2019 Legal Benchmarking Report

Royal Bank of Scotland

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Foreword

As the Commercial Head of Professional Services, I am delighted to present our seventh edition of the Royal Bank of Scotland annual legal benchmarking report which focuses on firms operating at the SME level across Wales, England and Scotland. Working alongside Robert Mowbray, our findings provide highly valued insight comparing the financial performance of local and national peers. We believe firms can employ this report to target areas of improvement to enhance profitability and working capital management.

This year's report consolidates the financial performance of 148 legal firms employing 10,500 people, covering the financial year end 2018, and also reviews the actual performance predicted by firms during the year.

The combined fee income of the firms in the survey is £1bn. The combined profits were £284m and cover 980 equity partners. The information is broken down both by region and size which results in some interesting findings and trends.

In a year when Brexit has continued to dominate our thoughts and resulted in significant uncertainty to both the economic and political landscape, it is pleasing to see that, despite headwinds, the legal sector continues to demonstrate growth at a rate consistent with previous years.

There are a number of key thematics which continue to impact the sector including the threat of cyber attacks, the adoption of AI, the increasing trend of Alternative Business Structures, the challenge of attracting and retaining talent and of course Brexit. This year the survey asks respondents how their own firm is likely to be impacted by these themes. What is clear is that there is a significant variance of views – what one firm might see as a threat could be viewed as an opportunity by another.

The report highlights that average fees per equity partner now stands at £608,000, a further increase of over 7%, or £40,000, from the prior year, which materially outstrips inflation. Average fees per fee earner were £134,000, a modest £2,000 increase from the previous year, demonstrating how difficult it is for firms to increase revenue per lawyer.

The average profit per equity partner (PEP) now stands at £128,000 which is £20,000 higher than the figure reported in the 2018 survey. The average profit margin has fallen from 22% to 21% this year, the third year in succession we have seen a decline. This shows that the growth in PEP is coming from an increase in volume which has been reduced by a fall in efficiency.

It is too easy for firms to focus on fees earned as opposed to PEP, and improving margins, efficiency and lawyer productivity should be front and centre of our thoughts. A thorough analysis of the type and profitability of work undertaken is key to addressing this steady decline in margin.

The report shows a further improvement in total lock-up to 99 days. This represents somewhat of a landmark for the sector given it's the first time since the survey commenced seven years ago that this number has been sub-100 days. While it is encouraging to see gains being made in this area, there is still room for significant improvement and the report poses some interesting questions which all firms should ask themselves.

In this year's report we wanted to reflect on the longer-term trends in the legal sector by producing a seven-year summary of the key metrics taken from previous benchmarking reports. The results do show some interesting longer-term trends and I would encourage firms to consider their own performance over this prolonged period as part of any benchmarking exercise.

The UK legal sector continues to be hugely important within Royal Bank of Scotland. We have a long and proud history of supporting legal firms throughout the UK in developing a successful and sustainable business. Our specialist Relationship Directors understand the Professional Services sector and benefit from accredited training and regular sector updates. If you would like to speak to one of our team, please get in touch.

Finally, I would like to thank Robert Mowbray for once again sharing his sector knowledge and experience in the production of this report and its continued development over the last seven years. I hope you enjoy this report.

Dave Weaver

Commercial Head of Professional Services,
The Royal Bank of Scotland

Executive summary

This annual survey is a substantial review of law firms with fee income of up to £67 million. One hundred and forty-eight firms employing 10,500 people took part in the survey from across England, Wales and Scotland. The total income of the firms in the survey was £1 billion.

Some of the more interesting findings of the survey were:

Profits

- The median profit per equity partner (PEP) is £128,000 which is £20,000 higher than the figure reported in the survey last year.
- The median PEP in small firms of £95,000 is only just over half of the median figure in large firms, being £184,000.
- The median profit margin dropped for the third year in a row to 21% which shows that the growth in PEP is coming from an increase in volume, which has been reduced by a fall in efficiency. Firms need to focus on delivering better margins and on lawyer productivity.
- If there is more focus on profitability and firms could perform at the upper quartile level in terms of gearing, chargeable hours, recovered rate and margin then a PEP figure of £542,000 can be achieved. This is over four times higher than the current median profit per equity partner of £128,000.

Fees

- Median fees per fee earner were £134,000 which is slightly up from £132,000 in the previous year. It is proving to be very difficult for firms to increase the revenue being generated by each lawyer.
- The median fees per equity partner is £608,000 being an increase of £40,000 on last year. Firms continue to deliver sizeable year-on-year increases in this measure.
- Fees have grown by 4% since last year. However, there is a reduction in the lower quartile by 1% and an increase in the upper quartile of 10%. This demonstrates how some firms are growing considerably faster than others.

Lock-up

- Median lock-up is 99 days, being a reduction from last year of two days. The upper quartile point is 62 days and the lower quartile point is more than double at 134 days.
- As firms get larger they find it increasingly difficult to manage lock-up. Median lock-up for small firms is 78 days, for large firms it is 125 days.

Finance

- Law firms remain cautious about carrying debt and the median bank balance at the financial year end was £65,000.
- The spare capacity in the overdraft has a median figure of 9% of annual fees, with little variance in this number for different sizes of firm. This suggests that the median firm would run out of money in about 33 days if they received no further money from clients in that period. Given that there are about 10,000 firms in England and Wales, this suggests that around 5,000 firms are potentially less than a month from potential insolvency.
- Client money balances are typically 158% of annual billings, being a considerable increase from 116% last year. The firms in the survey are holding about £1.56 billion in client deposits. It is clearly important that firms do everything possible to ensure that these funds are kept secure and that there is a clear focus on cyber security.

About the author

Robert Mowbray is a Chartered Accountant, trainer and consultant who has worked in and for professional firms for over 30 years.

His involvement with law firms began in the late 1980s and quickly developed into a niche business. His book entitled 'Maximising the profitability of law firms', published in the mid-1990s, was the first book on law firm financials. He has been involved in a large number of surveys in the legal profession which have focused on the financial health of firms, but he has also worked on many other surveys to research other aspects of law firm performance. He is the author of 'Law firm finance & administration handbook – A practical guide for COFAs and finance professionals' which was the first book to be published on the role of the COFA.

Robert works each year with about 80 firms and helps them with anything to do with improving 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 which reward improved business performance and strategic and business planning.

He has worked with law firms in over 40 countries and has worked with close to 1,000 firms in total. His clients range from the global elite, through major regional firms and to many small firms and sole practitioners. He is an owner of Taylor Mowbray LLP. This is a niche business which focuses exclusively on law firms which he runs with Janet Taylor, who is an authority on the SRA Accounts Rules.

If you have further questions for Robert, please feel free to contact him via **www.taylormowbray.com**

A few focused improvements can quickly lead to a significant improvement in performance and cash flow. Comparing your existing performance against that of peer group firms is a good way to determine where your opportunities lie.

Introduction

We will probably look back on 2018 as the year where Brexit dominated everything. Change is normally a good thing for lawyers as they help their clients when their circumstances change. Growth has continued in the legal sector at a similar rate to previous years.

Growth generally requires more lawyers and a major problem in many firms is that it is getting increasingly difficult to recruit high-quality people. Artificial intelligence is becoming more widely used and this is forcing many firms to think again about how services are to be provided and the basis on which fees can be raised.

Competition continues to increase both from traditional firms and new legal businesses. There would appear to be sizeable interest among investors about the prospect of investing in legal businesses and there have been more firms that have secured investment and some further firms have sought a listing. The large accounting firms are becoming a greater threat to many of the larger firms and it will be interesting to see whether this will continue over the next few years.

The cost of regulation continues to rise and this is undoubtedly having an impact on profit margins. Failure to invest in cyber security could be fatal for any firm as it would be difficult to survive a major loss of client data or money.

A few focused improvements can quickly lead to a significant improvement in performance and cash flow. Comparing your existing performance against that of peer group firms is a good way to determine where your opportunities lie. Please make best use of the information in this survey.

This is the seventh year of the survey and we were keen to continue with some of the reporting which has made the survey so popular while adding in some new elements to give readers something extra to consider. The report is based on contributions from 148 firms using figures from their financial year ending in 2018. The combined fee income of the firms in the survey is £1 billion. The combined profits were £284 million and cover 980 equity partners. The information is broken down into several regions as there is a significant difference in the performance of law firms across the UK. The report also analyses the performance of firms of different sizes to see if there is an optimum size of firm. At the end of each chapter we have also provided the longer-term trends over the last seven years. There is also a new comparison over the last seven years to illustrate the bigger changes that are happening in the legal sector.

The report provides median, lower quartile (LQ) and upper quartile (UQ) figures. Firms want to be the best at everything, but this is clearly unrealistic. Firms tend to talk about what they are good at and try to get even better at this rather than focusing on areas of under-performance where improvements might more easily be achieved. When looking at the tables, it is perhaps best to focus on the areas where your firm is currently below the upper quartile figure and to think about what needs to be done to generate better results.

Table 1 shows an analysis of the firms in the survey by region and by size. Three regions were grouped together to form Wales, Midlands and East of England as there were not enough firms for these regions to be analysed separately. The survey has divided the firms into two sizes of firm. Those with annual fees of less than £2.25 million are described as 'small' while those with fees more than £2.25 million are classified as 'large'. The tables contain an extra line of data for the 'very large' firms being firms with annual fees in excess of £5 million. These firms have then been subdivided into 'small' (annual fees between £5 million and £10 million) and 'large' being firms with fees in excess of £10 million. The results for these very large firms have also been included in the figures for 'large' firms, as was the case last year.

Table 2 shows the split of firms taking part in the survey by constitution. There are 67 LLPs compared to 35 partnerships and there are 45 companies. This demonstrates that a large majority of traditional partnerships have now become either LLPs or companies. It is perhaps surprising that there are still so many partnerships remaining, given that virtually all new firms choose to establish themselves as either a company or an LLP. 45% of firms in the survey are LLPs while in the very large firms this increases to 72%. There are some firms that spend too much time worrying about whether they have got the right structure and not enough time focusing on whether they are building a strong business. Having said that, firms should reflect periodically on what other firms are doing and whether they are operating with the most appropriate legal structure for their firm.

Table 1 – Firms by location	Small	Large	Total
London & South East	10	21	31
South West	8	16	24
Wales, Midlands & East of England	19	17	36
North East & North West	13	12	25
Scotland	19	13	32
Total	**69**	**79**	**148**
Very large firms	22	29	51

Table 2 – Firms by constitution	Partnership	LLP	Company	Sole Practitioner	Total
London & South East	7	17	7	0	31
South West	5	15	4	0	24
Wales, Midlands & East of England	10	12	14	0	36
North East & North West	2	10	12	1	25
Scotland	11	13	8	0	32
Total	**35**	**67**	**45**	**1**	**148**
Very large firms	6	36	8	0	50

Fees

There continues to be confusion in many firms between growth and profit. Ultimately, firms should be focused on increasing profits. It is clearly possible to make more profit without increasing fees by focusing on controlling and cutting expenditure or by improving the profitability of the work being done by replacing unprofitable clients and matters with more profitable work. However, when the economy is growing, it should also be possible to make more money by growing fee income. It is clearly important that the growth is profitable growth and not arising from poor quality and unprofitable work.

One of the widely used measures of performance in legal businesses is fees per fee earner as it demonstrates the level of income being generated by each fee earner. This can then be compared to 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 possible to make even higher levels of profit than have been achieved historically.

Table 3 shows the fees per fee earner being generated in the surveyed firms. The median figure overall is £134,000 which is £2,000 higher than last year, which has halted the fall in this key metric over the last two years. This drop has been happening even though fee income in most firms is rising. This trend suggests that perhaps firms are too quick to take on new staff to cope with the increase in fees, rather than thinking about how the productivity of existing staff could be improved. It is no surprise to see that for small firms the median is lower at £127,000 while for large firms the figure is £143,000. In very large firms, the median is £157,000. The difference between being upper quartile across all firms at £182,000 and the £108,000 achieved at the lower quartile point equates to a 69% difference which highlights the need to focus on fee earner productivity.

There are very significant regional differences once again. The overall median in London & South East is £173,000 while the equivalent figure in Wales, Midlands & East of England is £112,000. It is important in all firms that there is constant measurement between the fees generated per fee earner with the salary cost of that fee earner. The danger is that as fees increase, the cost of the fee earners will grow at the same or an even faster rate and there will be no improvement in profitability.

Table 3 – Fees per fee earner (£'000)	Small			Large			Total		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London & South East	112	131	183	129	190	304	122	173	221
South West	94	105	177	132	164	185	101	159	189
Wales, Midlands & East of England	92	105	136	103	117	128	93	112	130
North East & North West	98	106	127	125	136	151	98	123	141
Scotland	132	146	225	116	151	177	124	149	218
Total	**98**	**127**	**158**	**118**	**143**	**199**	**108**	**134**	**182**
Very large firms	110	127	161	149	184	239	122	157	227

Fees per equity partner is another useful measure. Combining the fees generated per fee earner with the number of fee earners working for each equity partner calculates 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

Table 4 shows the fees generated per equity partner and there is considerable variation across the regions and across the different sizes of firm. The median figure across all firms was £608,000 compared to the median in the survey last year of £568,000 which represents a significant 7.0% rise.

The median figure is £608,000 but the lower quartile figure is £439,000 and the upper quartile figure is £931,000. The upper quartile figure is therefore more than twice that achieved at the lower quartile point. It is important for firms to focus more on the billings of the partner and their team, rather than simply on the personal billings of the partner. If partners are too focused on achieving their own personal targets for billings, then not surprisingly the outcome might be that the team in total falls short of their target.

The median figures vary by region with the South West achieving the highest figure of £813,000 while Scotland showed the lowest figure at £476,000.

Table 4 – Fees per equity partner (£'000)	Small			Large			Total		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London & South East	301	410	575	662	765	1,179	444	683	941
South West	426	447	554	776	959	2,083	490	813	1,031
Wales, Midlands & East of England	343	453	592	582	705	1,033	451	575	800
North East & North West	296	450	651	970	1,326	2,253	450	654	1,181
Scotland	320	432	490	502	666	858	324	476	652
Total	**318**	**448**	**572**	**609**	**829**	**1,360**	**439**	**608**	**931**
Very large firms	561	763	998	801	1,179	2,460	662	929	1,755

Table 5 shows the rate of fee growth compared to last year. While the overall median shows growth of 4%, the lower quartile position was a fall of 1% and the upper quartile position was growth of 10%. These figures are like those reported last year. The median for small firms was 2% growth, for large 4% and very large firms it was 5% which demonstrates consistent growth across all sizes of firm.

It is also interesting to see that the median growth rate is almost identical across all regions which goes against the notion of a north-south divide.

There is always a danger if there is too much focus on increasing fees, as a firm should only be looking to grow if the additional work is profitable. The primary focus should be on sustainable increases in profit.

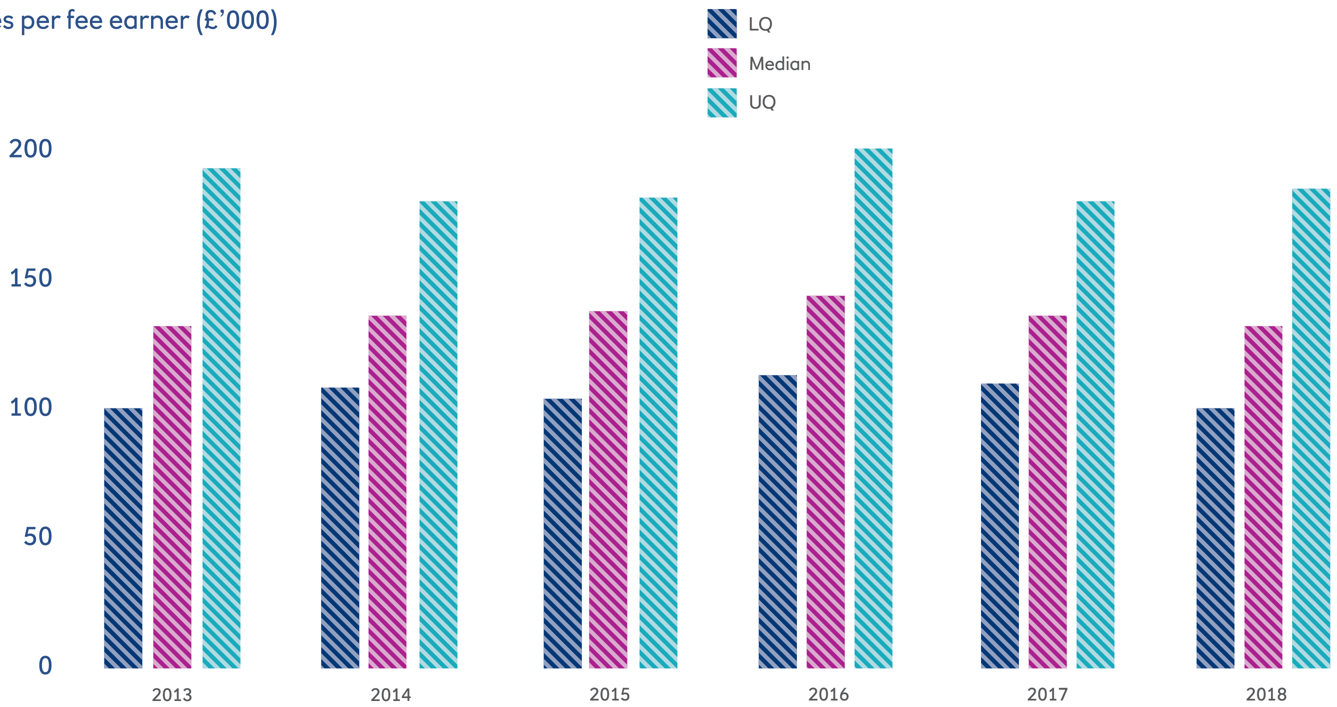
Table 5 – Fees as a percentage of last year	Small			Large			Total		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London & South East	100%	102%	110%	101%	105%	113%	100%	103%	112%
South West	98%	100%	107%	102%	105%	112%	100%	104%	112%
Wales, Midlands & East of England	95%	99%	108%	102%	107%	108%	98%	103%	109%
North East & North West	97%	104%	106%	101%	104%	107%	99%	104%	107%
Scotland	98%	105%	109%	102%	102%	106%	101%	104%	108%
Total	**97%**	**102%**	**109%**	**102%**	**104%**	**110%**	**99%**	**104%**	**110%**
Very large firms	101%	103%	108%	102%	106%	112%	102%	105%	110%

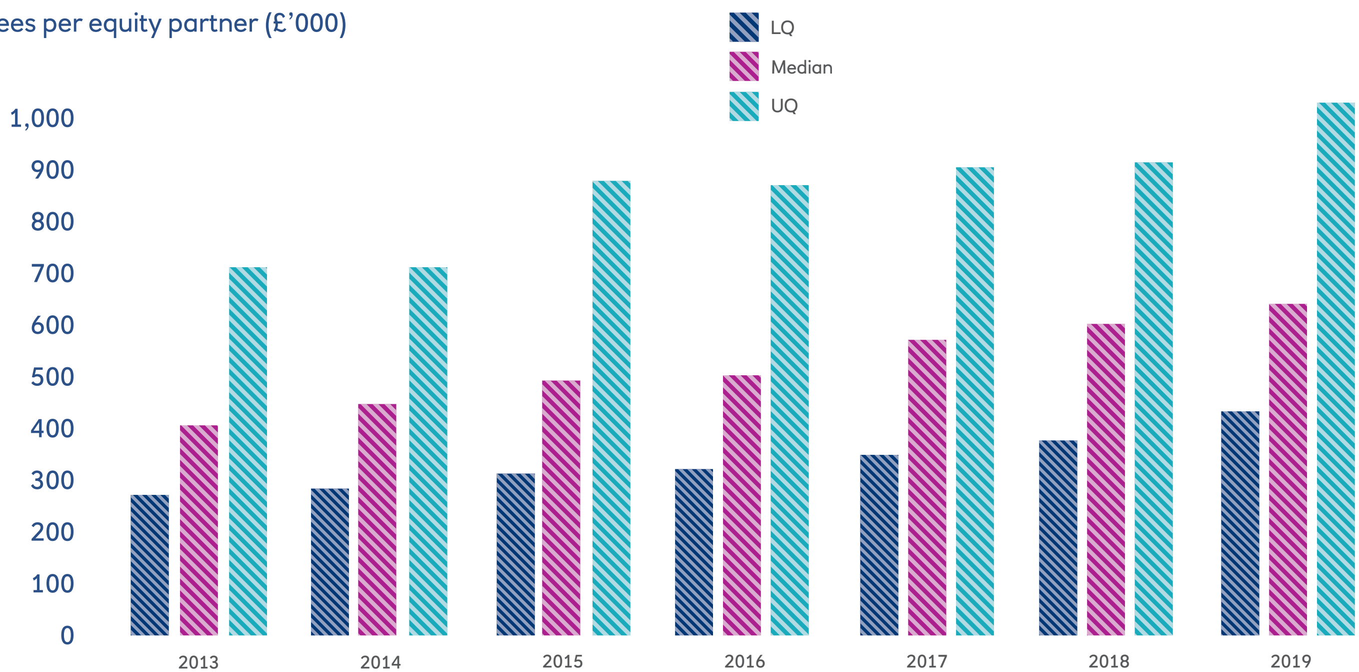
Historically, prior to the 2008 crash, it was true in many legal businesses that the profit for the year was often close to the bank interest earned figure. In other words, the law firm would cover its expenses with the fees earned and the profit would come from the premium interest earned on client accounts. The last few years have seen returning growth in transactional work which has resulted in law firms holding more client money again. This however, coupled with the fall in interest rates, has meant that the amount of interest being earned is still very low compared to the past. This has meant that most firms have had to look again at how they make money from legal services and to become less reliant on the interest earned on client account. We have had the first increase in base rates in a decade and if this increase is repeated in the coming years, then interest earned could become more significant, especially as the revised Accounts Rules will potentially allow firms to retain more of the interest being earned than is currently the case.

Table 6 shows just how little is still being earned in interest with the median figure being 0.21% of fee income. Table 4 showed that fees per equity partner totalled £608,000, which suggests that the interest earned per partner at 0.21% of fee income would be £1,277 which would presumably be insufficient for most equity partners to live on!

Table 6 – Interest received as percentage of fees	Small			Large			Total		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London & South East	0.01%	0.10%	0.22%	0.08%	0.82%	1.69%	0.04%	0.24%	1.31%
South West	0.10%	0.60%	0.73%	0.40%	0.63%	1.84%	0.33%	0.60%	1.18%
Wales, Midlands & East of England	0.15%	0.51%	1.73%	0.21%	0.49%	1.31%	0.19%	0.50%	1.52%
North East & North West	0.00%	0.06%	0.34%	0.06%	0.23%	0.50%	0.00%	0.11%	0.36%
Scotland	0.03%	0.06%	0.10%	0.06%	0.09%	0.17%	0.05%	0.08%	0.12%
Total	**0.04%**	**0.11%**	**0.57%**	**0.09%**	**0.37%**	**1.15%**	**0.06%**	**0.21%**	**0.90%**
Very large firms	0.44%	1.16%	2.02%	0.08%	0.30%	0.75%	0.11%	0.43%	1.23%

Longer-term trends – what do you notice?





Key questions

1. What investments do we need to make to enable fee earners to become more productive?
2. Are we training our fee earners properly so that they maximise their fee-earning potential?
3. Are fee earners focused on fully recording their time?
4. Are we confident about our pricing and can we charge more if we get the service right for every client?

Profit is more important than growth and there are too many firms who make the mistake of thinking that if they grow they are bound to become more profitable.

Profit

The dictionary definition of a partnership is 'two or more people coming together to trade with a view to profit'. Profit is always the most important measure, as it is the profit which is shared among the partners.

It is amazing how many firms focus too much on fees earned and time recorded and not enough on profit. Historically this has been because firms have always found it easier to measure fees billed and time recorded than to calculate the profit earned for different types of work, for individual matters, for individual clients and for different fee earners. As practice management systems have improved, it is now possible to measure the profit being earned on each matter, on each client and in each type of work provided that there is consistency of time capture, as this is the basis for allocating cost to a file.

A common starting point is to look at the profit available for the equity partners as a percentage of fee income. The helpful rule of thumb has always been that good firms will make 33%, with average firms making 25% and with under-performing firms doing even worse.

Table 7 provides some feedback on current performance. In total, the upper quartile score is 31%, the median figure is 21%, down from 22% last year and 23% in the year prior to that, and the lower quartile figure is 12% which is also down from 13% last year. These numbers reinforce the validity of the traditional model and demonstrate that the legal profession is steadily slipping backwards in a competitive market. Even if firms are still growing, they will struggle to make more money if profit margins continue to decline. This is the third year in a row that the median has fallen, and firms should be looking more closely to understand this. Perhaps instead of growing, firms should be looking to drop unprofitable work and replace it with more profitable work. This will require some analysis of profitability but as a minimum, firms should be targeting work that they know can generate profits and not simply keep people busy.

What is of perhaps greater interest in Table 7 are the significant regional variations. While the overall median figure is 21%, in London & South East it is 29% but in the South West it is just 18%.

Small firms have a median of 18% while large firms have a median of 23%. The very large firms have a median of 26%, which indicates that margins improve as firms get larger. There is no reason in principle why the size of a firm should affect the profit margin but perhaps larger firms with greater resources are more focused on the profit that is being made than in smaller firms. The key challenge in all firms is to make sure that the work being done is delivered in the most profitable way.

Table 7 – Profit as a percentage of fees	Small			Large			Total		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London & South East	18%	28%	41%	20%	30%	35%	19%	29%	35%
South West	7%	13%	18%	10%	23%	31%	8%	18%	26%
Wales, Midlands & East of England	11%	20%	25%	13%	16%	24%	13%	19%	24%
North East & North West	8%	16%	34%	16%	19%	28%	9%	19%	33%
Scotland	15%	18%	29%	18%	27%	31%	16%	23%	31%
Total	**11%**	**18%**	**29%**	**14%**	**23%**	**31%**	**12%**	**21%**	**31%**
Very large firms	11%	19%	31%	23%	27%	35%	17%	26%	35%

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

Table 8 shows that the median PEP across all firms is £128,000 compared with £108,000 last year and £120,000 in the previous year. While the increase this year is significant it has little more than reversed the decrease that happened last year. In the 2015 survey, median fees per equity partner were £473,000 and this delivered a median profit of £107,000. Four years later, median fees per equity partner have grown by 29% to £608,000 but median PEP has increased by 20% to £128,000.

Small firms achieve a median of £95,000 and large firms are achieving a median of £184,000. In the very large firms the smaller ones achieve a median of £179,000 while the larger ones achieve a median of £341,000. The difference between the largest firms (£341,000) and the small firms (£95,000) is greater than threefold per equity partner at the median level. While the man in the street would say that £128,000 is a great deal of money, it should be remembered that this figure covers the salary of the equity partner for doing the job and the profit being earned from the business. One can argue forever about what is a fair salary for an equity partner but once this figure has been deducted from the PEP figure, the resultant true profit figure suddenly looks far less impressive, in a large majority of firms.

Not surprisingly there is once again very significant regional variance. The median figure for all firms is £128,000 but this drops to £97,000 in Wales, Midlands, East of England and rises to £169,000 in London & South East.

It is always interesting to look at the upper quartile figures to see what can be achieved. The figure for London & South East at £279,000 is nearly twice the figure of £148,000 in Wales, Midlands & East of England.

Table 8 – Profit per equity partner (£'000)	Small			Large			Total		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London & South East	115	129	140	139	238	363	118	169	279
South West	25	39	97	61	182	316	35	114	192
Wales, Midlands & East of England	66	78	130	85	124	209	72	97	148
North East & North West	26	83	108	179	259	428	76	156	265
Scotland	42	97	120	63	193	215	52	106	194
Total	**36**	**95**	**128**	**105**	**184**	**347**	**63**	**128**	**217**
Very large firms	88	179	265	213	341	653	142	242	494

Table 9 looks at how profits have changed since last year. The overall median increase is 5% compared with 6% last year. The North East, North West saw an 8% increase while the South West saw just a 3% increase. Small firms have fared much better at 11% while large firms have seen an increase of just 1%. The very large firms have also seen an increase in profits of just 1%. While firms would like their profits to be going up faster, it is good that they are continuing to rise faster than inflation. If overheads are now properly under control, then it is not unreasonable to expect to see some further significant increases in profits if steady growth can be achieved in fee income. Fees are up by 4% in Table 5, but profits have only increased by 5%. If the increase in fees arises from an increase in productivity, then profits would rise at three to four times the rate of fees increase. Therefore, there needs to be a more focused emphasis on productivity.

Table 9 – Profit per equity partner as a percentage of last year	Small			Large			Total		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London & South East	10%	12%	33%	1%	1%	5%	1%	4%	14%
South West	3%	5%	15%	0%	1%	16%	0%	3%	17%
Wales, Midlands & East of England	7%	13%	20%	1%	2%	7%	1%	7%	17%
North East & North West	5%	11%	19%	1%	2%	9%	2%	8%	14%
Scotland	6%	9%	20%	0%	2%	4%	2%	5%	10%
Total	**5%**	**11%**	**22%**	**0%**	**1%**	**7%**	**1%**	**5%**	**14%**
Very large firms	0%	1%	2%	0%	1%	2%	0%	1%	2%

A useful way of understanding and benchmarking profitability is with the following model:

	Small firm – PEP £100,000	Large firm – PEP £630,000
PEP = Gearing	4	5
x Hours	1,000	1,200
x Recovered rate/ hour	£125	£250
x Profit margin	20%	30%

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 would have gearing of six. Clearly, the larger the team, the more it can bill and the more profit it can make. The reason why gearing can normally not get too high is to do with the complexity of the work. Only simple legal work can be done with huge gearing; more complicated work requires more supervision and experience.

The second variable is the annual recorded chargeable hours per fee earner. If everyone is busy and confident in 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 who pay the most seem to get the most hours recorded. When the first two variables are multiplied together you are calculating the annual hours generated by each partner through their team.

The third variable is the recovered rate per hour billed. The higher this rate can be then the greater the profit margin will be. Clearly if work is complex it can demand a higher rate than if the work is routine. 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:

Recovered rate per hour = Recorded rate per hour x Realisation %

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

The final variable is the profit margin. This is the percentage of the fee which ends up as net profit. It is the efficiency with which a firm turns fees into profit. If the firm is efficient, then the net profit margin will be high, while if there is inefficiency the margin will drop and can become negative.

The numbers used above show that to go from a PEP of about £100,000 to a PEP of about £450,000 does not require a four-fold increase in all of the variables. Relatively small increases in one or more of the variables can deliver very significant improvements in profitability. Therefore, firms should regularly benchmark against their competitors so that they can identify where they can most easily improve.

Table 10 shows how gearing varies with size of firm and by region. The median figure for all firms is 4.33 compared with a figure of 4.00 in last year's survey. It is encouraging to see this number rising from last year as it should be possible to run with considerably higher numbers, as demonstrated by the very large firms. As work volumes grow, firms need to focus on getting this variable as high as possible, as clients are not going to be willing to pay a partner to do the more routine work that needs to be done on a file. The figure should not however be increased until everyone is working at capacity, as it is always better if additional work can be resourced with the existing fee earners before recruiting new people. Perhaps firms should look at employing some more business development professionals to help fee earners to become more productive. Fee earners will never be fully productive if they spend too much time doing business development and other administrative activities.

It is particularly interesting to see that the median figure in small firms is 3.00 while in large firms it is significantly higher at 5.71. Once again there is an insight into what might be possible if the upper quartile figures are reviewed. In very large firms, the upper quartile figure is 8.78.

If gearing is to improve then perhaps there needs to be a rule that when a file is opened at least two fee earners must be allocated to the file. It is too easy for one person to do everything and the consequences will be lower gearing and poor efficiency. Often the senior lawyer is personally incentivised to do the work on their own as they need to achieve a certain number of recorded hours. Incentives need to be linked to the desired behaviours.

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 that firms had about the same number of fee earners as they did support staff. In the last decade, while secretarial numbers have been falling, firms have found it necessary to recruit new people in business development, information technology and other management roles, so in aggregate maybe nothing has really changed. This is very different to what is seen in large accountancy firms where fee earners often account for 75% or more of total headcount.

Table 11 provides an update on the relationship between fee earners and non-fee earners.

Across all firms, 50% of people are fee earners meaning that 50% are non-fee earners which reinforces the traditional view of a 50/50 split. In small firms the figure is 47%, this rises to 53% in large firms. Last year the figure in total was 55% so there has been significant reduction this year. Investing in non-fee earning staff is good if it improves fee earner productivity. As has been seen in Table 3, this has not really been achieved and has contributed to the lower profit margins seen in Table 7.

There are significant regional variances too, with London & South East seeing a median figure of 63% fee earners compared with South West at 41%.

Table 10 – Gearing (total fee earners per equity partner)	Small			Large			Total		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London & South East	2.17	3.00	8.25	3.14	4.67	6.15	2.53	3.66	6.17
South West	2.83	3.67	4.53	4.61	5.99	9.13	3.33	4.80	6.45
Wales, Midlands & East of England	3.27	3.83	4.90	5.02	6.05	9.75	3.54	4.80	6.24
North East & North West	3.00	4.00	5.50	7.57	10.00	20.00	3.17	5.45	9.58
Scotland	1.73	2.00	3.00	3.13	4.86	5.94	2.00	2.75	5.53
Total	**2.29**	**3.00**	**5.00**	**3.88**	**5.71**	**8.75**	**2.98**	**4.33**	**6.33**
Very large firms	4.23	6.05	6.36	4.66	5.98	10.07	4.53	6.05	8.78

Table 11 – Fee earners as percentage of total headcount	Small			Large			Total		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London & South East	57%	61%	66%	49%	67%	70%	50%	63%	68%
South West	30%	35%	49%	32%	41%	56%	30%	41%	55%
Wales, Midlands & East of England	32%	40%	49%	43%	51%	54%	37%	44%	53%
North East & North West	42%	47%	60%	50%	59%	61%	43%	50%	61%
Scotland	27%	43%	61%	44%	56%	69%	35%	47%	63%
Total	**35%**	**47%**	**61%**	**43%**	**53%**	**67%**	**37%**	**50%**	**63%**
Very large firms	41%	50%	57%	50%	58%	67%	42%	53%	67%

Table 12 looks at the percentage of partners that are equity partners. The median figure in small firms is 100% while in large firms the figure drops to 67% and in very large firms to 60%. All firms, and in particular small firms that are looking to grow, should be clear about the criteria for becoming a partner and then the criteria for becoming an equity partner. A fixed-share or salaried partner will need to be paid fairly for the job that they are doing but there needs to be some incentive to also contribute to the development of the firm. The reward of an equity partner should be linked to the sustainable profit that they are generating. The emphasis should not be on their personal hours and billings but on the profit being generated by their team. It is very healthy to have significant gaps between what senior fee earners earn and what fixed-share partners earn, with a further significant rise up to what the equity partners earn. This will only be achieved if there is a real focus on the maximisation of profit and the required behaviours of everyone involved.

Table 12 – Equity partners as a percentage of total partners	Small			Large			Total		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London & South East	100%	100%	100%	43%	70%	100%	42%	75%	100%
South West	100%	100%	100%	44%	50%	66%	45%	56%	100%
Wales, Midlands & East of England	62%	90%	100%	47%	80%	100%	50%	90%	100%
North East & North West	69%	100%	100%	58%	65%	100%	58%	100%	100%
Scotland	73%	100%	100%	64%	72%	100%	67%	100%	100%
Total	**67%**	**100%**	**100%**	**50%**	**67%**	**100%**	**50%**	**92%**	**100%**
Very large firms	47%	57%	70%	51%	60%	95%	49%	60%	91%

Fees will only be maximised if fee earners are recording all of their time. If clients cannot see the effort which has been put into their affairs, then they are unlikely to pay for this effort. Full time capture is the most basic thing for fee earners to do properly but most fee earners still massively under-record their 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 considered there are still 220 working days in a year, this suggests a capacity of 1,650 hours per year. Fee earners will spend time on business development, knowhow, training and may have some sickness but equally they will often work additional hours either in the office or away from the office.

Table 13 shows the level of chargeable time being recorded and highlights that considerable time is being lost. The overall median figure of 1,000 hours per fee earner equates to 4.5 hours per working day. This does not tally with how most fee earners tell you that they are working hard on client matters for most of every working day and that this often continues when they leave the office as it is increasingly easy to work remotely with the help of technology.

The upper quartile figure at 1,396 is almost double the lower quartile figure of 750. Very large firms perform even better with the figures at every level being nearly 200 hours higher. It is worth noting that larger firms might pay their fee earners more but if they are recording more time then the cost per hour might be lower. Having bonuses for fee earners that are linked to hours recorded can be a very effective way of improving profitability. Even if hours improve and there is no increase in profitability it highlights the inefficiencies that are being incurred which can hopefully then be dealt with through improvements in efficiency.

Law firm culture often confuses time recording with billing and a well-run firm constantly trains their lawyers on the difference between time recording and billing. Time recording establishes the cost of doing a piece of work while billing establishes the value of a piece of work. The difference between the two is the profit being earned. Firms need a clear time-recording policy and guidance on grey areas. Firms also need to focus on the quality of narratives being written because it is always difficult to charge a client for time spent on their affairs if the client sees no value to them from the activity undertaken.

Table 13 – Chargeable hours per fee earner

	Total		
	LQ	**Median**	**UQ**
London & South East	897	1,216	1,678
South West	519	858	1,065
Wales, Midlands & East of England	809	1,023	1,571
North East & North West	800	991	1,200
Scotland	432	566	700
Total	**750**	**1,000**	**1,396**
Very large firms	903	1,200	1,554

Clients continue to put all suppliers, including their law firms, under pressure on fees. Indeed, commercial clients are often better at negotiating fees than solicitors, many of whom have never really had to negotiate hard on fees until relatively recently. There continues to be significant pushback on charging by reference to hourly rates and clients and the courts are looking for more certain and creative ways of charging. It seems unlikely that this price pressure is going to disappear anytime soon. Most firms don’t think that they will be able to increase rates.

Table 14 shows the recovered rate per hour which is being achieved. The median recovered rate for all firms is £146. If the realisation rate were 80%, which is a common figure, this is implying a headline rate of £183 with a further £37 discount at the point of billing. Small firms have a median figure of £110 while large firms have a median of £148. The figure for very large firms is higher again at £161. The difference between the upper quartile figure of £198 and the lower quartile figure of £106 is very significant. Nearly all lawyers believe that they cannot charge any more per hour without losing the client. These figures suggest that this is not true. Lawyers need more confidence when it comes to pricing and they could easily charge more per hour if they are more efficient than other lawyers who are doing the same type of work.

Firms should probably consider greater charge out rate differentials between fee earners at different levels to encourage more work being delegated to more junior levels of staff.

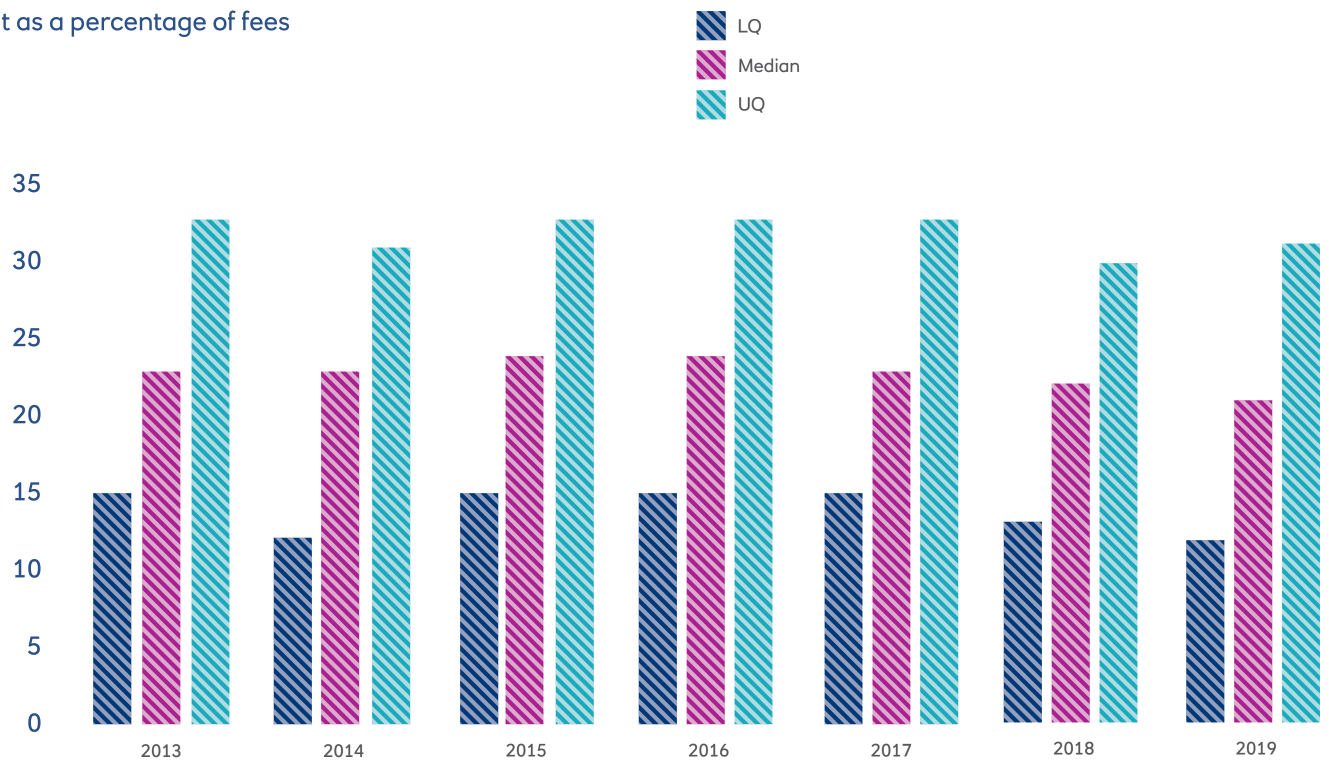
Table 14 – Recovered rate per hour by size of firm (£)	Small			Large			Total		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
Total	**82**	**110**	**189**	**123**	**148**	**198**	**106**	**146**	**198**
Very large firms	126	153	187	144	162	191	128	161	194

Table 15 calculates what the PEP figure would be for firms of different size if they achieved lower quartile, median or upper quartile performance for each of the four drivers of profitability. While it would be difficult to be the best at everything, it should be possible to achieve upper quartile performance at everything. The table shows that achieving upper quartile performance will nearly always deliver a PEP figure of at least 10 times of what would be achieved at the lower quartile level.

Table 15: Profit per equity partner £'000 – using median across all regions	Small			Large			Total		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
Gearing	2.29	3.00	5.00	3.88	5.71	8.75	2.98	4.33	6.33
Hours	562	923	1,335	852	1,029	1,486	750	1,000	1,396
Recovered rate (£)	82	110	189	123	148	198	106	146	198
Margin %	11	18	29	14	25	31	12	21	31
Total PEP (£'000)	**12**	**55**	**366**	**57**	**217**	**798**	**28**	**133**	**542**
Very large firms									
Gearing	4.23	6.05	6.36	4.66	5.98	10.07	4.53	6.05	8.78
Hours	761	921	1,137	1,194	1,504	1,934	903	1,200	1,554
Recovered rate (£)	126	153	187	144	162	191	128	161	194
Margin %	11	19	31	23	27	35	17	26	35
Total PEP (£'000)	**45**	**162**	**419**	**184**	**393**	**1,302**	**89**	**304**	**926**

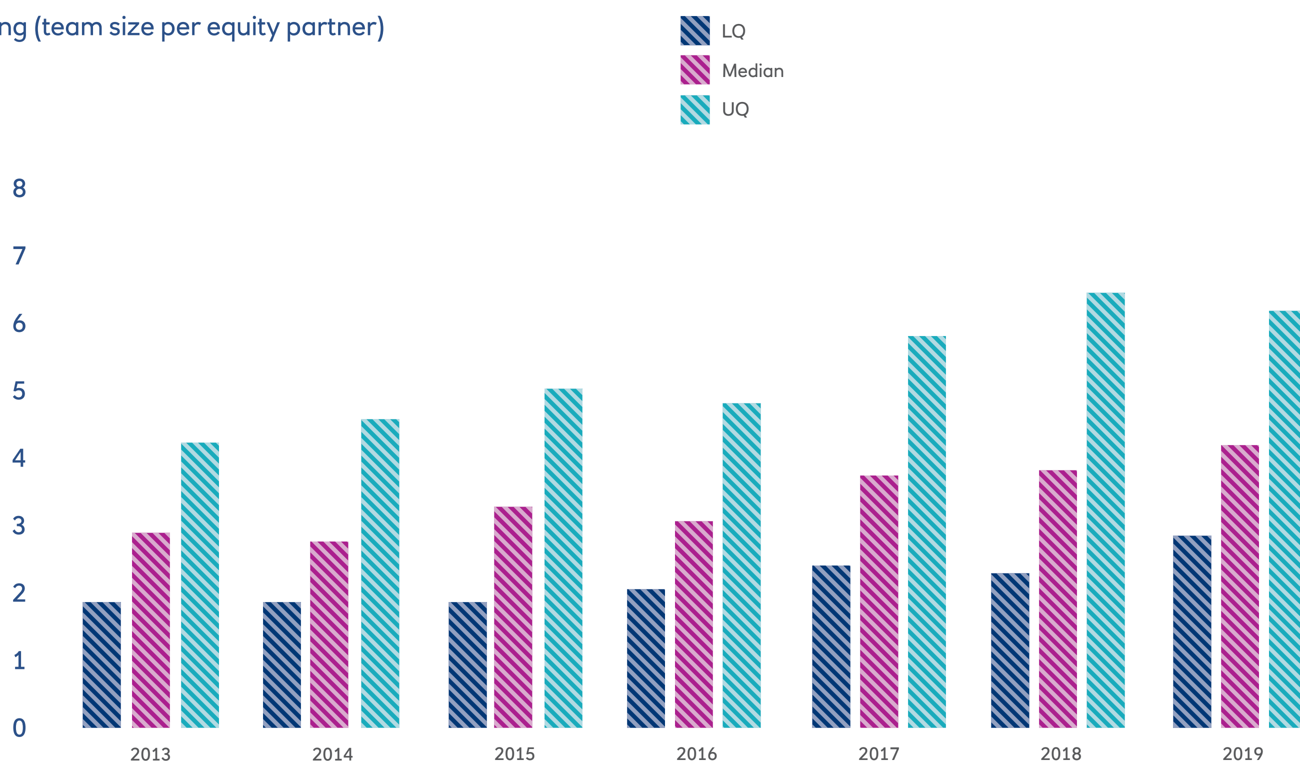
Longer-term trends – what do you notice?

Profit as a percentage of fees

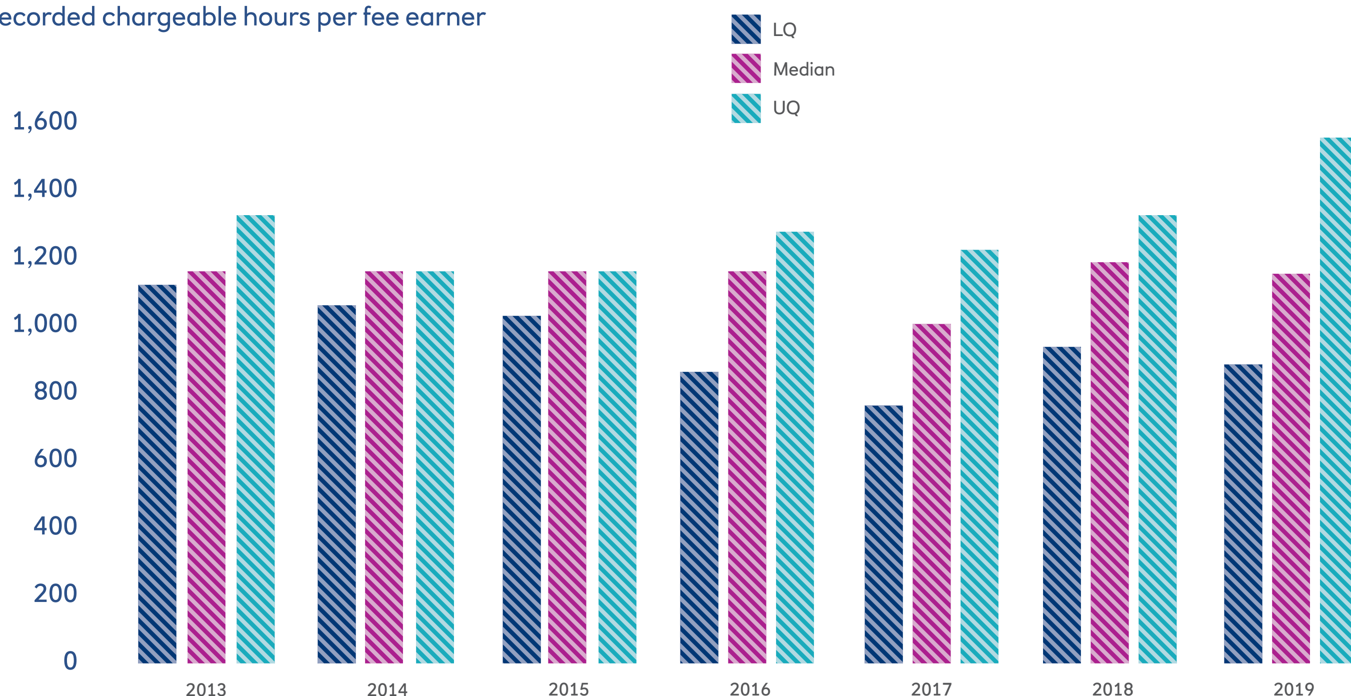


Profit per equity partner (£'000)

Gearing (team size per equity partner)



Recorded chargeable hours per fee earner



Key questions

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 and client expectations of our service?
4. Do we use matter planning tools which help us to understand the profitability of the work we are doing?
5. Do we have a clear strategy and are we making progress in getting it implemented?
6. Is profit sharing properly linked to performance and attainment of our strategic goals?

Lock-up

Most legal businesses fail to manage lock-up effectively and, as a consequence, provide far too much credit to clients which in turn can create cash flow problems. Having said that, lawyers are naturally cautious and do not like borrowing money. The consequence of all of this is that firms will often 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 lower levels of capital would be required.

Table 16 shows the number of WIP days being carried in 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 49 days being a reduction of two days from last year while the upper quartile position is 28 days and lower quartile performance is 76 days. It is interesting to see how performance worsens as firms get larger. The median for small firms is 41 days, for large firms 58 days and for very large firms 63 days.

The figures are consistently high, and firms should continue to act because when work volumes pick up there is always a tendency to focus on finding the resources to get the work done and less focus on managing billing and WIP. There are a wide range of practical steps that can be followed to reduce WIP days including proactively progressing matters rather than waiting for things to happen, splitting the month into two halves each with a pre-set billing date and billing more matters at completion rather than at the month end following completion.

Table 16 – WIP days	Small			Large			Total		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London & South East	65	35	20	81	64	32	78	54	27
South West	60	47	36	87	70	47	77	50	43
Wales, Midlands & East of England	89	53	33	101	83	50	99	68	33
North East & North West	64	48	32	95	39	30	71	42	32
Scotland	37	28	17	59	53	21	55	30	18
Total	**64**	**41**	**23**	**95**	**58**	**31**	**76**	**49**	**28**
Very large firms	103	49	32	89	66	33	94	63	32

Table 17 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 is 41 days which is three days less than last year and 10 days less than two years ago which represents real progress. At the upper quartile level, the figure is 21 days and rises to 67 days at the lower quartile level. Once again it is interesting to see how the larger firms do worse. The median for small firms is 31 days, for large firms 49 days and for very large firms 53 days. While the very large firms tend to be more profitable than smaller firms, they are not as 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 and to get clients to settle their bills.

It is worrying that not many fee earners see their job as recovering outstanding bills and they believe that this is something more easily undertaken by the finance function of the firm. It is also interesting to see how many firms allow more credit than perhaps they should before a bill becomes payable. Given that table 16 shows that 49 days' credit are typically given before a bill is raised there is little reason to be allowing clients further credit before these bills are settled.

Table 18 provides statistics on total lock-up days. This measures in days how long it takes from a fee earner recording an hour to the cash being received from the client. The total median figure is 99 days which is two days better than last year and is the lowest level seen in the seven years of the survey. There is considerable regional variance with the median in South West being 119 days while in Scotland it is just 65 days. There is no reason why so much credit should be given, and it is simply a culture that has persisted for many decades.

For small firms the figure is 78 days, for large firms it is 125 days and for very large firms it is 130 days. This evidence confirms yet again that larger firms struggle to manage cash flow compared to smaller firms.

Despite the improvements seen in the survey this year, all fee earners need to think about what they can do with their clients to increase money on account, to accelerate billing and to take a more active role in credit control. If there is no ownership of the problem, then performance is unlikely to improve.

Table 17 – Debtor days

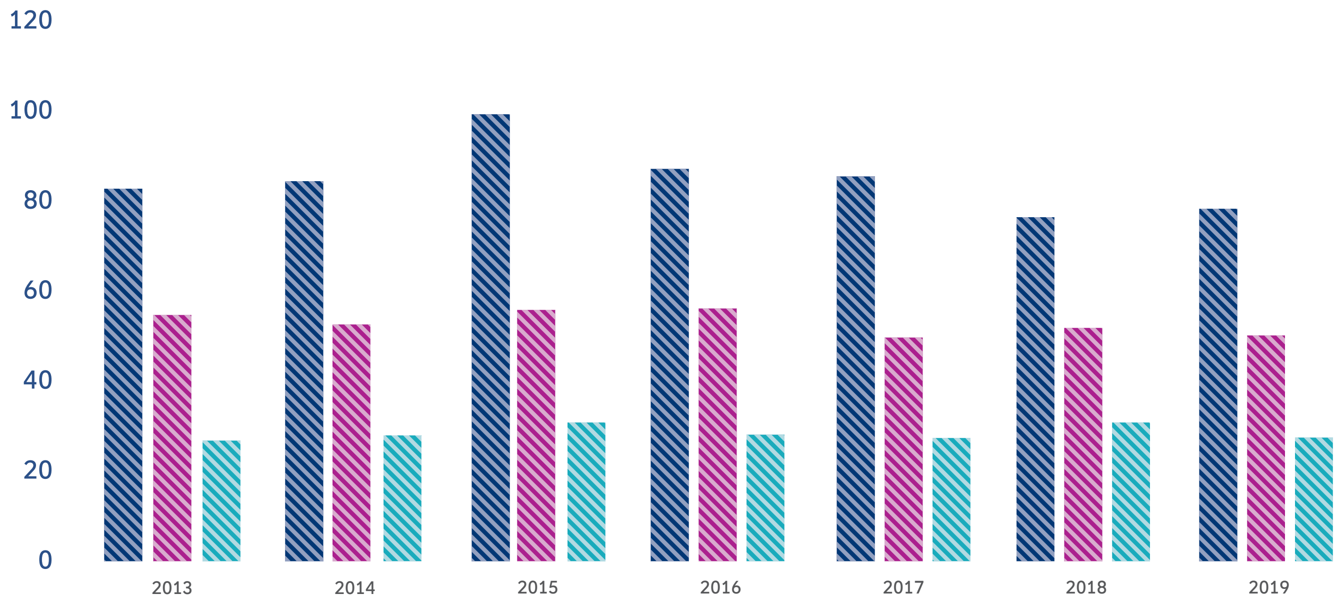
	Small			Large			Total		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London & South East	52	34	21	76	63	40	74	50	26
South West	48	39	21	56	43	18	56	41	19
Wales, Midlands & East of England	58	35	28	53	37	30	57	37	29
North East & North West	57	31	20	74	43	26	69	38	21
Scotland	43	18	12	73	64	31	65	31	16
Total	**52**	**31**	**18**	**73**	**49**	**30**	**67**	**41**	**21**
Very large firms	53	46	35	88	71	49	75	53	39

Table 18 – Total lock-up days

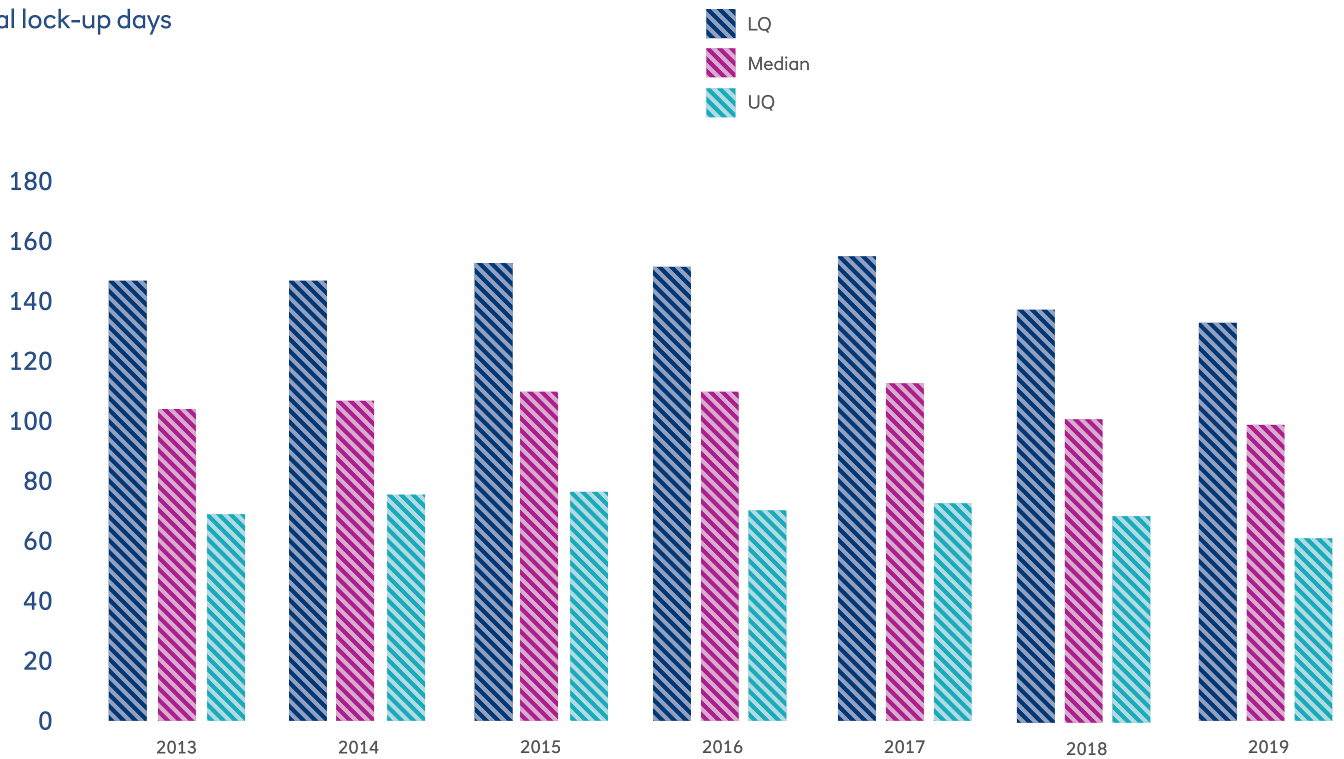
	Small			Large			Total		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London & South East	111	67	54	165	129	96	163	118	68
South West	120	86	56	136	124	109	134	119	85
Wales, Midlands & East of England	130	94	54	160	126	96	157	117	71
North East & North West	99	88	80	142	98	60	114	89	70
Scotland	77	58	37	134	129	65	112	65	45
Total	**103**	**78**	**50**	**153**	**125**	**78**	**134**	**99**	**62**
Very large firms	133	115	84	165	134	125	157	130	108

Longer-term trends – what do you notice?

WIP days



Debtor days



Key questions

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 make a more effective contribution to working capital management?
3. Are the appropriate carrots and sticks in place to deliver improved lock-up?
4. Have fee earners been trained to manage lock-up effectively and to appreciate how clients can be handled so that they would want to pay earlier?

Finance

Firms fail when they run out of money. Not making a profit is unlikely to cause the collapse of a firm in a hurry, but running out of money can cause immediate failure and many firms have failed during the last year. All firms should therefore monitor their bank balance constantly and prepare regular cash flow forecasts to make sure 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 on the verge of collapse who comes knocking at their door. Law firms have always been prudent and do not traditionally like to carry debt.

Table 19 shows the year-end bank balance of firms. The median year-end bank balance was £65,000 (last year £75,000) in the bank. There is some regional variance in this figure with the South West figure being £234,000 and the figure in North East, North West being £43,000.

Given that the lower quartile bank balance is £0 this means that about a quarter of firms were overdrawn at the year end.

Table 20 looks at the capacity to borrow more money, compared to annual fees, when considering the year-end office account balance and the overdraft facility available. 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 even though most firms are not currently in overdraft, just how quickly and easily many firms could become insolvent if their lock-up deteriorates by relatively small amounts. The figures are very similar for all sizes of firm and across all regions.

Table 19 – Year-end bank balance (£'000)	Small			Large			Total		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London & South East	0	14	90	0	40	519	0	18	295
South West	18	58	100	250	521	1,444	60	234	1,056
Wales, Midlands & East of England	18	82	239	-261	98	326	-18	82	268
North East & North West	-38	1	109	-80	171	646	-41	43	172
Scotland	9	47	178	4	224	1,326	6	50	350
Total	**0**	**37**	**145**	**0**	**199**	**640**	**0**	**65**	**327**
Very large firms	-330	184	549	16	505	2,776	-45	266	1,326

Table 20 – Capacity in overdraft as a percentage of fees	Small			Large			Total		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London & South East	4%	4%	14%	5%	7%	14%	4%	6%	14%
South West	2%	6%	14%	4%	8%	25%	3%	7%	19%
Wales, Midlands & East of England	7%	14%	23%	4%	13%	16%	7%	13%	20%
North East & North West	5%	10%	15%	4%	7%	15%	5%	9%	15%
Scotland	6%	9%	16%	3%	10%	15%	5%	9%	16%
Total	**5%**	**10%**	**18%**	**5%**	**7%**	**15%**	**4%**	**9%**	**17%**
Very large firms	6%	7%	14%	5%	7%	15%	5%	7%	15%

Table 21 – Partner capital as a percentage of fees	Small			Large			Total		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London & South East	7%	17%	25%	17%	28%	41%	14%	22%	34%
South West	15%	19%	43%	18%	32%	41%	16%	27%	41%
Wales, Midlands & East of England	12%	22%	37%	15%	21%	30%	12%	22%	33%
North East & North West	13%	21%	67%	15%	24%	30%	14%	22%	35%
Scotland	22%	32%	63%	29%	35%	50%	27%	34%	54%
Total	**14%**	**25%**	**42%**	**17%**	**29%**	**40%**	**15%**	**26%**	**41%**
Very large firms	18%	27%	39%	25%	33%	41%	21%	32%	41%

Firms can become less reliant on bank finance if more partner capital is introduced and retained. One way of benchmarking partner capital is to express it as a percentage of annual fees. Given that the median firm has total lock-up per Table 18 of 99 days this could be financed by having partner capital equal to 27% of fees.

Table 21 shows the position for firms and the overall median figure is 26%. On this measure, Scotland firms have more capital than in any other region at 34% of annual fees. Larger firms are not holding more partner capital but as seen earlier the larger firms tend to have more days of WIP and debtor lock-up.

Banks are more comfortable where the percentage of borrowings against partner equity is lower and where the partners can demonstrate that they clearly have a level of personal financial commitment to the firm.

Table 22 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 5%, showing that there is very little debt, while the median figure for all firms is 35%. The median figure of 35% is down from 40% in the previous year and could suggest that capital accounts are being built up with reduced levels of drawings. The median figure in very large firms is higher at 54% which indicates that banks rather than partners are financing the relatively poor lock-up management of these firms. The upper quartile figure for large firms in North East, North West is 104% showing borrowings which are more than 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 bank may become less happy to continue to provide so much finance in future.

Table 22 – Percentage of partner capital borrowed	Small			Large			Total		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London & South East	0%	18%	50%	8%	46%	94%	0%	36%	86%
South West	29%	34%	63%	11%	38%	55%	20%	34%	64%
Wales, Midlands & East of England	0%	32%	71%	26%	43%	103%	13%	34%	89%
North East & North West	25%	51%	96%	15%	57%	108%	15%	54%	104%
Scotland	12%	32%	51%	19%	37%	138%	12%	32%	60%
Total	**5%**	**32%**	**60%**	**16%**	**43%**	**98%**	**11%**	**35%**	**86%**
Very large firms	45%	78%	105%	16%	33%	93%	25%	54%	100%

Many firms carry significant client account balances. While this money does not belong to the firm, a firm is able to keep any interest earned over and above what they have detailed in their interest policy to clients. The returns in recent years have been considerably lower because of long-term low interest rates but this might 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.

Table 23 shows the client bank balance at the year end as a percentage of annual fees.

The median figure for small firms at 225% is significantly higher than the median figure for large firms at 105%. The median figure for very large firms is lower again at 87%. In Scotland the upper quartile figure is 342%, representing 3.42 years of fee income. The median figure for all firms is 158% with regional variances peaking at 229% in Wales, Midlands & East of England. Given that the survey covers firms with combined fees of £1 billion, this suggests that if client money balances are 158% of fees that client money held will be about £1.58 billion.

There have been some significant thefts from client accounts over the last few years and all firms should be looking again at what they have done to best minimise the risk of this happening to them. Organised crime gangs will continue to target these funds and the frauds which they attempt will continue to become increasingly sophisticated.

Table 23 – Client bank balance as a percentage of fees	Small			Large			Total		
	LQ	Median	UQ	LQ	Median	UQ	LQ	Median	UQ
London & South East	0%	227%	559%	18%	64%	180%	9%	79%	220%
South West	241%	326%	453%	15%	52%	87%	26%	90%	157%
Wales, Midlands & East of England	217%	302%	350%	109%	204%	258%	154%	229%	319%
North East & North West	9%	28%	108%	52%	116%	227%	43%	75%	227%
Scotland	85%	198%	366%	46%	141%	280%	54%	198%	342%
Total	**109%**	**225%**	**352%**	**38%**	**105%**	**232%**	**50%**	**158%**	**304%**
Very large firms	39%	175%	281%	38%	64%	141%	39%	87%	228%

Longer-term trends – what do you notice?

Key questions

1. Do we have sufficient capital to run the business now and will we need more capital as the firm grows?
2. Is it time to look again at our legal structure and how capital is to be retained within the firm?
3. Is it right that we aim to fully distribute profits?
4. Do we need to think again about how quickly new partners are asked to contribute capital and how quickly departing partners can extract their capital?

Comparison with accountancy firms

In 2017 a similar survey to this one was conducted for accountancy firms of a similar size to those that take part in this survey of law firms. It was prepared in the same way as this survey and it is interesting to compare the performance of law firms with accounting firms. It might be expected that the results would be very similar as both professions are providing professional services to the same clients.

The results of the comparison can be seen in **Table 24**. Solicitors generate 10% higher fees per equity partner than accountants. The revenue generated per fee earner is £26,000 higher for solicitors.

The PEP is higher for accountants at £141,000 compared with the median figure for solicitors of £128,00. The margin in accountancy firms at 23% is higher than in law firms where it is 21%. Maybe not surprisingly, the expenses per equity partner in accountancy firms are lower at £410,000 than in legal businesses where the figure is £480,000. Given that accountants will often advise on cost management it would be worrying if this result had not materialised. Spending more money in the law firm did however result in a higher income figure and this did result in a higher profit. Perhaps there is a lesson in this that you might need to invest in the right areas to maximise income, productivity and profits. It is also however possible to spend money in areas that do not add real value.

Levels of chargeable time recorded are the same in both professions at just over 1,000 hours which equates to about 4.7 hours per day; both professions should think again whether everyone is recording all of their time properly.

A lawyer recovers £146 per hour while an accountant recovers only £124 per hour. The two professions are both suffering intense pricing pressures. Firms would be well advised to reconsider how pricing is handled. A more systematic approach which requires a more detailed analysis before a price is offered should result in better margins.

Lawyers beat accountants at total lock-up management by 16 days. It is also interesting to see that accountants are better than solicitors at getting bills out quickly but that solicitors are better at collecting outstanding bills. The fact that solicitors are better at collecting debts might have something to do with the fact that law firms often offer debt recovery as a service to clients.

I hope that this report will encourage both professions to think again about their own performance and to strive to improve their results next year.

Table 24 – Comparing accountants with solicitors

Total median figures – comparison of two professions	Accountants	Solicitors
Fees per equity partner	£551,000	£608,000
Fees per fee earner	£108,000	£134,000
Profit per equity partner	£141,000	£128,000
Profit as a percentage of fees	23%	21%
Total fee earners per equity partner	4.2	4.33
Chargeable hours per fee earner	1,054	1,000
Recovered rate per hour	£124	£146
WIP days	38	49
Debtor days	71	41
Total lock-up days	115	99

Longer-term trends in the legal sector

As this is the seventh year of this report, it might be helpful to reflect on what has happened over this longer period and to see whether the legal profession is faring well and to consider some of the major issues now affecting legal businesses.

Over the six years from the first report to the publication of this seventh report, RPI has increased by 15.8% and CPI has increased by 10.1%. If the legal profession is doing well then over the period one might have expected fees being invoiced and profits being earned to have risen by at least this amount.

Table 25 shows for some of the main financial benchmarks how things have changed over the seven years.

The table makes it clear that the growth in PEP of 42% has been achieved from a growth in fees per equity partner of 55% but with a slowly declining profit margin. The growth in fees per equity partner has not been achieved by large rate increases as the increase in the recovered rate per hour is only 7% over the period.

There has been no increase either in the recorded chargeable hours per fee earner which has stayed static at 1,000 hours per year. The increase in fees per equity partner has been driven primarily by an increase in gearing of 44%. The need to grow by recruiting new fee earners might make it increasingly difficult to recruit people with the required skills and therefore the profession needs to focus more on improving the fees generated by each fee earner by focusing on the productivity of individual lawyers.

Lock-up has been reduced from 104 days to 99 days over the period. To see the total fall below 100 days is a landmark event, but the profession should not get complacent as there is no reason in principle why the supplier of legal services has to wait over three months to be paid.

Table 25 – Major changes over the last six years

Financial benchmark (median figure)	2013 survey	2019 survey	% movement over six years
Fees per fee earner	£132,000	£134,000	2%
Fees per equity partner	£393,000	£608,000	55%
Profit as a percentage of fees	23%	21%	-9%
Profit per equity partner	£90,000	£128,000	42%
Gearing (team size per equity partner)	3.0	4.33	44%
Recovered rate per hour	£136	£146	7%
Total lock-up	104 days	99 days	5%

The firms in the survey were also asked to comment on their thoughts on a few topical issues which will affect the profession in the next few years. **Tables 26–29** summarise the thoughts of firms.

Not surprisingly, a significant majority of firms have invested in new IT in the last 12 months. The figure is 56% in small firms, 76% in large firms and 86% in very large firms. It is unlikely that the need to invest in this area is likely to fall over the coming years.

47% of firms have experienced a cyber-attack in the last year. The incidence of these attacks is higher in larger firms which is not really surprising. Being aware of this threat and taking steps to reduce the likelihood of such attacks is clearly important.

There are now several hundred ABSs and while some of them have not been successful others are proving to be a significant threat to traditional firms. It will be interesting to see whether this perception changes in future years.

Table 26 – Percentage of firms that have invested in new IT in the last 12 months

	Small	Large	Total
London & South East	20%	67%	52%
South West	43%	83%	68%
Wales, Midlands & East of England	58%	80%	68%
North East & North West	46%	83%	64%
Scotland	88%	77%	83%
Total	**56%**	**76%**	**67%**
Very large firms	75%	96%	86%

Table 27 – Percentage of firms that have experienced a cyber-attack or fraud-related loss in the last 12 months

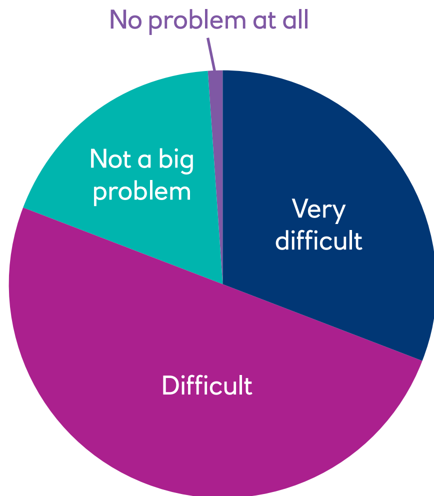
	Small	Large	Total
London & South East	30%	52%	45%
South West	0%	58%	37%
Wales, Midlands & East of England	25%	30%	27%
North East & North West	23%	64%	42%
Scotland	76%	69%	73%
Total	**37%**	**55%**	**47%**
Very large firms	42%	74%	60%

Table 28 – Percentage of firms that perceive the increasing trend of Alternative Business Structures (ABSs) to be a threat to the firm

	Small	Large	Total
Total	**24%**	**21%**	**22%**
Very large firms	16%	22%	19%

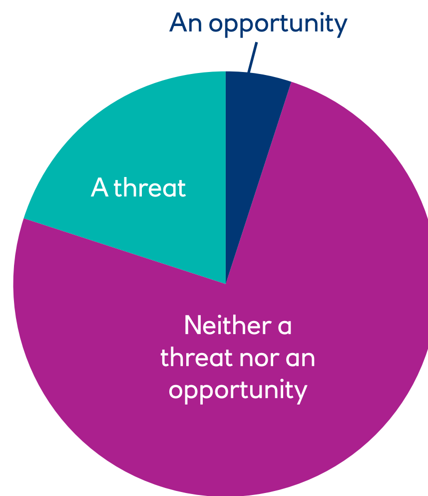
We have seen that the growth achieved by firms has come largely by taking on new fee earners. It is interesting therefore to see whether recruitment is easy or difficult in the legal market. The picture below shows that 82% of firms now think that recruitment is difficult or extremely difficult. Firms will therefore have to work harder at recruitment in future or need to find ways of making their existing lawyers more productive.

How difficult do you find it to attract talented people?



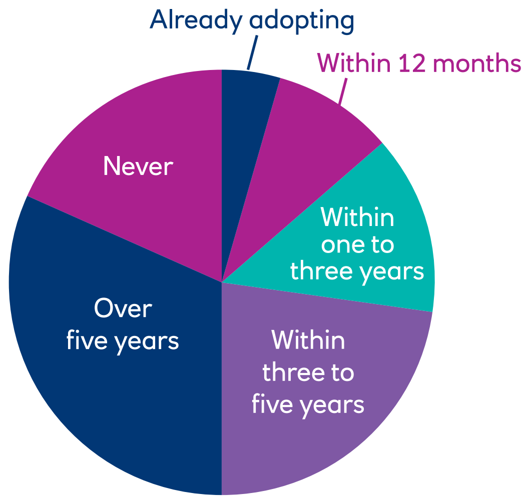
At the time of writing this report we still do not know how Brexit will unfold. Every firm is aware of this major event but it can be seen below that most firms are not particularly worried about Brexit for their firm. Given that most of the firms in the survey are smaller firms and most of their work is arising in the UK, Brexit is unlikely to have a significant impact.

Do you see Brexit as an opportunity or a threat for your firm?



The final hot topic that we asked firms for their views on concerned the development of artificial intelligence in the legal sector. The results below show that about half of firms think that they will not adopt artificial intelligence for at least five years or never. The other half are already adopting AI or plan to do so over the next five years. Again, it will be interesting to see if views change over the next few years.

When do you think your firm will adopt artificial intelligence (AI)?



Want to know more?

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 Dave Weaver, Head of Commercial Professional Sectors, The Royal Bank of Scotland:

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