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WHY DO FIRMS REPORT PROFITS PER PARTNER?

An article in the August 22 issue of *The Wall Street Journal* reported that, according to an analysis by Citi Private Bank Law Firm Group, more than half of the top 50 U.S. law firms may have overstated their PPP [profits per equity partner] as published by the *American Lawyer* magazine last May. This is not the first time in recent years that the issue of reporting PPP has been raised.

Early last year Ralph Baxter, chair and CEO of Orrick Herrington & Sutcliffe, announced the firm would no longer report its PPP. Subsequently Steve Taylor wrote in *Of Counsel*, "We hope that Baxter has set another trend in motion." In our last two annual reports on "What's Hot and What's Not in the Legal Profession" we stated that "reporting profits/partner doesn't make sense when clients are pressuring firms to reduce fees."

And five years ago this month *The Legal Intelligencer* published a lengthy commentary, "Profits Per Partner: The Bane of the Profession" by Peter Spirgel, managing shareholder of Flaster Greenberg, in which he wrote "... PPP is not the appropriate measurement of profitability and the legal industry's infatuation with this ratio is counterproductive."

PPP is supposed to be arrived at by dividing net operating income or "profits" by the number of equity partners. However, there are several reasons for questioning the accuracy of the figure due to inconsistency in how firms calculate it.

- How is "net operating income" defined? Different firms use different definitions.
- How is "equity partner" defined? There are various definitions. In this case, *American Lawyer* believes its definition is more strict than Citi's.
- How is the number of equity partners determined? Is it the full time equivalent (FTE), the number at year-end or an average?
- A firm can increase its PPP by de-equitizing partners. Many have done this.

There are also reasons for questioning the value of PPP as an indicator of a firm's health. Robin Sparkman, editor in chief of the *American Lawyer*, is quoted in the WSJ article that "Revenue per lawyer ... is actually a better metric for gauging firm health."

We concur with all the above. But we believe the most important point of all is to question the judgement of firms in reporting their PPP when clients are pressuring them to reduce fees or provide more value – or both.

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