# Ep #42: Ditch Effective Hourly Rates: How to Calculate Matter-Level Profit


## Full Episode Transcript

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# Ep #42: Ditch Effective Hourly Rates: How to Calculate Matter-Level Profit

For the past few episodes, I've been sharing why Clio and I both think that a shift away from hourly billing and towards flat fees is a good idea for many law firms. But one of the problems with that advice is that managing a firm for profitability is vastly different under an hourly model versus under a flat fee model. In fact, the drivers of revenue and profit for flat fee versus hourly can actually work against each other. Now, some firms use a metric called effective hourly rate to try to bridge this gap, but I think there's some real problems with that line of thinking.

So instead, today I'm going to teach you a better approach for measuring profitability on a matter by matter basis that works for every possible billing model and allows you to do apples to apples comparisons across different models. And good news, your accountant and bookkeeper will thank you for making the switch. Ready to become a more agile attorney? Let's go.

Welcome to *The Agile Attorney* podcast powered by Agile Attorney Consulting. I'm John Grant and I've spent the last decade helping lawyers and legal teams harness the tools of modern entrepreneurship to build practices that are profitable, scalable, and sustainable for themselves and their communities. Each episode I offer principles, practices, and other ideas to help legal professionals of all kinds be more agile in your legal practice.

Hey there, welcome back to the podcast. So, this week I'm going to continue my takeaways from the Clio Cloud Conference this year. Especially this movement that Clio is starting to make towards recommending that lawyers transition more parts of their practices to flat fee or other value based pricing and away from hourly work. And again, this is largely in response to the technology driven efficiencies and especially the efficiencies coming from generative AI that Clio sees as eating away at the number of hours that people are going to have to work on legal issues.

And therefore, they're seeing generative AI as a very real revenue risk to firms that continue down an hourly billing path. One of the problems we have as an industry though, is that there aren't a ton of great tools still around how to convert a practice from hourly to flat fee. There's sort of some knee jerk conventional wisdom that I don't think is great advice. And so, I wanted to spend a little bit of time in this episode talking about a specific problem, which is, how do we gauge the relative effectiveness of a flat fee product line versus a comparable hourly fee product line?

To put it another way, how do we gauge the relative profitability of our flat fee work versus our hourly work? And this is especially important for practices that are doing both under the same roof, because the business drivers and the business behaviors that encourage profitability under a flat fee model are in a lot of ways the inverse of the behaviors that drive profitability for hourly. And so, we've got to figure out ways to reconcile the two under the same umbrella of the same practice.

This is compounded by the fact that most of the tools that are used by lawyers, and that includes software, that includes a lot of the practice management advice, whether it's coming from your bar or the ABA or even a lot of third party consultants. Are all really geared towards how to maximize profitability under an hourly model. And I don't actually love that advice even for hourly or maybe, and I'm going to talk about this in a minute, it creates these really perverse behaviors that I think are a little bit crazy.

But they're especially crazy if you are still engaging in these behaviors but you're not getting sort of the 'benefit' of working under an hourly model if you're using flat fee or any other value based pricing, whether it's subscription or contingency or whatever else. And I'm actually going to start by diving into some of those behaviors.

So, there's this problem about the hourly billing business model and it's frankly the core thing is that you have immediately capped your potential profit margin on your work as soon as you set your hourly rate. You can never make more than a certain amount of money per hour, per unit of effort invested once you've actually set an hourly rate for yourself. And if you can get away with a high hourly rate, maybe that's not a big deal, but it still is a cap and it's an unnecessary one.

Then once you have that cap, the whole name of the game is to incentivize yourself and your team members to use as much of your available working capacity as possible doing work that can be billed to clients under that hourly rate. And this is where the typical firm winds up using billable hours targets, either as part of their base expectations for workers or as part of their incentive compensation plan or oftentimes both.

And as I said last week, and I will talk about a little bit more at the end of this episode. If you're incentivizing your team members to expend extra effort under a flat fee model or under any sort of non-hourly model. You're actually working against your business model.

So going back to hourly, once you've established this effort expended over time number as your core unit of value, it leads to a seemingly logical series of steps that will both maximize efforts and minimize costs. And I say seemingly logical because in a lot of ways I see hourly billing as the ultimate anti-pattern inside of the legal industry. And remember, an anti-pattern is something that seems logical in the moment or seems intuitive but leads to less than ideal results and sometimes wildly suboptimal ones.

So, one set of activities that immediately falls from this hourly billing thinking has to do with stopping leaks in the pipeline between doing the work and getting paid for the work. And there is an inordinate amount of conventional wisdom in legal practice and a whole host of tools and technology that has built up around these leak stopping activities. It starts with time capture tools and methods because if you're doing work but not capturing the time spent on that work, then you have no hope of getting paid for that effort.

So, we in legal have any number of mandates around contemporaneous time tracking. We have tools inside of law practice management systems to make time tracking easier. We even have separate third party tools that are effectively sanctioned spyware that watches your computer and tries to figure out what you're doing inside of every six minute increment of your day.

And I'm not seeing those tools don't work, but never once have I come across a lawyer or a member of a legal team who's like, "Yeah, I really like the micromanagement elements of having to capture every single thing I do inside of my waking hours." Maybe there's some tech bro or biohacking, finance chick that has bought into hustle culture, maybe gets their nutrition from flavorless powders somewhere and thinks they can discipline their way into true happiness. But I really don't think that's the way most of us want to live our lives.

I'm not saying there's not a role for some amount of time tracking, even under hourly or contingency work. But we don't necessarily have to be under the microscope like hourly billing encourages us to be. The second set of tools and concepts to stop leaks in this hourly capture pipeline has to do with things like bill descriptions and time write downs and realization rates.

And I think I've said before that I personally think one of the dumbest books in the annals of law practice advice is the one titled *How to Draft Bills That Clients Rush To Pay*. And the fact that that book has made it through three whole editions just tells you how endemic these weird behaviors are in the legal space. And here's my argument. If you're relying on your bill to communicate the value your work is bringing to your client, you have already lost the game. Writing bill descriptions is just damage control in that situation.

Your client should be feeling they're getting value from your deliverables and your communications with them all along the way, not just from the invoice they get at the end of the matter or the end of a month. And this gets back to one of my recommendations from last week which is that regardless of your billing model, you need to be really intentional about phasing out your work on a matter and creating clear deliverables for each phase.

Deliverables that the client's going to see, and I'd even go so far as to say that even if the natural flow of the matter doesn't technically require a deliverable, you should make one up. You should invent one. Maybe it's just a number update, update. Maybe it's a road map that says, "Hey, your matter is on track." But you need to be putting something tangible in front of your client on a regular basis that gives them a signpost for how they're progressing on the pathway to meeting their goals for their case, and the bill is not it.

So, the next problem in this time capture, bill description sort of universe that so many of us are in. Is that the managers or the law firm owners wind up with this whole onerous bill review or pre bill process where they've got to spend a whole bunch of their capacity, basically nitpicking their team's time entries to decide what stays on the bill and what gets cut or written down. And it's sort of this tacit admission that not all of the effort spent on a matter is value adding.

And so, the manager winds up trying to engage in this form of reading the client's mind to try to anticipate what they will and won't pay for. It is a total guessing game and it's one with a feedback loop that can only lose you money because if you cut too much you'll never know it because the client will never see what you cut out. And if you cut too little, you're definitely going to hear about it from the client, who will then convince you to make another cut anyway.

Then you get to this whole realization thing where you wind up in a weird game of cat and mouse with clients who don't pay their bills right away. And in that situation, clearly the client has some issues with the cost, but to call them up and sort out those issues would be uncomfortable or painful. And so, we avoid it and we just keep sending bill reminders until we can't avoid it anymore, at which point so much time has passed and frankly, oftentimes so much resentment has brewed up on both sides that having a productive conversation about what was or wasn't on the bill is darn near impossible.

So instead, the lawyer typically just offers a discount and the client accepts it, or maybe negotiates it even lower. And both sides move on having learned nothing about what actually went wrong in the relationship or what the root cause of the issue was. And so, the pattern repeats, either with that client or the next one. And a lot of firms, especially the bigger ones, just sort of accept this as a normal part of the legal business. Let me be really clear, it is not normal. It is crazy.

And I'll go ahead and admit that I've actually leveraged this tendency before. Several years ago, I was an unofficial advisor to a family member's divorce and it was a contentious one. It was that perfect storm of an unreasonable opposing party who found an unreasonable lawyer to match their energy. But my family member's lawyers weren't blameless, and in my opinion, they went down a number of unnecessary rabbit holes and sort of churned up their hours on work that wasn't really core to the resolution of the case.

And my family member noticed and they were increasingly stressed out by monthly bills that often approached and occasionally exceeded five figures, this was a big thing. And at one point I advised that family member to just stop paying their bill and it went just like I said a minute ago. The bill reminders kept coming alongside sort of aging statements with increasingly implorative language to try to get the account settled up. But it took nearly four months for the relationship attorney to call that family member. And at that point, I'd already advised them to simply say, "The bill seems too high."

And that simple statement, no explanation, no detail, was all it took for the attorney to offer a 20% discount on all outstanding balances. And my family member, to their credit, negotiated it to 30% and it only took about five minutes. The discount itself was over 10 grand at that point, and the attorney basically just took it. So much for believing in the value of their work.

And here's the thing, of course, that attorney didn't believe in the full value of the bill because they knew that the effort expended and the effort captured on that bill is not a great proxy for the value they were delivering. It was just the only tool they know how to use. Going back to the way that hourly billing and hourly targets incentivize workers, there's this other problem where it completely sort of degrades the value of what a lot of firms will call, I mean, blanketly call non-billable work.

You might be a little bit more generous and call it administrative work. But I tend to think of it as enabling functions. It's not like it's not necessary work, it just isn't directly billable. But it's the work that empowers and enables the value delivery activities to happen in a firm and whether that is maybe client communication stuff that you might be tempted to write off. Maybe it's the opening and closing or the management of the matter itself that you don't really feel is billable.

Maybe it's the sharpening the saw type work of going to CLEs or doing process improvement or fixing a template or a document library. All of those things are really beneficial in the overall context of a law firm, and they're totally necessary. But because we put them under this blanket of 'non-billable work', we really give them short shrift. Which means we're not doing the things to empower our practices and improve our practices in ways that are going to improve your delivery of value over time to all of your clients.

That was a little bit longer on the problems of hourly billing than I meant. And despite all of those problems, I still think there's a place for hourly work in certain situations. But those situations, to me, are a lot more limited than most lawyers believe. Meaning that most lawyers are engaging in this sort of suboptimal, crazy train of activities around hourly billing that is totally avoidable if you get your workflows right and if you build up the right processes and procedures around those new workflows.

But I'll admit, it is hard to do when so much of the legal industry's conventional wisdom, and so many of its toolsets and technology tools are built to support hourly work. Everything just seems designed to add more cars to the crazy train. And when that's the world you know and when you go to switch your practice or parts of your practice to flat fee work, we have a tendency to do it within the context of this hourly universe that we already know about.

And so, what that means is that, number one, we tend to engage in this quasi hourly way of even setting our flat feet to begin with. And I talked about this last week. But we come up with an estimate for how long we think something's going to take and then we multiply that by our hourly rate because our hourly rate's the thing we know and that gives us a number that we think is the right flat fee. Again, maybe we pad it a little bit, do whatever we need to do, but it's this very hourly oriented way to establishing pricing under a flat fee.

Then once we do that work on a flat fee, the way that we tend to want to do or at least try to get to an apples to apples comparison between our flat fee work and our hourly work is, we come up with a metric called effective hourly rate. And this is a metric I really don't like very much. Although I get why everybody does it, it's the easy thing, it's the universe we know. But I think there's a better tool, and that's what I'm going to talk about in a few minutes. But let me talk about the problems with effective hourly rate.

The biggest one is that when we calculate that effective hourly rate, we tend to compare it with our actual hourly rate. And that is a false comparison, because remember, that actual hourly rate is only your ideal state. It is the top most profitable that you could be but there's all these other places where you have leaks in the pipeline that can cause that effective hourly rate, under-hourly billing to be way lower.

But when we're doing this flat fee to hourly comparison, we don't do effective hourly rate to effective hourly rate. We do effective hourly rate to published hourly rate. And so, we always wind up making ourselves feel like we are losing money on the flat fee work because it's really hard for it to hold up to this idealized thing that we have put it up against.

The other problem with effective hourly rate is it allows us to continue to live in this fantasy world where all of the other activities we engage in, billable hours targets and tracking and everything else. Still makes sense under a flat fee billing model and it doesn't really. Again, as I keep saying, hours targets are the enemy of flat fee work. They're going to kill you in the long run. And if you don't solve for that, then your flat fee stuff is going to be at a tremendous disadvantage right out of the chute.

So, here's what I'm going to recommend you do instead, which is, we need to get to a true profitability calculation for each one of your matters. And eventually we want to be able to roll that up to different matter types or different lines of business, different product lines if you're thinking sort of in terms of products like I tend to. But being able to calculate the actual profitability on that matter by matter basis or product by product basis is really the key to doing a true apples to apples comparison. And getting you real actionable advice about where you should apply your finite time, resources, capacity, whatever.

So how do we do that? Well, so another one of the sort of anti-patterns of traditional hourly practices is to the extent that they calculate profitability. They're tending to calculate the net profitability of the practice on sort of a yearly basis or maybe slightly more often. They might go half yearly or quarterly or maybe even monthly, but I don't usually see it monthly. And that sort of high level net profitability, it's popular because it's the easiest one to do.

At the end of the year, you basically add up all of your revenues and you subtract all of your costs and that gets you your net profit. And you can then express that as a fraction, the ratio between your net profit and your gross receipts and that gives you a profit margin. And like I said, calculating the expenses is really easy because you just look at everything you've spent money on for the year, including salaries and real estate and overhead and technology and marketing expenses and so on and so on and so on.

You just lump them all together as costs and that is how you get to that net profitability number. But that's a lot harder to do on a matter by matter basis because you have to try to then figure out how I'm going to allocate some of these costs to each one of the matters. And that requires a whole lot of assumptions and a whole lot of math and neither of those is necessarily things that lawyers are great at.

The better way to do it and the way that almost any other industry in the world does it, especially industries that are dealing in products, is that you calculate a gross profit margin or gross profitability based on individual matters, individual product sales. And eventually you can roll that up to a product line basis. So gross profitability is different. It's a slightly more nuanced way of calculating your costs because you have to basically split your total firm expenses into two categories.

And again, this is something that almost any accountant and almost any bookkeeper you work with is going to know how to do. They just don't typically do it with law firms. I have talked about this with a lot of different CPAs and other financial managers, though. And none of them can find any fault with this way of thinking. In fact, they really like this way of thinking about matter profitability and law firm profitability, Again, because it's closer to what they learned and what they do with other clients.

So, the first category that you need to be able to delineate for your expenses when you're doing this sort of gross profitability analysis is direct costs or direct expenses associated with delivering that particular matter, that particular widget. And if we're in the manufacturing world, there are actually quite a number of things that can go into that.

A big chunk of it is the raw material costs for the things you have to buy in order to convert them into whatever your widget happens to be. Whether that's metal or chemicals or plastics, whatever. You have direct costs for the raw materials that you bring in, in order to produce the thing that you wind up selling to your customers. Now, in legal, that is a much smaller component. In fact, for some practices it may even be non-existent. To the extent that we do have direct costs, it's things like court filing fees, maybe expert witness fees.

Whatever we have to pay to someone else, that is a necessary part of delivering this chunk of legal work, this case or this matter. The other part of this cost of goods sold metric though, and this is true both in manufacturing and legal, is the direct labor cost associated with producing whatever the product or the widget is. Which means we need to know what we're paying the workers all in, in order to be available to work on whatever it is that our business produces.

And here's the way I think of it and full disclosure, as I record this episode, I am working on a spreadsheet and it's a multi tab spreadsheet that is going to hopefully help attorneys and law firms capture this information. I am working really hard to get it ready to go by the time this episode launches. I may not get there, as with anything, it's a little more complicated than I thought it might be when I first set into it. But reach out to me, sign up for my mailing list or subscribe to this podcast and I will definitely let you know when it is ready for publication.

But to me, here are the things that go into calculating that cost of goods sold metric. And ultimately what I'm looking for is for each member of your legal delivery team to come up with not an hourly rate number, but an hourly cost number. And so, the way that I get to that is, I start with their annual base salary. However, much money we're paying them as part of their salary through the course of the year. Then I'm going to add benefits to that. So whatever insurance I'm covering, whatever retirement benefits I'm covering.

I'm going to add payroll taxes. I'm going to add bar dues or other licensing that's associated with keeping that employee's license active. And then any other direct costs that are just associated with hiring that person, whether it's an attorney, a paralegal, whoever, and keeping them on staff in our team. After that, I am going to come up with a calculation for their available delivery hours.

And for available delivery hours, I start by assuming that this person is a 1.0 full-time equivalent. They're a full-time employee. Which, if you assume that they're working 52 weeks at 40 hours a year, you come up with a maximum available hours of 2,080 working hours for the year. And let's ignore for now that a lot of people work more than 40 hour work weeks. I don't think it matters as long as we're consistent in how we calculate this number. And the easiest way to do it is based on that 40 hour work week number.

Now, if you happen to be one of those firms that's already converted to a four day work week and Richard, I'm talking to you, then you might actually want to shrink that number. You might actually say, "I'm going to calculate this based on a 32 hour work week instead of a 40 hour work week." Once you have that 2080 number though, then the next thing you need to do is subtract all of the time that you really don't expect someone to be working at all. And so, I'm going to remove a certain number of sick days.

And eventually I'm going to come up with an available delivery hours number. And just to give an example, someone who's got three weeks of vacation, ten holiday days and five sick days, that available number is 1840 hours. The last thing I'm going to do is come up with a percentage at which that person is allocated to delivery work. But I'm going to give you a hint here and this was something that was given to me by a very smart financial advisor that helped out with the Commons Law Center for a number of years.

Your default assumption for anyone involved in doing legal delivery work should be that 100% of their hours are at least available to be allocated to delivery. It ultimately doesn't matter how you allocate it. And again, if you know for sure that someone is spending 50% of their time on non-delivery work, whether that's marketing and intake or whether that's administrative stuff, whatever it happens to be. Then you can allocate them by a certain percentage. But I strongly, strongly, strongly recommend that you just allocate everyone at 100%. It's easier and it makes the apples to apples comparison better.

And in this model I'm looking at right now, which is a prototype of my spreadsheet, I'm assuming that we are paying someone about $250,000 a year. That may seem high. That may seem low. That's just my assumption. I have estimated some other direct costs around salary, benefits, taxes, whatever. I've, like I said, estimated 1840 available annual hours. And eventually that gets me to a direct hourly cost for that person of $151 per hour. And that's the number I'm going for, that direct hourly cost number.

And the sum of the direct hourly cost of all the people that worked on that particular matter is really how I'm going to calculate my cost of goods sold when I do a gross profit analysis on an individual matter. So, if it's a matter that we billed hourly for then I'm not necessarily going to worry about this on a bill by bill basis or month by month basis. I'm only going to look at it after the matter is closed and complete, done and dusted.

And I'm going to look at a few high level things. Number one, what was the total revenue that came in for that matter, that I actually got paid? Number two, I'm going to sum up for each individual that worked on it, what was the total number of hours they worked. And I'm going to multiply it by their direct hourly cost. And once I have the sum of the direct costs or the cost of goods sold for each of the workers on that matter, I'm going to add in any other direct cost, like filing fees or expert fees like I talked about before, and then I am going to subtract.

That's going to get me my gross profit for that individual case, for that individual matter. And then I can take the gross profit and divide it by the total revenue and come up with a profitability percentage. If I'm doing flat fee work, it's exactly the same process. And again, this assumes that I'm tracking time underneath my flat fee. One of the things about doing it this way is, you don't have to track time in 6 minute increments, 15 minute increments is totally fine. I would say 30 minute increments is acceptable.

We're not looking for a Six Sigma of accuracy in this number. We're just trying to get some directional information. And so, whether or not you bill in 6 or 15 or even 30 minute increments isn't going to give you that much noise in your system but like I said, we do the exact same thing. We take in whatever we got paid for that matter and hopefully if it's flat fee, hopefully we got paid upfront. We don't have to worry about billing and collections, quite so much, but regardless you get paid for it.

And then we've got to calculate the direct cost. So, we come up with how many hours each person on our team spent delivering that piece of work. We multiply those hours by the direct hourly cost calculation that we just came up with. And then we sum all those up and we can create that same ratio of gross profitability. We can calculate both a gross profit amount and a gross profit margin.

And now especially for doing both hourly and flat fee under the same practice umbrella, now we can do that apples to apples comparison. Which of these practice areas is more profitable? And that's really key because in a world where you have finite capacity, so many resources to apply to this legal work.

If you calculate, and I'll go back to an example of an estate planning firm where it's actually pretty common to have an estate planning practice inside of that firm that does flat fee work on the estate plans themselves. But then maybe does probates or trust administrations on an hourly basis.

And the interesting question is, when faced with a capacity limitation, if you determine that you have capacity to only take on one new matter. But you have two potential clients, one within an estate plan and one with the trust administration. You might look at it in terms of what's going to bring in the most total revenue but you can now look at it in terms of which is going to be the most profitable. We can say, "We have X profitability for our typical trust administration, but we have Y profitability for our typical flat fee estate plan."

And all things being equal, we're better off taking whichever case is going to be the more profitable case regardless of how much total revenue it generates.

Now, there's some other things that we can do once we've got that gross profit number. We can sort of divide it by the typical gross profitability for certain matter types under certain billing models. We can then divide by the typical length of time it takes to deliver that piece of work. And that allows us to do an interesting sort of apples to apples comparison around potential profit per month or potential profit per day that we're holding a matter inside of our system.

And that in turn gives us all kinds of information and incentive to get the work flowing more smoothly. Because the faster a piece of work moves through our process, the better that revenue per month or revenue per day or profit per month, profit per day number is going to be. Like I said, I won't go too deep down that rabbit hole, but there are some really effective things you can start to measure once you kind of break yourself out of this effectively hourly rate type thing.

The last thing I'll say is just because one of your lines of work is more profitable than another, doesn't necessarily mean you should get rid of your less profitable lines of business. I tend to look at it a little bit like you might look at portfolio diversification in your investment strategies. If you are feeling saucy, maybe you are going to go 100% into growth stocks. But most financial advisors will tell you that that's risky. On average, over time, yes, the growth stocks are probably going to outperform other types of investments, but it's going to be a rocky ride, they're a lot more volatile.

And so, it can be important to have some safety stocks or some bonds or some other assets in that investment portfolio to sort of help buffer the variability of being in a single type of asset. And the same thing is true in your law practice. So just because, and for most of the clients I work with, that are these estate planning firms. I will go ahead and say their flat fee estate planning work is almost always more profitable than their hourly probate or trust administration work, but that doesn't automatically mean that I'm going to recommend that they stop doing probates or administrations.

Sometimes I do, and sometimes that makes sense. In fact, there are some practices I work with that love going purely into one or the other of those lines of business, sometimes for profitability reasons and sometimes just because it better matches the interests of the lawyers in the firm. But I also think that there is some sound advice in the idea that you should continue doing both because one of the things about the probate or the trust administration. Probate is an interesting one because oftentimes you don't get paid till the end, but you get paid relatively stable chunks of money.

So doing a pure probate practice can be a little bit tough because you have to have enough of a reserve built up to basically keep the lights on and pay your bills while you're waiting for those probates to come in. But for firms I work with that do a mix, they really like it when those probates come in because that creates the pools of money that sort of become available for paying bonuses or making other investments in the firm. And so, it winds up being almost sort of this is going to sound flippant, but splash cash or fund money.

It's not like you haven't done the work, but it creates these bigger bursts of revenue that can be useful in certain ways. Whereas the flat fee estate planning work, the amounts of money aren't as big, but they tend to be more stable and you tend to be able to knock them out on a more consistent basis over time.

The trust administration work if you live in a state where that is something that is common, it kind of splits the difference between the two. They tend to be bigger total amounts of money, but they're also oftentimes billed monthly. And so, you can get some consistent revenue off of that work on a monthly basis.

When you're doing all three of those things under the same umbrella, though, and this gets back to the importance of having this gross profit or this cost of goods sold way of measuring the effectiveness of your practice. You can be way more intentional about how you allocate the members of your team to different parts of your mix. And so, you can really say, "Hey. attorney A, I need you to be spending 60% of your time and effort on the estate planning work and only 40% on the probate and trust administration."

And maybe we block off specific days of the week or maybe we do other forms of calendar blocking to really try to enforce that mix. Because you know as a business owner that having that mix right is what's going to give you the returns that you want on the investments you're making on the people inside of your law practice. Alright, I'm going to leave it at that.

A couple of things to wrap up. Number one, just recognize that there is so much that we do in legal practice that we think of as just the normal part of running a law firm. That is really sort of this perverse thing that we've come to do because of the hourly billing model. And it's not necessarily the soundest business practice, I think even within hourly billing, but especially once you introduce any form of non-hourly billing.

Number two, I would say try to break yourself of this notion of a strict binary between billable and non-billable work. The non billable work really is enabling the billable stuff. And you want to have a certain amount of your capacity allocated to it. In fact, in the example I just gave, I would never say that 60% of someone's time should be on estate planning and 40% should be on probate and administration. I want to reserve 5 to 10% of that person's capacity for the enabling functions.

Probably at least 5, maybe 10%, is just going to be the administrative stuff, attending firm meetings and opening and closing files or doing other work that we don't necessarily think of as billable. On top of that, I probably want to allocate at least 5% to those sharpening the saw activities, going through and updating tools and templates and forms and building up research libraries and attending CLEs. And doing whatever we can do to make ourselves more efficient in the delivery of the work.

Again, especially once you move to non-hourly work, that efficiency is going to really help drive profitability so we want to invest in it.

The third thing is if you can avoid it, get out of the idea of using effective hourly rate as your proxy for profitability. Do the work, make the calculations, come up with a spreadsheet, or like I said, eventually, I'll be able to get you a version of mine that is going to allow you to calculate that direct hourly cost and then do a true gross profitability or cost of goods sold analysis for each of your matters that's going to give you that apples to apples comparison for all of your matters, and eventually all of your product lines, regardless of what your billing method is.

Alright, I'm going to leave it at that. Stay tuned. Next week I'm going to be working on a listener question I got from last week's episode. Which is basically if you don't recommend using hourly billing targets to incentivize employees because it works against you on any non-hourly billing method, what do you recommend instead?

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