Second survey

2014 Financial Benchmarking Report - Law Firms

A significant analysis of the current legal market

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Ahead for Business

After five years of challenges it will be interesting to see how legal firms cope with the *increased work* associated with an economic recovery.

There needs to be *a significant change in thinking* to believe that the future is no longer about cost cutting but is about careful investment against improved efficiency and good financial management.

This is the second year of a survey that tracks the financial data of small to medium-sized law firms in 2013 and *represents significant analysis covering 380 firms from across the country.*

In addition to the benchmarking data, *the report also incorporates some predictions* as to how lawyers believe their firm will perform in 2014.

To ensure that your legal firm outperforms the rest – read on...

FOREWORD

In February 2013 NatWest Commercial Banking published its first legal benchmarking report, which focused specifically on firms outside the top 100.

Working in partnership with Robert Mowbray, the bank looked to deliver a report that could be easily interpreted by legal firms and their relationship managers to compare performance with regional and national firms of a similar size.

We were delighted that so many legal firms took the opportunity to download the free report, and are grateful for the positive feedback and the motivation to produce this report covering the financial performance of legal firms at 2013 year end.

In response to your feedback, we looked to widen the report to provide specific data covering larger firms with revenues in excess of £5 million. We also incorporated predictive data, representing anticipated performance in 2014 from some of the 400 delegates who attended the bank's legal conferences during Q4 2013.

This year's report is based on the performance of 380 firms, an increase of 12% compared to last year, providing a truly representative benchmarking database.

As Britain slowly pulls clear of what has been a long and challenging recession, lawyers appear to be sharing the optimism and our review portrays a positive statement regarding the year ahead:

- **Fees will remain flat or grow, according to 94% of lawyers, with 23% believing they will grow by more than 10%**
- **While 92% of firms believed their profits will grow or remain the same, 48% anticipated an improvement of up to 10%**
- **Only 30% believed that work in progress (WIP) days will reduce**
- **However, 35% believed that debtor days will decrease**
- **Office bank balances will improve, according to 62%**

Continued revenue and profit improvement during 2013, combined with a positive outlook for 2014, represents good news indeed. But that positive news should be balanced against a word of caution when it comes to cash management, as Robert Mowbray details.

In 2013 we saw a number of profitable legal firms fail because they ran out of cash. As our review suggests, lawyers continue to struggle to understand the relationship between profit and cash, given that a firm is unlikely to improve its bank balance by growing revenue and profit if it fails to improve lock-up days and potentially runs the risk of over-trading. To avoid this problem, firms must pay special attention to their cash flow forecasts and they should engage their bank regarding any future funding requirements.

We hope that this report will enable you to understand the performance of your own firm against its peer group, at the same time supporting the identification of areas where attention and focus can enhance future financial performance and security.

This report represents part of the bank's commitment to the legal sector. In addition, we provide access to professional sector relationship managers who benefit from accredited training, our annual series of continuing professional development-qualifying legal conferences and quarterly *Legal Sector Business Sense* publication.

Finally, we would like to thank Robert Mowbray for his continued support in producing this publication. If you have any comments about the report, or would like to discuss any particular aspect of the legal sector, please do not hesitate to contact me.

Steve Arundale
Head of Professional Sectors, NatWest Commercial Banking

TAYLOR MOWBRAY LLP

About the author

Robert Mowbray is a chartered accountant who has worked for professional firms for more than 30 years. His involvement began in the late 1980s and quickly developed into a niche business. His book *Maximising the Profitability of Law Firms*, published in the mid-1990s, was the first on law firm financials. Robert has been involved in a large number of surveys of the legal profession focusing on the financial health of firms, but he has also worked on surveys to research other aspects of law firm performance. His latest book, *Law Firm Finance & Administration Handbook – A Practical Guide for COFAs and Finance Professionals*, is the first to be published about the role of compliance officers for finance and administration (COFAs).

Each year, Robert works with about 80 firms and helps them to improve their financial performance. He has assisted in many areas, including: improving the quantity and quality of time capture; improving the ability of fee earners to negotiate fees with clients and to introduce more creative fee arrangements; managing lock-up to improve cash flow; profit sharing arrangements that reward improved business performance; and strategic and business planning.

Robert has worked with nearly 1,000 law firms in more than 30 countries. His clients range from the global elite through to major regional firms, as well as many small firms and sole practitioners. He is an owner of Taylor Mowbray LLP – a niche business that focuses exclusively on law firms – which he runs with Janet Taylor, who is an authority on the SRA Accounts Rules.

Client testimonials

Lees Solicitors LLP

Joanna Kingston-Davies, CEO and Alexander Mansfield, Head of Finance

"In a fast evolving market place where the provision of legal services is increasingly diverse and competitive, knowledge of benchmarking to inform strategy has never been so important. NatWest and Taylor Mowbray have unrivalled access to accurate and current data from a cross section of relevant competitors within our sector. This report is extremely helpful for both the data provided and the constructive interpretation of it.

"We are a 5.5 million turnover practice based in the Northwest. A large proportion of our work is in Clinical Negligence and Court of Protection. Lock up is therefore high on our agenda and our relationship with the bank is central to our strategy for sustainability and growth. The report highlights to us what we are doing well compared with our peers and where there is room for improvement. We encourage you to use it, as we do, to feed into your strategy and to set some measurable development objectives.

"The report is a positive read, not only due to economic growth, but also in so far as its statistics demonstrate clear prospects for improved margin through some simple and achievable changes in operational model. In particular, we see the scope and potential for growth by streamlining processes which will in turn allow for increases in chargeable hours and leverage within teams.

"If acted upon appropriately, the 2014 report will bring huge opportunities for us all."

Ridley & Hall LLP

Adam Fletcher, Managing Partner

Adam has been Managing Partner at Ridley & Hall LLP since January 2012. He has been in the legal profession for 12 years and witnessed the legal landscape change from relative prosperity in the early noughties through to the economic downturn of the last few years.

"It is great to see that the *Financial Benchmarking Report* has been published for a second year running. With the legal market continuing to change at a rapid pace, never has it been so critical to ensure that focus is on profitability and financial stability.

"I am not aware of any other benchmarking report within the sector that has access to such a library of financial data providing a wealth of financial information.

"Although Ridley & Hall has been established since 1926, seeing various changes within the legal landscape, we are focused on transforming the 'law firm' into a 'legal business'. While our traditions and the quality of our legal service is still at the heart of the organisation, the business approach is what we believe will assist with our financial successes in the future.

"Last year's report allowed the partners to fully understand how we were performing financially compared with other law firms. It enabled us to focus upon particular key areas of profitability, WIP and lock up. At our recent business strategy session with the management team, I was able to use the benchmarking results to highlight those areas of our financial performance that we need to focus on in 2014.

"Going forward we will review our internal gross profitability in closer detail by individual fee earning teams. What has become apparent is that the issues identified as a result of reviewing last year's report were often interlinked, and while only requiring small improvements have had noticeable impact on profitability."

Executive summary

The survey is a substantial review of law firms with fee income of up to £25 million. From across England, Wales and Scotland, 380 firms, employing a total of 14,400 people, took part in the survey. Their combined total income was £1.08 billion

Some interesting findings from the survey include:

Profits

- Median profit per equity partner, as a percentage of fee income was 23%. However, there were wide regional variations, for example it was 17% in the South West but 27% in Scotland.
- Profit per equity partner stood at £87,000, with the median figure dropping to £64,000 at small firms and rising to £133,000 at large firms. At very large firms the figure was £165,000.
- Profits were up by 7% since last year, increasing by 15% at smaller firms and 3% at large firms.
- The number of chargeable hours per fee was 1,000, which suggests some under-recording of work.
- Gearing was 2.88, which means that each equity partner was managing just 1.88 other fee earners. This figure will need to increase for more routine work, as clients will not pay a partner rate for such work.
- Performing at the upper quartile level will provide a profit per equity partner figure that is about 10 times higher than if performance is at the lower quartile level.
- Profits are likely to increase in 2014, according to 92% of firms, but only 19% believed they will increase by more than 10%.

Fees

- Fees increased by 3% at the median level – roughly in line with inflation. For small firms the figure was 2%, for large firms the figure was 4%, and for very large firms the figure was 5%.
- The median fee per fee earner was £136,000. However, there were considerable regional differences, for example £176,000 in London but £114,000 in Scotland.

> “Most law firms *had* money in the bank”

- Fees will increase or remain the same in 2014, said 94% of firms, but only 3% believed fee growth will exceed 20%.

Lock-up

- Median lock-up was 107 days – for small firms it was 89 days; for large firms it was 121 days; and for very large firms it was 138 days, which suggests that larger firms have significantly more trouble in managing lock-up.
- Median upper quartile lock-up was 76 days, while lower quartile lock-up was 146 days.
- Only 30% of firms said that work in progress (WIP) days would be reduced in the next year, and just 35% of firms believed that debtor days will be reduced, which shows a lack of confidence in this area.

Finance

- Most law firms had money in the bank. Last year, the median bank balance was £20,000. This suggests that most can afford to invest as the economic growth takes hold.
- Median partner capital stood at 25% of annual fees, while the upper quartile figure was 40% and the lower quartile figure was 15%.
- In terms of bank balances, 62% of firms were expecting an improvement by the end of 2014.

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INTRODUCTION

Last year was another challenging one for the legal sector. A number of businesses failed and went into administration. More than 100 firms closed down because they were unable to obtain new professional indemnity (PI) insurance.

Meanwhile, continuing legal aid cutbacks led to a vote of no-confidence in the president and chief executive of The Law Society (England and Wales) by solicitors at the end of 2013.

Furthermore, about 200 alternative business structures (ABSs) have now been established, challenging traditional firms over the best way to operate if they want to be sustainable and meet clients' increasing demands.

Against this backdrop, in the second half of the year the economy seemed to start growing again, following five years of no real economic growth. Given that legal businesses provide support to individuals and businesses, it is likely that there will be a delay of some months before the legal sector begins to feel this growth.

It will be interesting to see how they fare, as it may require a significant change in mindset. For firms that have spent the last five years believing that in order to make more money they need to spend less, it may now be difficult to believe they may need to spend more to make more. After previous recessions, some firms grew quickly and made significant profits, while others were slower to invest and failed to make the profits they might otherwise have achieved.

In recent months, some firms that carry out residential conveyancing have suddenly experienced a huge increase in demand and are now struggling to find the people to carry out the work for them. Clearly, if there is a limited number of people who can do the work, then the firms that invest first are most likely to attract the people with the necessary skills.

There remains a real danger that some firms will start to relax when their earnings begin to increase again. Even if work volumes pick up, it seems likely that pricing pressures will continue and therefore they will need to continue to think about and invest in greater efficiencies in their working practices.

> "Firms will need to continue to *invest* in efficiencies in working practices"

Successful firms will try to increase fees without increasing their head count by focusing on productivity. If a fee earner only generates twice the amount of their salary cost it is difficult to make a profit from their efforts once overheads are accounted for. However, if a fee earner can generate three or more times their salary cost in fees it becomes much easier to achieve a very healthy profit. Investing now to increase this productivity may be wise.

This is the second year of the survey and we were keen to continue with some of the reporting that made the survey so popular last year – more than 2,500 people read the publication online – while adding new elements to give readers something extra to consider.

The report is based on contributions from 380 firms, using figures from their financial year end in 2013, and represents a very significant analysis of the current legal market. The combined fee income of the firms in the survey was £1.08 billion, while the combined profit was £266 million and covers 1,875 equity partners.

The information is broken down regionally, as there is a significant difference in law firms' performance across the UK. The performance of different sized firms is also analysed to see if it reveals an optimal size.

The report provides median, lower quartile (LQ) and upper quartile (UQ) figures. While firms may aspire to be the best at everything they do, this is clearly unrealistic. They tend to talk about what they are good at doing and try to get better at this rather than focusing on areas where they under-perform – and possibly where improvements may be more easily achieved.

When looking at the tables, it is perhaps best to focus on the areas where your firm is currently performing below the median figure and to think about what can be done to generate better results.

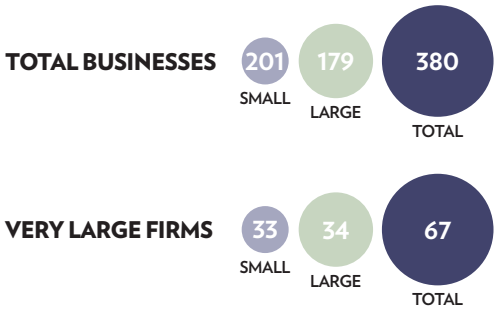
Firms are either described as 'small' (with less than £1.5 million annual fees) or as 'large' (more than £1.5 million annual fees).

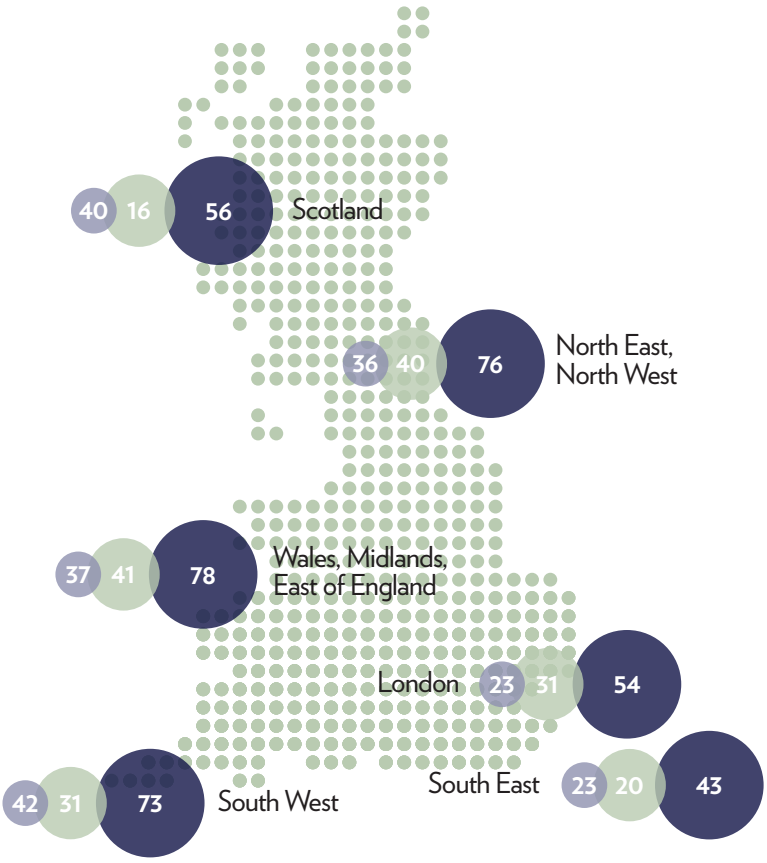
The bulk of the information is historical and relates to the most recently ended financial year.

NatWest organises a series of conferences each autumn for its legal sector clients and contacts, and conference delegates were asked to comment on how they thought they might perform in 2014. This predictive data is included within the survey and next year it will be interesting to see whether lawyers are better at financial forecasting than economists.

Table 1 shows an analysis of the firms in the survey by region and by size. Three regions are grouped to form Wales, Midlands and East of England, as there was an insufficient number of firms from Wales and East of England to be analysed separately. Firms are divided into two categories: those with annual fees of less than £1.5 million are described as 'small', while those with fees in excess of £1.5 million are 'large'. In the 2013 survey, bigger firms indicated they would welcome additional information about the largest firms in the survey. Accordingly, tables in this year's report include an extra line of data for 'very large' firms with annual fees in excess of £5 million. Additionally, in Table 1 these are subdivided into 'small' (annual fees between £5 million and £8 million) and 'large' (fees in excess of £8 million) firms. Elsewhere, the results for 'very large' firms are included in the figures for 'large' firms, as previously.

1. Firms by location





2. Firms by constitution

	PARTNERSHIP	LLP	COMPANY	SOLE PRACTITIONER	TOTAL
London	21	21	7	5	54
South East	20	17	5	1	43
South West	28	29	12	4	73
Wales, Midlands, East of England	35	35	7	1	78
North East, North West	29	30	13	4	76
Scotland	37	13	5	1	56
TOTAL	170	145	49	16	380
VERY LARGE FIRMS	16	44	7	0	67

Table 2 shows the firms that took part in the survey categorised by constitution. Just over half were limited liability partnerships (LLPs) or companies. Among the very large firms, almost two thirds were LLPs.

It is interesting to note that there was a higher proportion of companies in the north than elsewhere. One possible explanation is the development of personal injury (PI) firms, which have grown in this part of the country, often with a corporate structure. Just 10% of very large firms were trading as companies and, unsurprisingly, there were no sole practitioners.

Statistics from the Solicitors Regulation Authority (SRA) in November 2013 showed that there were 10,650 legal businesses, of which 15% were LLPs, 29% sole practitioners, 25% partnerships and 30% incorporated companies. The number of legal businesses decreased by nearly 300 from the previous year. While these figures are significantly different to those from our survey, that is because it did not include very small sole practitioners or incorporated practices.

[SECTION 1]

Fees

Key questions to consider

1. What do we need to do to enable fee earners to become more productive?

2. Are we training our fee earners properly so that they maximise their fee income?

3. Can we charge more for what we do if we get the service right?

FEES

It is possible to increase profit without increasing fees by controlling and cutting expenditure. This has been the focus over the last few years, as fee income levels have generally fallen or remained flat. For many legal businesses, now is the time to focus more on the growth of fee income to increase profits. As noted in the introduction, this may require a change in thinking as generating more income may require a firm to spend more on fee earners and on supporting overheads.

One of the widely used measures of performance in legal businesses is fees per fee earner because it demonstrates the level of income generated. This can then be compared with the salary cost of the fee earner to determine the multiple of salary costs which the fees generated represent.

Good law firms have always talked about the need to achieve fees equal to three times salary costs when budgeting to achieve healthy profits. If this can be done and a further third is spent on overheads then a healthy net profit of one third is earned for the equity partners.

If a multiple of three times salary cost is not achieved then it will be difficult to achieve the same level of profits. Clearly, if productivity can be increased and the multiple is higher than three then it should be straightforward to make even higher levels of profit than have been achieved historically.

3. Fees per fee earner (£000s)

REGION	SMALL			LARGE			TOTAL		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London	130	163	180	166	241	330	139	176	302
South East	101	122	152	129	148	184	115	135	178
South West	103	128	168	122	146	176	111	137	175
Wales, Midlands, East of England	98	125	160	105	126	152	102	125	158
North East, North West	99	132	171	127	186	283	112	148	227
Scotland	96	116	157	96	113	143	96	114	157
Total for all regions	102	128	168	115	146	213	108	136	180
Very large firms	120	152	192	124	175	229	124	153	211

Table 3 shows the fees being generated per fee earner at the firms surveyed. Overall, the median figure was £136,000 but there was a significant range, with a lower quartile figure of £108,000 and upper quartile figure of £180,000. It is not surprising that the median for small firms was £128,000, while for large firms the figure was £146,000. There are quite significant regional differences too. For example, there was a median of £176,000 for firms in London – 56% higher than the median figure of £114,000 in Scotland. At £153,000, the median for very large firms was not significantly higher than that of large firms at £146,000.

> “Now is the time to focus more *on the growth* of fee income to *increase profits*”

Fees per equity partner is another useful measure as it combines fees generated per fee earner with the number of fee earners working for each equity partner to calculate the revenue generated by the equity partner and their team, as can be seen in the following formula:

Fees per equity partner = Fees per fee earner X Gearing

4. Fees per equity partner (£000s)

REGION	SMALL			LARGE			TOTAL		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London	173	349	464	674	833	1,177	386	544	930
South East	233	362	488	438	603	772	361	483	632
South West	249	306	446	415	559	1,005	291	397	613
Wales, Midlands, East of England	159	270	390	382	513	725	261	399	600
North East, North West	222	318	410	513	928	1,900	281	466	979
Scotland	237	286	337	424	653	807	254	312	546
Total for all regions	211	298	429	437	668	1,028	275	425	680
Very large firms	524	693	993	560	801	1,164	529	747	1,100

Table 4 shows the fees generated per equity partner. There was considerable variation across the regions and between firms of different sizes. The overall median figure was £425,000 but for very large firms the figure was 76% higher than for all firms at £747,000. There are other much greater differences. The lower quartile figure of £159,000 for small firms in Wales, Midlands and East of England was only a fraction of that achieved at the upper quartile level for very large firms of £1,164,000. All firms should set fee targets for equity partners both for the current year and five years' time. The figure can be increased marginally over the next year without making significant changes, but to achieve larger wholesale changes might require a complete rethink on the structure of the team, how the work is done and whether the right sort of work is being obtained. The overall median figure of £425,000 when compared with the overall median figure of £136,000 for fees per fee earner in Table 3 suggests that gearing is running at 3.125. In other words, an equity partner is typically managing just over two other fee earners.

What has happened to fees since last year? Has growth returned? Given that the survey is comparing figures achieved over the last two years it would be surprising if there had been a large increase. These will probably be seen later, once the economy is growing more strongly.

5. Fees as a % of previous year's fees

REGION	SMALL			LARGE			TOTAL		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London	88	96	118	101	106	119	95	106	118
South East	98	103	106	98	105	107	98	103	107
South West	98	104	110	96	102	111	98	102	111
Wales, Midlands, East of England	99	103	107	97	103	113	98	103	108
North East, North West	91	101	106	100	106	110	97%	103	109
Scotland	93	99	106	98	102	106	94	100	106
Total for all regions	95	102	108	98	104	112	97	103	109
Very large firms	99	102	108	101	106	112	100	105	112

Table 5 shows what has happened to fee growth and the overall median figure was growth of 3%, which is roughly in line with inflation. It is reassuring to see this figure because it shows that the legal sector is still growing, even if it is not growing as quickly as it was prior to the slowdown in 2008.

While the overall median showed growth of 3%, the lower quartile position had a drop of 3% in fee income and the upper quartile position had growth of 9%. The median for small firms was 2% growth, for large firms it was 4% and for very large firms it was 5%. It is difficult to explain why the larger firms are seeing more growth but it might be because they are better at business

development and marketing and are therefore picking up more available work than the smaller firms. It could, however, be that they are simply more confident at pricing and billing work than the smaller firms.

Median growth rates of about 3% can be seen across England and Wales but it is interesting to see that there was 6% growth in London but none in Scotland, highlighting that there remain very different pressures and issues in different parts of the UK.

Prior to the recent economic slowdown, annual profit was often fairly close to the bank interest earned figure for many legal businesses . In other words, the law firm could cover its expenses with the fees earned and profit would result from the premium interest earned on client accounts. The last few years have seen significant falls in transactional work which has resulted in law firms holding less client money. Coupled with a fall in interest rates, the amount of interest being earned has fallen to very low levels compared with the past. This means that many firms have had to look again at how they make money from legal services and become less reliant on the interest earned on client accounts.

6. Interest received as % of fees

REGION	SMALL			LARGE			TOTAL		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London	0	0.06	0.45	0.01	0.16	0.72	0	0.12	0.68
South East	0.11	0.29	1.36	1.12	1.58	2.91	0.23	1.15	2.28
South West	0.22	0.48	1.99	0.08	0.50	1.27	0.22	0.48	1.96
Wales, Midlands, East of England	0.17	0.75	1.48	0.67	1.32	1.90	0.45	1.03	1.77
North East, North West	0.11	0.36	1.31	0.03	0.23	1.17	0.03	0.30	1.26
Scotland	0	0.15	0.41	0.03	0.15	0.44	0	0.15	0.42
Total for all regions	0.06	0.33	1.27	0.07	0.64	1.52	0.06	0.43	1.35
Very large firms	0.43	1.25	2.05	0.09	0.49	1.01	0.17	0.89	1.60

Table 6 shows just how little interest is being earned with the median figure at 0.43% of fee income. Table 4 showed that fees per equity partner totalled £425,000, suggesting that the interest earned per partner at 0.43% of fee income is £1,828, which would presumably be insufficient for most equity partners' basic living expenses. It will be interesting to see how these numbers grow in the coming years, with an inevitable rise in interest rates expected at some point and, hopefully, larger volumes of transactional work returning.

Predictions from the NatWest conferences – what will happen in 2014?

Fee income – % movements in 2014

	> -20	-10 to -20	-10 to 0	0	0 to 10	10 to 20	> 20
FEES < £1.5 MILLION							
Fees per fee earner	0	3	5	15	64	8	5
Fee income	0	3	8	10	56	18	5
FEES > £1.5 MILLION							
Fees per fee earner	0	0	5	20	60	15	0
Fee income	0	0	3	20	55	23	0
TOTAL							
Fees per fee earner	0	1	5	18	62	11	3
Fee income	0	1	5	15	56	20	3

There is not much difference between the expectations of small and large firms. In total, 94% of respondents believe that fee income and fees per fee earner will grow or remain unchanged, which is a very strong sign of confidence. Only 3% of firms believe that this growth will exceed 20%. If this prediction is accurate it is likely that there will be greater fee income growth in the 2015 survey.

[SECTION 2]

Profit

Key questions to consider

1. Have we benchmarked our performance against comparable firms and have we identified where we are below the upper quartile point?

2. Are we under recording time and not showing clients the full extent of our efforts?

3. How can we get a better rate per hour for what we do; do we understand creative fees?

4. Do we use matter planning tools which help us to understand the profitability of the work we are doing?

PROFIT

Profit is the most important measure. After all, this is the money that is shared between the partners. It is surprising how many firms focus too much on revenue and not enough on profit. This is probably because firms find it easier to measure fees billed than to calculate profit earned for different types of work, for individual matters and for different fee earners.

A common starting point is to look at the profit available for the equity partners as a percentage of fee income. The rule of thumb has always been that good firms will make 33%, while average firms will make 20%-25%. For under-performing firms the percentage figure is lower. Table 7 provides some feedback on performance.

In total, the upper quartile score was 31%, the median figure was 23% and the lower quartile figure was 12%. These figures reinforce the validity of the traditional model and demonstrate that five difficult years have not killed off the legal profession. The reality is that the profession continued to generate profit levels that were just below the traditional norms.

What is of greater interest in Table 7 is the significant variation between the regions. While the overall median figure was 23%, in Scotland it was 27% and in the South West it was 17%.

Small firms had a median margin of 24%, while large firms had a margin of 22%. The very large firms had a median of 26%. It is interesting that the margin was not constant across all sizes of firm and that it cannot be directly correlated.

This supports the view that the size of a firm is irrelevant to its ability to make profit. The key thing is always to make sure that the work is done in the most profitable way.

7. Profit as a % of fees

REGION	SMALL			LARGE			TOTAL		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London	9	21	27	8	26	46	9	22	43
South East	15	25	34	19	26	29	15	26	31
South West	11	19	28	13	17	30	12	17	29
Wales, Midlands, East of England	10	24	31	4	18	26	8	20	29
North East, North West	16	24	31	13	22	31	14	24	31
Scotland	13	26	33	21	31	39	14	27	36
Total for all regions	11	24	31	12	22	32	12	23	31
Very large firms	12	24	32	21	28	37	14	26	33

A better way of looking at profit is to calculate profits per equity partner. Some surveys now calculate this but because non-equity partners are not risk takers and are effectively just higher-paid fee earners, such calculations are perhaps not as useful. Where the business in the survey is incorporated we have used the number of shareholders as the number of equity partners.

8. Profit per equity partner (£000s)

REGION	SMALL			LARGE			TOTAL		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London	20	55	123	120	284	415	27	127	315
South East	58	71	124	100	150	183	65	108	162
South West	26	62	76	73	123	177	48	73	124
Wales, Midlands, East of England	14	37	88	35	68	142	22	61	116
North East, North West	48	68	92	108	164	319	64	107	172
Scotland	38	68	98	101	129	299	48	86	116
Total	31	64	94	75	133	252	46	87	147
Very Large Firms	100	145	194	104	188	409	103	165	323

Table 8 shows that the median profit per equity partner across all firms was £87,000, with small firms achieving a median of £64,000 and large firms achieving a median of £133,000. Among the very large firms, the smaller ones achieved a median of £145,000, while the larger ones achieved a median of £188,000. The difference between the large firms in the very large firm category (£188,000) and the small firms (£64,000) was nearly three times greater per equity partner at the median level.

Not surprisingly, there was very significant regional variance. The median figure for all firms was £87,000, but this dropped to £61,000 in Wales, Midlands and East of England, rising to £127,000 in London. The figure in the South East at £108,000 was only marginally higher than the figure in the North East and North West at £107,000.

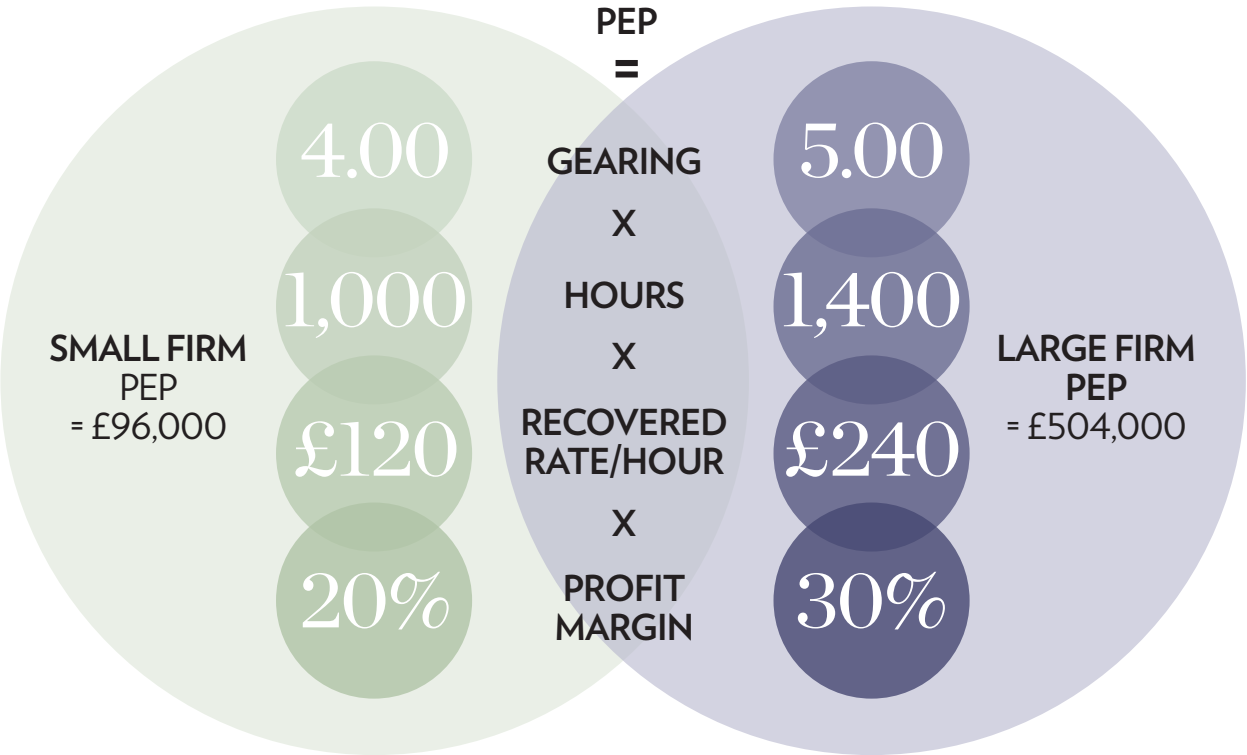
It is always interesting to look at the upper quartile figures to see what can be achieved. The figure for London at £315,000 was nearly three times the figure in Wales, Midlands and East of England and also in Scotland at £116,000.

9. Increase in profit from 2012 (%)

REGION	SMALL			LARGE			TOTAL		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London	9	17	39	1	5	10	1	9	26
South East	14	32	53	1	2	8	3	11	32
South West	7	15	39	1	4	10	3	9	29
Wales, Midlands, East of England	5	15	26	1	3	5	1	5	19
North East, North West	6	19	35	1	6	24	4	11	30
Scotland	4	10	17	0	1	2	1	6	14
Total for all regions	7	15	32	1	3	9	2	7	25
Very large firms	1	1	3	0	1	1	0	1	2

Table 9 looks at how profits changed compared to the previous year. The overall median increase was 7%. Small firms fared much better at 15%, while large firms saw an increase of just 3%. The very large firms saw an increase of just 1%. While firms may like to see profits increasing more quickly, it is good that they stayed in line with inflation and had stopped falling, which was the case in the first couple of years after the economic downturn. If overheads are now properly under control, then it is not unreasonable to expect to see some significant increases in profits once steady growth is achieved in fee income.

Benchmarking profitability



Variable 1: Gearing

The first variable is referred to as either gearing or leverage. It is a number representing the size of each team in the firm, including the equity partner. So, if a partner manages two fee earners they have gearing of three, while if they manage five fee earners they have gearing of six. Clearly, the larger the team, the more it can bill and the more profit it can make. The reason gearing is not normally high is related to the complexity of the work. Only simple legal work can be done with large gearing; more complicated work requires greater supervision and experience.

> “It is not surprising that the firms *that pay the most* seem to get the *most hours* recorded”

Variable 2: Chargeable hours

The second variable is the annual recorded chargeable hours per fee earner. If everyone is busy and confident about recording their time then the number will be high. If there is a shortage of work, or if people are slack over their time recording, then the recorded hours will be lower. It is not surprising that the firms that pay the most seem to get the most hours recorded. When you multiply the first two variables you are calculating the annual hours generated by each partner through their team.

Variable 3: Recovered rate per hour

The third variable is the recovered rate per hour billed. The higher this rate, then the greater the profit margin. Clearly, complex work can demand a higher rate than routine work. Some firms like to break this variable down into the recorded rate and the percentage of this rate that has been billed. In other words:

(With realisation % being the percentage of time recorded that can be billed)

The multiple of the first three variables determines the fees billed by the partner in the year.

Variable 4: Profit margin

The final variable is the profit margin. This is the percentage of the fee that becomes net profit. In other words, it is the efficiency with which a firm turns its fees into profit. If the firm is efficient, then the net profit margin is high, but if there are inefficiencies the margin will drop and can become negative.

The figures on the table on the previous page show that to go from a PEP of about £100,000 to a PEP of about £500,000 does not require a fivefold increase in all the variables. Relatively small increases in one or more of the variables can deliver very significant improvements in profitability. That is why firms should regularly benchmark against their competitors, so they can identify where they can most easily improve.

10. Gearing

REGION	SMALL			LARGE			TOTAL		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London	1.00	2.00	2.88	2.23	4.25	6.25	2.00	2.50	5.50
South East	1.88	2.50	3.63	2.80	4.00	5.70	2.49	3.33	4.67
South West	1.50	2.00	2.94	2.94	4.25	6.68	2.00	2.69	4.94
Wales, Midlands, East of England	1.08	2.00	3.00	2.72	3.71	5.62	2.00	3.00	4.00
North East, North West	1.71	2.00	3.00	2.89	5.00	7.75	2.00	3.00	6.00
Scotland	1.67	2.08	3.08	3.08	4.59	6.96	1.73	2.63	4.00
Total for all regions	1.50	2.00	3.00	2.68	4.35	6.78	2.00	2.88	4.76
Very large firms	2.83	5.00	6.93	3.43	4.77	6.44	2.91	4.79	6.82

Table 10 shows how gearing varies by size and region. The median figure for all firms was 2.88, which implies that an equity partner was managing 1.88 other people. This is very low and fell during the recession – when there was not enough work to keep everyone busy it was normally a fee earner who was made redundant rather than the equity partner who fell on his sword. As work volumes pick up again, many firms will need to focus on getting this variable back to a more sensible figure, as clients will not be willing to pay a partner to do the more routine work that needs to be done on a file.

It is particularly interesting that the median figure for small firms is 2.00, while for large firms it is more than double at 4.35. The figure does not get much higher at very large firms, where the median is 4.79. Once again, this offers an insight into what might be possible if the upper quartile figures are reviewed. At large firms, the upper quartile figure is 6.78, but this varies regionally and increases to 7.75 in the North East and North West, which is about three times higher than the median figure for all firms.

Staffing ratios are clearly important and all firms need to have the right mix of fee earning and non-fee earning staff. Traditionally, it was not uncommon to find they had about the same number of fee earners as support staff. In recent years, although secretarial numbers have fallen, firms have found it necessary to recruit new people in business development, information technology and other management roles, so in aggregate perhaps nothing has really changed. Table 11 provides an update on the relationship between fee earners and non-fee earners.

Across all firms, 49% of people were fee earners, meaning that 51%were non-fee earners – reinforcing the traditional view of a 50/50 split. At the very large firms, 55% of people were fee earners, which would suggest they had achieved some economies of scale. This can also be seen if you look at the difference between small firms, where the median was 45% fee earners, and large firms which had a median was 50% fee earners.

There are significant regional variances, too. London saw a median figure of 56% fee earners compared with Wales, Midlands and East of England at 43%.

11. Fee earners as % of total headcount

REGION	SMALL			LARGE			TOTAL		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London	33	44	57	47	59	69	42	56	67
South East	35	47	57	43	59	69	40	50	65
South West	32	46	54	43	50	55	38	48	54
Wales, Midlands, East of England	33	41	50	36	43	53	34	43	53
North East, North West	30	44	60	30	46	56	30	44	57
Scotland	40	50	71	50	75	83	44	50	74
Total for all regions	33	45	57	39	50	62	36	49	60
Very large firms	43	52	57	48	59	73	45	55	64

Fees will be maximised if fee earners are recording all of their time. If clients cannot see the effort that has been put into their affairs then they are unlikely to pay for this effort. Full time capture is the most basic thing that fee earners are required to do but most massively under-record their working time. Different firms have different working cultures but most fee earners are asked to work a minimum of 7.5 hours per day. Given that when holidays (seven weeks, including Bank Holidays) and weekends are taken into account there are still 225 working days in a year, this suggests a capacity of 1,688 hours per year. Fee earners will spend time on business development, know-how, training and may have some sick days, but equally they may work additional hours either in the office or away.

Table 12 shows the level of chargeable time recorded and highlights a considerable amount of lost time. The overall median figure of 1,000 hours per fee earner equates to 4.4 hours per working day. This does not tally with what most fee earners would say about working hard on client matters for most of each working day. There does not appear to be much regional variance.

12. Recorded chargeable hours per fee earner

REGION	SMALL			LARGE			TOTAL		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London	770	875	979	881	938	1,000	839	918	1,000
South East	772	894	988	892	925	1,000	801	912	1,000
South West	998	1,154	1,463	821	1,166	1,619	884	1,154	1,537
Wales, Midlands, East of England	891	1,000	1,000	827	1,000	1,000	862	1,000	1,000
North East, North West	1,000	1,000	1,044	1,000	1,011	1,050	1,000	1,000	1,050
Scotland	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Total for all regions	961	1,000	1,000	893	1,000	1,018	913	1,000	1,001
Very large firms	919	1,000	1,000	960	1,000	1,025	940	1,000	1,006

Clients continue to put all suppliers, including their law firms, under pressure about fees. Indeed, commercial clients are often better at negotiating fees than solicitors, many of whom have never really had to negotiate very hard until quite recently. There is significant push back on charging hourly rates, and clients and the courts are looking for more certain and creative ways of charging. It seems unlikely price pressure is going to disappear any time soon.

13. Recovered rate per hour (£)

REGION	SMALL			LARGE			TOTAL		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London	130	188	215	184	238	349	143	196	331
South East	132	170	198	125	164	201	128	168	203
South West	91	103	125	103	129	164	96	110	136
Wales, Midlands, East of England	118	140	161	111	134	169	114	138	163
North East, North West	97	127	164	128	189	259	114	148	212
Scotland	94	112	151	96	118	159	95	115	153
Total for all regions	98	128	169	117	159	214	107	140	189
Very large firms	128	164	213	117	151	212	124	162	213

Table 13 shows the recovered rate per hour that was achieved. The median for all firms was £140. If the realisation rate was 80%, which is common, this implies a headline rate of £175 with a £35 discount. There is considerable variance by region, with a London median of £196, while in the South West it was just £110. Small firms had a median of £128, while large firms had a median of £159. The figure for very large firms was only slightly higher at £162, but within this category it is surprising that it was only £151 for the large firms. This is because they had much higher levels of gearing (see Table 10). As gearing increases, it reduces the average rate per hour.

14. Profit per equity partner (PEP) (£000s)

(using benchmarks for all regions)

	SMALL			LARGE			TOTAL		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
Gearing	1.50	2.00	3.00	2.68	4.35	6.78	2.00	2.88	4.76
Hours	961	1,000	1,000	893	1,000	1,018	913	1,000	1,001
Recovered rate (£)	98	128	169	117	159	214	107	140	189
Margin %	12	24	31	12	22	32	12	23	31
Total PEP (£000s)	17	61	157	34	152	473	23	93	279
Very large firms									
Gearing	2.83	5.00	6.93	3.43	4.77	6.44	2.91	4.79	6.82
Hours	919	1,000	1,000	960	1,000	1,025	940	1,000	1,006
Recovered rate (£)	128	164	213	117	151	212	124	162	213
Margin %	12	24	32	21	28	37	14	26	33
Total PEP (£000s)	40	197	472	81	202	518	47	202	482

Table 14 calculates what the PEP figure would be for firms of different sizes if they achieved lower quartile, median or upper quartile performance for each of the four drivers of profitability. While it is difficult to be the best at everything they do, it should still be possible for firms to achieve an upper quartile performance. The table shows that achieving upper quartile performance delivers a PEP figure of about 10 times of that achieved at the lower quartile level.

Similar calculations can be done by region. For all firms with upper quartile performance, the PEP would be as shown in Table 14a. Most firms would look at the PEP figure and wonder how that can be achieved. The answer is in the four variables that give this result. As every firm is different, the result might be achieved with a slightly different mix of the four variables to reflect the nature of the clients and the work being undertaken.

14a. PEP with upper quartile performance (£000s)

REGION	Gearing	Hours recorded	Recovered rate (£)	Margin %	PEP (£000s)
London	5.50	1,000	331	43	783
South East	4.67	1,000	203	31	294
South West	4.94	1,537	136	29	299
Wales, Midlands, East of England	4.00	1,000	163	29	189
North East, North West	6.00	1,050	212	31	414
Scotland	4.00	1,000	153	36	220
Total	4.76	1,001	189	31	279

Predictions from the NatWest conferences – what will happen in 2014?

Profit & profit drivers – % movements in 2014

	> -20	-10 to -20	-10 to 0	0	0 to 10	10 to 20	> 20
FEES < £1.5 MILLION							
Profit per equity partner	0	3	3	26	49	15	5
Gearing	0	0	5	41	41	13	0
Hours	0	0	3	34	55	8	0
Recovered rate	0	3	3	27	62	3	3
Margin	0	0	5	30	59	5	0
FEES > £1.5 MILLION							
Profit per equity partner	0	3	8	25	48	15	3
Gearing	0	5	5	41	44	3	3
Hours	0	0	5	43	50	3	0
Recovered rate	0	0	5	44	44	8	0
Margin	0	0	8	28	58	6	0
TOTAL							
Profit per equity partner	0	3	5	25	48	15	4
Gearing	0	3	5	41	42	8	1
Hours	0	0	4	38	53	5	0
Recovered rate	0	1	4	36	53	5	1
Margin	0	0	7	29	59	5	0

There was not a great deal of difference between the expectations of small and large firms. In total, 92% of firms expected their profits to grow or remain the same in 2014. Among them, 19% thought that profits would grow by at least 10%. In terms of the recovered rate, 68% of small firms believed this would increase, while the equivalent figure for larger firms was 52%, which suggests less confidence. Equally, 63% of small firms believed that they would be able to increase chargeable hours per fee earner, while only 53% of large firms agreed.

Those surveyed were asked whether they had a detailed time recording policy which gave fee earners detailed advice on exactly how this should be recorded. A lack of such a policy is one of the main reasons for under-recording. The survey showed that 53% of firms believed they had a detailed policy. At larger firms this rose to 60%, while at smaller firms it was just 45%.

Another issue that will impact on profits over a longer period is whether there is a detailed business plan in place to cover the next three to five years. Budgets manage performance over the next year but it is important to plan over longer periods, too. Across all firms, 72% said they had a detailed business plan, rising to 76% at large firms and falling to 68% at small firms.

It is important that all partners are motivated to deliver marginal increases in profit. This is going to be achieved more easily if profits are shared in line with partner performance. It was interesting to see that just 36% of firms felt that profit sharing was linked to partner performance. At small firms this dropped to 30% and at large firms it was 41%. This might be an area that firms would like to review again.

[SECTION 3]

Lock-up

Key questions to consider

1. Given that clients don't want nasty shocks when they are billed, why do we wait so long before we talk about money?

2. Do fee earners have the necessary management information available to manage lock-up?

3. Are the appropriate carrots and sticks in place to deliver improved lock-up?

LOCK-UP

The vast majority of legal businesses fail to manage lock-up effectively and consequentially provide far too much credit to clients, which potentially generates cash flow problems. Having said that, lawyers are naturally cautious and do not like borrowing money.

The result is that firms will require considerable capital from the partners, and there will need to be some delay between generating profits and those profits being distributed to the partners. If cash flow could be improved then there would be less pressure on the firm and less capital would be required.

> "If cash flow *could* be improved then there would be *less pressure* on the firm and less capital required"

15. Work in progress (WIP) days

REGION	SMALL			LARGE			TOTAL		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London	7	15	22	38	55	78	21	46	67
South East	13	32	57	31	60	80	18	46	72
South West	25	46	63	42	73	111	28	53	80
Wales, Midlands, East of England	27	40	88	47	78	103	34	66	97
North East, North West	25	48	74	32	60	93	29	52	91
Scotland	29	42	62	30	56	64	28	47	64
Total for all regions	23	42	67	38	61	98	28	52	84
Very large firms	49	68	101	39	64	103	42	67	103

Table 15 shows the amount of WIP days being carried by firms. This is a measure of how long it takes from the recording of an hour to the billing of that hour. The total median figure is 52 days, while the lower quartile position is 28 days and upper quartile performance is 84 days. It is interesting to see how performance worsens as firms get larger. The median for small firms is 42 days, for large firms 61 days and for very large firms it is 67 days. There was also some variance by region, with London and South East doing equal best at 46 days, while Wales, Midlands and East of England performed worst at 66 days.

16. Debtor days

REGION	SMALL			LARGE			TOTAL		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London	12	28	54	40	49	81	30	47	76
South East	27	41	52	46	52	64	35	48	61
South West	18	34	71	35	46	61	26	41	70
Wales, Midlands, East of England	17	34	66	38	50	62	31	46	63
North East, North West	22	53	87	27	44	65	26	46	69
Scotland	25	44	68	55	80	117	36	52	80
Total for all regions	20	39	68	36	50	68	30	47	69
Very large firms	37	49	60	50	70	94	42	56	76

Table 16 provides feedback on debtor days. This is a measure of how many days it takes to get a bill paid from when it is issued. The median figure was 47 days in total, falling to 30 days at the lower quartile level and rising to 69 days at the upper quartile level. Once again, it is interesting to see that the larger firms fared worse. The median for small firms was 39 days, for large firms it was 50 days and for very large firms 56 days. While the very large firms tended to be more profitable than the smaller firms, they were not so successful at managing cash flow. This is probably because more people need to be managed – and perhaps more time should be spent training fee earners on what they should be doing to manage cash flow more effectively.

17. Total lock-up days (WIP + debtor days)

REGION	SMALL			LARGE			TOTAL		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London	27	50	102	96	114	159	80	107	139
South East	60	88	102	85	109	139	74	92	122
South West	59	74	127	91	130	184	68	98	154
Wales, Midlands, East of England	57	87	152	106	123	169	85	119	161
North East, North West	62	108	137	86	108	153	78	108	150
Scotland	76	98	116	124	145	158	79	106	135
Total for all regions	60	89	124	92	121	158	76	107	146
Very large firms	94	122	153	112	153	175	107	138	164

Table 17 provides statistics on total lock-up figures. This measures how many days it takes between a fee earner recording an hour to the cash being received from the client. It shows that the total median figure was 107 days. For small firms the figure was 89 days, for large firms it was 121 days and for very large firms it was 138 days. This confirms that larger firms struggled to manage cash flow when compared with smaller firms.

Predictions from the NatWest conferences – what will happen in 2014?

Lock-up – % movements in 2014

	> -20	-10 to -20	-10 to 0	0	0 to 10	10 to 20	> 20
FEES < £1.5 MILLION							
WIP days	0	8	16	39	32	5	0
Debtor days	0	13	16	34	29	8	0
FEES > £1.5 MILLION							
WIP days	0	8	29	37	24	3	0
Debtor days	0	8	33	26	31	3	0
TOTAL							
WIP days	0	8	22	38	28	4	0
Debtor days	0	10	25	30	30	5	0

A reduction in debtor and WIP days would be a positive thing and help to improve cash flow. In the survey, only 30% of all firms believed that WIP days would be reduced and just 35% of firms believed that debtor days would be reduced. At small firms, 24% thought that WIP days would diminish and 29% believed that debtor days would be reduced. At large firms there was more optimism, with 30% believing that WIP days could be reduced and 41% believing that debtor days could be controlled better.

This highlights that firms have less confidence about managing their lock-up than in their ability to increase fees and profits.

[SECTION 4]

Finance

Key questions to consider

1. Do we have sufficient capital to run and grow the business?

2. Is it time to look again at our legal structure and how capital can grow within the firm?

3. Is it right that we aim to fully distribute profits?

FINANCE

Firms fail when they run out of money. Not making a profit is unlikely to cause a firm's immediate collapse, but running out of money can cause immediate failure. All firms should continually monitor their bank balance and prepare regular cash flow forecasts to ensure that they can live within their agreed bank facilities.

Banks make money out of lending to businesses – but they are unlikely to lend to anyone who comes knocking at their door on the verge of collapse. Law firms are fairly prudent and do not feel comfortable with too much debt. Table 18 shows the year end bank balance of the firms surveyed. The median was £20,000 in the bank, with not a great deal of regional variance, although the South East figure was £104,000.

18. Year end bank balance (£000s)

REGION	SMALL			LARGE			TOTAL		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London	-17	16	251	-5	27	166	-8	20	213
South East	-19	19	76	171	387	643	4	104	387
South West	-33	2	40	-147	-10	302	-93	1	66
Wales, Midlands, East of England	-30	8	58	-392	-54	132	-113	-3	69
North East, North West	-4	35	100	-211	60	345	-104	35	253
Scotland	-28	29	75	-90	171	932	-46	30	121
Total for all regions	-26	13	70	-170	66	335	-68	20	146
Very large firms	-76	101	600	-193	282	972	-155	191	686

19. Capacity in overdraft as a % of fees

REGION	SMALL			LARGE			TOTAL		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London	7	10	22	5	9	14	5	10	16
South East	6	9	19	8	14	20	6	11	20
South West	4	7	12	3	12	18	4	8	15
Wales, Midlands, East of England	3	7	13	4	9	16	3	8	15
North East, North West	7	11	20	3	10	20	4	11	20
Scotland	4	11	16	4	6	11	4	10	15
Total for all regions	4	9	17	4	10	17	4	9	17
Very large firms	5	10	17	5	11	16	5	10	16

Table 19 looks at the capacity to borrow more money, compared with annual fees, when considering the year end office account balance and the overdraft facility available. It is interesting that the median figure, at 9% of fee income, represents about 33 days of income. The lower quartile point is about 15 days and the upper quartile point represents about 62 days of income. This highlights how quickly and easily many firms could become insolvent if their lock-up deteriorated by relatively small amounts.

Firms can become less reliant on bank finance if more partner capital is introduced and retained. One way of benchmarking is to express that as a percentage of annual fees. Given that the median firm had total lock-up of 107 days (see Table 17), this could be financed by having partner capital equal to 29% of fees. Table 20 shows the overall median figure was 25%. Scottish firms had more than other regions, at 38% of annual fees. Small firms had a median figure of 24%, large firms had 26% and very large firms had 28%; this is in line with the higher levels at larger firms in table 17.

20. Partner capital as a % of fees

REGION	SMALL			LARGE			TOTAL		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London	9	18	29	22	27	44	16	24	40
South East	6	17	37	15	31	44	11	22	41
South West	15	18	29	12	24	34	15	21	31
Wales, Midlands, East of England	16	22	30	18	23	33	17	23	33
North East, North West	12	31	46	15	26	39	15	28	44
Scotland	24	42	51	30	35	42	25	38	50
Total for all regions	12	24	41	17	26	39	15	25	40
Very large firms	19	25	35	23	31	48	21	28	40

A bank will not be happy with partner capital if that capital has been borrowed by the partners and the firm has been asked to provide a guarantee that it will repay the loan when the partner leaves the firm.

Table 21 shows the percentage of bank borrowings (including borrowed partner capital) as a percentage of real partner capital. The lower quartile figure for small firms is 0%, showing that there is no debt, while the median figure for all firms is 41%. The upper quartile figure for large firms in Scotland is 107%, showing borrowings that are in excess of real partner capital. Firms in this position should think again about their facilities, the amount of capital being provided by the partners and the ability of the firm to manage lock-up, as their bankers may become less happy to continue to provide so much finance in future.

21. Bank borrowings as a % of real partner capital

REGION	SMALL			LARGE			TOTAL		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London	0	41	81	3	22	58	1	37	73
South East	0	41	123	2	28	84	0	37	99
South West	0	29	84	26	61	91	1	44	87
Wales, Midlands, East of England	0	14	58	24	80	125	7	47	103
North East, North West	0	36	122	9	31	87	4	33	104
Scotland	22	49	86	22	91	146	22	53	107
Total for all regions	0	37	82	11	47	103	5	41	97
Very large firms	9	63	105	12	25	98	9	40	103

Many firms carry significant client account balances. While this money does not belong to the firm, it has been able to earn premium interest on such money held in general client account, over and above what the individual clients would have got had their money been held in separate designated client accounts. In recent years, returns have been considerably lower because of long-term low interest rates but this may change in the future.

The amount of money held is also an indicator of how busy a firm might be and with what value of transactions.

22. Client bank balance as a % of fees (£000s)

REGION	SMALL			LARGE			TOTAL		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London	121	260	333	15	31	136	19	109	287
South East	207	357	452	114	203	301	155	264	385
South West	157	281	419	51	133	214	96	212	319
Wales, Midlands, East of England	170	256	434	118	201	272	120	221	328
North East, North West	47	191	362	11	81	148	14	115	294
Scotland	0	19	195	0	0	62	0	6	146
Total for all regions	58	231	401	28	121	242	37	165	313
Very large firms	50	133	208	18	61	99	27	91	141

Table 22 shows the client bank balance at the year end as a percentage of annual fees. The median figure for smaller firms at 231% was nearly double the median figure for larger firms at 121%. In the South East, the upper quartile figure for smaller firms is 452%, representing 4.5 years of fee income. The median figure for all firms is 165% with regional variances, peaking at 264% in the South East. Given that the survey covers firms with combined fees of £1.08 billion, this suggests that if client money balances are 165% of fees, client money held will be about £1.8 billion.

Predictions from the NatWest conferences – what will happen in 2014?

Fee income – % movements in 2014

	> -20	-10 to -20	-10 to 0	0	0 to 10	10 to 20	> 20
FEES < £1.5 MILLION							
Bank balance	0	0	3	33	41	18	5
FEES > £1.5 MILLION							
Bank balance	0	0	16	24	42	11	8
TOTAL							
Bank balance	0	0	9	29	42	14	6

Only 9% of firms believed that their office bank balance would decrease over the next year and 62% believed their bank balance would improve. This prediction conflicts with the predictions on lock-up, where there was little confidence about any real improvement. It is still possible for firms to improve their bank balances by slowing down distributions, retaining profits and asking partners for additional capital.

Conclusion

We have already detailed how important it is for all firms to benchmark themselves against their peers in order to assess how well they are performing and to identify how financial performance can be improved.

We hope that this report provides the robust data required to undertake effective benchmarking, and that it offers practical advice on how to interpret the outputs and implement strategies to deliver improved financial performance.

To aid you in this objective, the following table gives you the ability to examine your own firm's performance on a comparative basis against the upper quartile (UQ) output across total firms.

For some, the results may be worrying but will hopefully motivate the implementation of an action plan. For others, this exercise will serve to simply endorse the business plan and operational model already in place.

	UQ	FIRM'S RATIO	ACTIONS REQUIRED
Fees per equity partner (£000s)	680		
Fees per fee earner (£000s)	180		
Profit as % of fees (%)	31		
Profit per equity partner (£000s)	147		
Chargeable hours (per year)	1,001		
Recovered rate per hour (£s)	189		
WIP days	84		
Debtor days	69		
Total lock-up (days)	146		

Research and methodology

We analysed the financial data, representing the performance of 380 legal firms operating in the small to medium enterprise (SME) space, employing 14,400 people in total (including 1,875 partners), and covering year end 2013. The total for all regions in each table represents the aggregate figure for all participating firms, across all regions. Further details of the methodology of this report are available on request.

For the purposes of this report, those firms with fees of less than £1.5 million are described as 'small', while those with fees in excess of that amount are described as 'large'.

Contact us

If you have any comments on the contents of this report or would like to have a discussion on any aspect of the legal profession more generally, please contact Steve Arundale, Head of Professional Sectors & Financial Institutions, Business & Commercial Banking on 020 7747 1393 or by email at steve.arundale@rbs.co.uk

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