of business transactions
- Bookkeeping
- Review Balance sheet and P&L
- Dealing with ATO (Tax Returns, BAS's , IAS's, reporting wages, PAYGW, super, payroll tax)



What is Profit?

Profit is how much you earn (or lose) after deducting your expenses from your income.

- What is a good profit?
 - This can have a different meaning to different people.
- Does it simply equate to a good salary?
- Superannuation.
- What about compensation for risk?
 - Salaries increase gradually, business owners have good and bad years.
- What about interest on the money you borrow to 'buy in'?
- What if you never see that money when you exit?
- What are your expectations for remuneration?

Profit

It must have these components

- ✓ A reward for effort
- ✓ A reward for risk
- ✓ To recoup your capital investment
- ✓ To reward you for having debt
- ✓ Retained earnings to set aside (COVID-19)
- ✓ Retained earnings to reinvest



Your financial plan must support an assumption that you will be profitable, at least in the long term.

Pricing, Productivity and a Return to Equity Holders

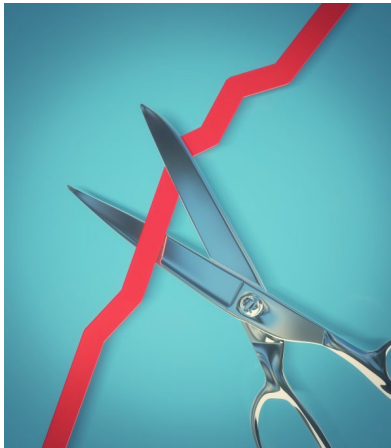


Your financial plan

- Having a financial plan for your business is important
- Helps guide your operational plans
 - People
 - Processes
 - Resources
 - Markets
 - External factors & risk
- Your capital requirements
- Peak cash flows
- A budget to monitor



A Firm's Cost Structure



| | FY 2018 | FY 2017 | FY 2016 |
|--------------------------|--------------------|--------------------|--------------------|
| Fees | \$35 | \$66 | \$0 |
| Interest & other | \$1,565,634 | \$1,775,989 | \$1,659,791 |
| | \$1,565,669 | \$1,776,055 | \$1,659,791 |
| Taxation | \$7,675 | \$20,060 | \$14,285 |
| Advertising | \$45,505 | \$69,899 | \$49,546 |
| Bad debts | \$4,268 | \$14,459 | -\$11,346 |
| Bank charges | \$6,418 | \$10,506 | \$13,465 |
| Cleaning | \$3,357 | \$6,466 | \$4,533 |
| Computer | \$30,480 | \$33,330 | \$29,768 |
| Depreciation | \$3,744 | \$5,327 | \$7,864 |
| Electricity | \$6,404 | \$5,641 | \$6,034 |
| Insurance | \$53,542 | \$45,897 | \$43,578 |
| Telephone | \$11,051 | \$17,507 | \$17,486 |
| Staff training & welfare | \$5,304 | \$10,482 | \$4,541 |
| Postage | \$9,225 | \$8,995 | \$8,475 |
| Printing & Stationary | \$18,582 | \$18,957 | \$24,157 |
| Rent | \$167,149 | \$142,417 | \$135,030 |
| Subscriptions | \$35,624 | \$31,220 | \$48,537 |
| Travel | \$7,293 | \$20,411 | \$26,081 |
| General Office | \$39,914 | \$16,817 | \$9,234 |
| | \$455,535 | \$478,391 | \$431,268 |
| Staffing | \$570,000 | \$660,000 | \$695,000 |
| | \$1,025,535 | \$1,138,391 | \$1,126,268 |
| | \$540,134 | \$637,664 | \$533,523 |
| WIP | \$491,665 | \$410,752 | \$483,815 |
| Debtors | \$400,590 | \$340,221 | \$267,060 |

Budgets

- Setting and monitoring a budget is important but remember this is a moving feast.
- Re-evaluate your budget regularly and whenever there is a fundamental change
 - Pay rises require more income = more chargeable hours or higher rates
 - Bigger marketing spend = more work = more income
- Constantly monitor performance
- Keep an eye on cashflow, debtors, WIP, productivity & write offs

Setting a Revenue Target

| | |
|------------------|--------------------|
| Revenue Target | |
| Employees | \$570,000 |
| Partners | \$460,000 |
| | \$1,030,000 |
| Overheads | \$455,000 |
| Return to Equity | \$80,000 |
| | \$1,565,000 |



Set Charge Rates and Productivity Targets for your Resources. There are many different methods for setting charge rates.

Other ways of setting Charge Rates

Can be determined a multitude of ways:

- Using market rates
- Setting a rate for partners and cascading downwards

Regardless of which method used:

- Rates must generate the revenue target;
- Rates should reflect seniority and experience; and
- Not price you out of the market

Special or reduced charge out rates

- May be a strategic reason
- Ideally reflect real efficiencies, such as the ability to sustain high levels of productivity for a sustained period of time or a volume discount
 - Secondments
 - A lot of work with one client where you know them backwards or have repeatable work

Value Based Billing

- Does not eliminate the need to set quasi charge out rates.
- Value based billing needs to generate the required hourly rate / overall revenue target.



A Focus on Income or Expenditure?

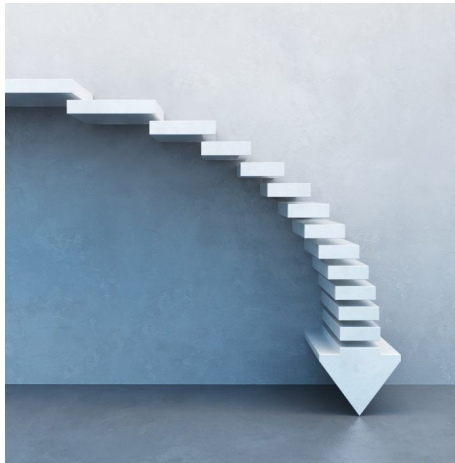
At 90% productivity (Professional Staff) and 5% write-offs

| | | | |
|-------|---------------------|-----------------------|----------------|
| 748 | \$405.00 | \$302,988.22 | Partner |
| 748 | \$405.00 | \$302,988.22 | Partner |
| 1,347 | \$316.95 | \$426,818.18 | Lawyer |
| 1,347 | \$264.13 | \$355,681.82 | Lawyer |
| 1,347 | \$176.09 | \$237,121.21 | Lawyer |
| 0 | \$158.48 | \$0.00 | Office Manager |
| 599 | \$88.04 | \$52,693.60 | Clerk |
| | | \$1,678,291.25 | |
| | Target | \$1,565,000.00 | |
| | Extra Profit | \$113,291.25 | |

Impact of the three professional staff charging an extra 48 minutes a day.

Impact of Not Monitoring KPIs

At 80% productivity (Professional Staff) and 15% write-offs



| | | |
|-------|--------------------|-----------------------|
| 748 | \$405.00 | \$302,988.22 |
| 748 | \$405.00 | \$302,988.22 |
| 1,071 | \$316.95 | \$339,457.74 |
| 1,071 | \$264.13 | \$282,881.45 |
| 1,071 | \$176.09 | \$188,587.63 |
| 0 | \$158.48 | \$0.00 |
| 599 | \$88.04 | \$52,693.60 |
| | | \$1,469,596.85 |
| | Target | \$1,678,291.25 |
| | Less Profit | -\$95,403.15 |

Impact of the three professional staff writing off an extra 36 minutes a day.

Time Recording

A time recording system is essential to:

- Stop you losing what you sell!
- Determine the amounts to bill your clients;
- Is a justification for those charges; and
- Is a tool for monitoring staff productivity.

Monitoring KPIs from your time recording system is essential.



Monitoring KPIs

Key Performance Indicators (KPIs) are the numbers or ratios that allow you to monitor how you are tracking towards your goals.

Compare them to where you planned to be

- reset, redirect and take corrective action.

If you don't monitor KPIs the horse will bolt and you may only become aware of this when you have trouble paying the practice's bills or taking your draw.

KPIs from your Practice Software

Income Drivers

Productivity

- Low productivity reduces the income that can be generated from available time

Write offs

- Excessive write offs = time spent that is unbillable

Charge out rates

- Lower rates may result in fewer write-offs and can bring more work to a practice, but reduces the amount of income that can be generated.



Some people factors that affect your Income Drivers Productivity

- Inadequate training or experience resulting in less time being put on the clock to minimise write-offs
- A fear of complaints about the size of a fee or a desire to 'look after' the client
- Timesheets not completed on a timely basis leads to billable time being lost
- Motivational issues.



Some people factors that affect your Income Drivers

Write-offs

- Inadequate training or experience resulting in too much time being put on the clock
- Not staffing jobs appropriately to leverage the partners experience
- Not enough work can result in people filling in their day by spending too much time on a job
- A fear of complaints about the size of a fee or a desire to 'look after' the client
- Inaccurate fee quotes or special deals.



Other Useful KPIs

| Focus | Measure | Comments |
|----------------------|------------------------------------|--|
| Profitability | Revenue per FTE | Indication of the appropriateness of staffing structure, efficiencies and charge out rates |
| | Average fee per client | An indication of the profitability of clients. |
| | Average fee per type of engagement | Indicates the relative profitability of the types of engagement you undertake. |
| | Profit and fees per partner | Measures amount of fees and profit per partner |
| | Wage to fee ratio | Indication of appropriateness of charge rates |
| | Fees as a % of revenue capacity | Indication of unused capacity |
| | Profit as a % of fees | If costs are controlled, indicates revenue and efficiency problems |

Other Useful KPIs

| Focus | Measure | Comments |
|------------------------|---|---|
| Productivity | Productivity of individuals | Can be indicators of training or motivational issues |
| | Overall productivity | Can be an indication of not enough work or the way jobs are staffed |
| Write offs | Write-offs as a % of gross production or fees | Measures write offs and productivity |
| Chargeable Time | A combination of productivity less write offs | Can be an indication of unused capacity, productivity or write off issues |
| Turnaround Time | Time taken to complete jobs | High turnaround time delays billings and can lead to unsatisfied customers. |
| WIP Levels | Age and total | Indicates delays in billing and the completion of work, consider interim fees. |
| Debtors | Age and total | Put someone in charge of monitoring and chasing debtors, consider interim fees, regular monthly fees, upfront billing and retainers to reduce 'bill shock'. |

Understanding Financial Statements

Profit and Loss

Is the water in the dam being used to produce a growing crop?

Balance Sheet

How much water is in the dam right now?

Cash Flow Statement

Will the dam run out before the crop is harvested?



Understanding Financial Statements

Profit and Loss

- It tells you how much money you're making, even if your clients don't pay (receivables)
- It includes allowances for things you paid off years ago (depreciation)
- It doesn't take into account loan repayments
- It takes into account bills you will need to pay later (leave accruals)



Understanding Financial Statements

Balance Sheet

- What you've got and what you owe (receivables & payables)
- What you can turn into cash soon, to pay your bills later (WIP)
- What you bought today, that you need tomorrow (prepayments)
- Work that you've been paid for, and will need to pay someone to do it later
- Equipment that will eventually be, or may even be worth nothing now (photocopier)
- Loans – amounts you need to pay now and amounts you can put off



Understanding Financial Statements

Cash Flow Statement

- A short-term view, but what's needed at the time.
- Not produced by accounting systems which are accrual based.
- It tells you your clients aren't paying, but looks good if you're not paying your bills.
- It can show you when you're investing 'more than you can afford' right now
- Factors in payments that aren't in the profit and loss (loan payments, buying a photocopier)



Look at what are your gauges (financial statements & KPIs) are telling you But are they accurate?



Do you trust your bookkeeper too much?

Is the information they provide complete and up to date

- Do they only record expenditure when you pay something?
- What about amounts you owe, are they appearing in the accounts?
- Are they reconciling to your practice management software?

Is your bookkeeper afraid to give you bad news?

Will you listen to bad news?



- Is there money in the bank because you're behind in the rent?
- Is there money in the bank because you haven't lodged your BAS'?
- Is there money in the bank because you haven't paid the super?
- Is your credit about to be cut off?
- Do you know where the money is going?
- Do you really know how much you can afford to draw out of the business and spend on yourself?



What should you do?

- ✓ All revenues and expenses to be entered, not just cash based accounting.
- ✓ A timely month end for pro-active, feed forward management.
- ✓ Compare actuals to budgets and forecasts.
- ✓ Create specific reports, Power BI can make MYOB & Xero more powerful.
- ✓ Anticipate what needs to be paid and ask why isn't it in the reports.
- ✓ Question your accountants and bookkeepers.

Managing Cashflow

- There is a difference between profit and cashflow.
- Profit is required for ultimate success, while cash is required for immediate survival
- Ideally, your total monthly cash inflow > total monthly cash outflow
 - Cash inflow mainly consists of fee payments
 - Cash outflow may include wages, other creditors, rent, loan repayments (principal and interest), capital purchases and partners' drawings...

Cash is King

There are two things that don't age well for a professional services firm:

- Work-in-progress (WIP)
- Debtors



Lock Up

- Lock Up measures the number of days taken to convert your WIP and your Debtors / Receivables into Cash
- Lock Up = $(\text{WIP} + \text{Debtors} - \text{Provisions}) \div \text{Annual Revenue} \times 365$



Improve WIP

- ✓ Prepayment/upfront fee, retainers
- ✓ Interim fees
- ✓ Avoid disbursements (if unavoidable, bill disbursements as soon as they are incurred)
- ✓ Bill promptly at the end of each engagement
- ✓ Regular monitoring of aged WIP and be REALISTIC (write off or make provisions for old WIP)
- ✓ WIP management as a KPI for performance appraisals

Improve Debtors

- ✓ Clear communication of credit terms before each engagement
- ✓ Credit checks on high-risk clients
- ✓ Use technologies to make it easy and convenient for clients to receive bills and make payments
- ✓ Reward those who pay early (discounts)
- ✓ Penalise those who pay late (late fees, interest charges)
- ✓ Debtor factoring or 3rd party fee funding services
- ✓ Regular monitoring of aged debtors

Manage Outgoings

- ✓ Take full advantage of creditor payment terms
- ✓ Consider payment terms when choosing suppliers
- ✓ If you can rent don't buy. SaaS is almost universal but what about outsourcing IT – shown to reduce cost and risk.
- ✓ Consider “hidden” payroll liabilities, e.g. annual leave, LSL – are staff accumulating too much leave entitlements?
- ✓ Consider adequacy of working capital when partners take their first draws
- ✓ Plan for capital expenditure in advance

ANY
QUESTIONS
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