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A track record of providing solutions to the legal profession

The Armstrong Watson Legal Sector Benchmark
Annual Report for 2016/17
November 2017

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Endorsed by
The Law Society

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Commentary

We have prepared this report using information from the law firms we advise. We supply a bespoke individual report to all of our legal sector clients as part of our normal accounts service when discussing their annual accounts. Those individual discussions allow us to take more of a strategic stance with our legal clients.

We act for over 100 law firms each year. This document is the annual report summarising the results of those individual practices. The results cover firms of all sizes up to 30 partners, mostly located in the North of England. Where possible the results have been analysed by practice size.

In general, 2016/17 shows that the return to profitability appears to be continuing. As a result, firms have looked to recruit, with higher numbers of staff per partner. Crucially that recruitment has had a positive impact on profits, as staff costs as a percentage of fees has been kept in line. Firms have also looked to use this increased profitability to invest, with increased marketing costs being evident. However despite this increased profitability, cash still appears to be tight as lock up has increased; investments have been made and therefore drawings have fallen behind profits. This has resulted in average partner capital accounts increasing, which may cause succession problems in the future.

The highlights from this 2016/17 report are as follows:-

- The average fee income per equity partner was £598,000 which is 48% higher than in 2015/16.
- The average fee income per fee earner was £126,000 which is 25% higher than in 2015/16.
- The average net profit per equity partner was £129,000 which represents 33% of fee income. That has increased from £97,000 in 2015/16. Law firms with 8+ partners performed above this benchmark with average net profit per partner of £184,000.
- Overheads have remained at a similar level to the previous year.
- On average there are 4.1 fee earners for every equity partner, an increase from 3.0 in 2015/16.
- Staff costs as a proportion of fee income have increased by 1.3% on the previous year to 34.6%.
- The number of staff per equity partner has increased from 7.1 people to 9.2 people.
- The number of support staff has remained broadly the same as the previous year at 1.0 per fee earner.
- On average, equity partner charge out rates have increased by 18% across all law firms. Law firms with 1-7 partners show an uplift to equity partner charge out rates of 20%.
- Salaried partner and associate charge out rates have also increased by 8% and 6% respectively across all law firms. Assistant charge out rates have seen smaller inflationary increase of 3% on the previous year.
- The average time taken to bill work in progress has increased from 62 days to 108 days. The average time taken to collect debts has increased from 60 days to 70 days.
- The average partner's capital account has increased by 56% from £137,000 to £214,000.

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We are in the process of extending our benchmarking database to include the law firm clients of a select number of other accountancy firms with a specialism in acting for lawyers. That will be on a completely anonymous basis and should increase the number of firms in next year's database significantly.

If you are interested in seeing how your firm compares with the benchmarks in this report or want to investigate variances with your own firm's performance then please contact me.

Andy Poole

Andy Poole

Legal Sector Partner

Armstrong Watson LLP is a top 30 UK accountancy firm with 16 offices throughout Northern England and Southern Scotland. Further information on our unique offering to law firms can be found at www.armstrongwatson.co.uk/legalsector

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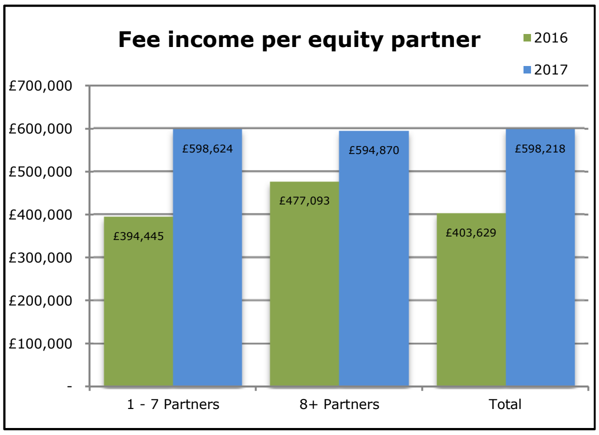
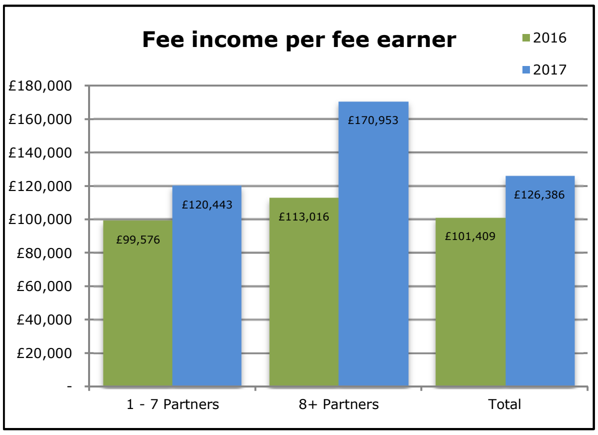
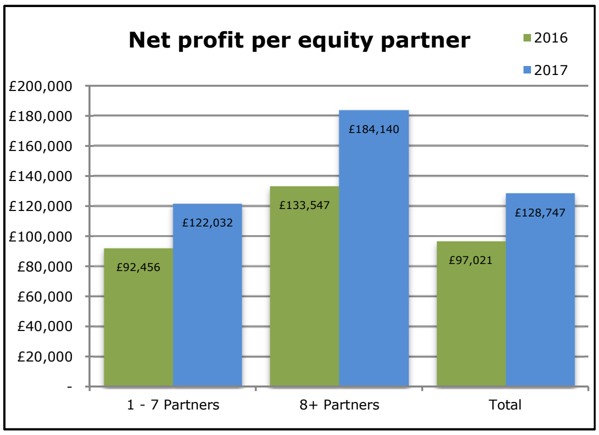
The Law Society

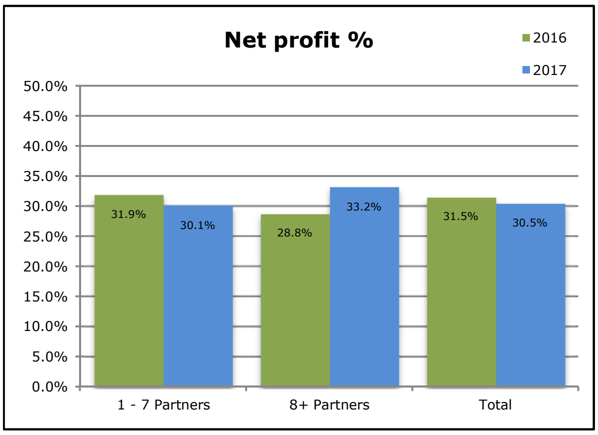
Armstrong Watson LLP is endorsed by the Law Society for the provision of accountancy services to law firms throughout the North of England.

1. Fee income and profits









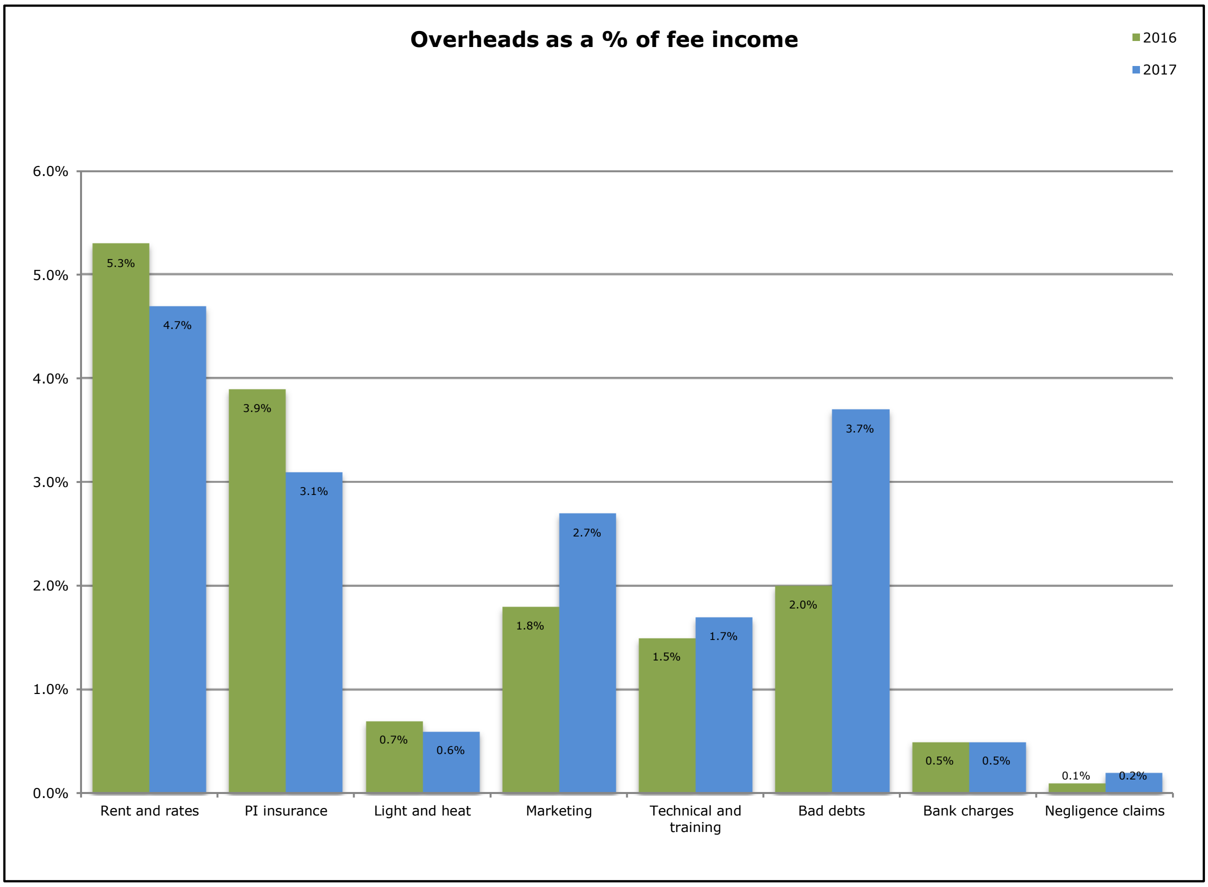
For all law firms, fee income per equity partner has increased by 48% from 2015/16 to 2016/17. With law firms with 1-7 partners showing an increase of 52%, higher than the law firms with 8+ partners where the increase is 25%.

Despite that, for law firms with 8+ partners, fee income per fee earner and net profit per equity partner has increased on the previous year more that the firms with smaller numbers of equity partners. In total the level of fee income per fee earner for all firm sizes have increased by 25% from 2015/16 to 2016/17.

The average net profit per equity partner for all law firm sizes has increased by 33% between 2015/16 and 2016/17.

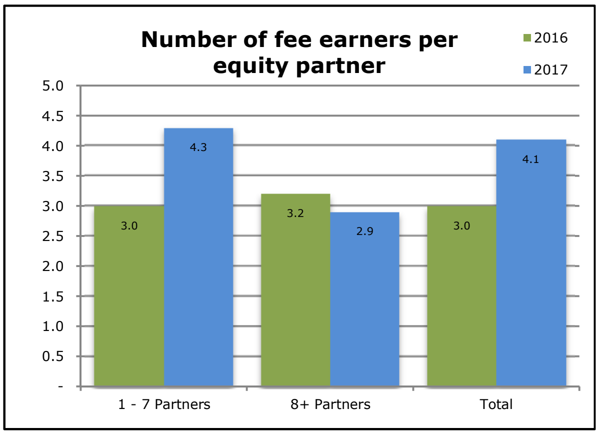
The above trends continue in the net profit percentages which on average remain strong, with the average across all firms broadly unchanged at 31%. This is particularly pleasing given the number of changes in the legal sector in recent years.

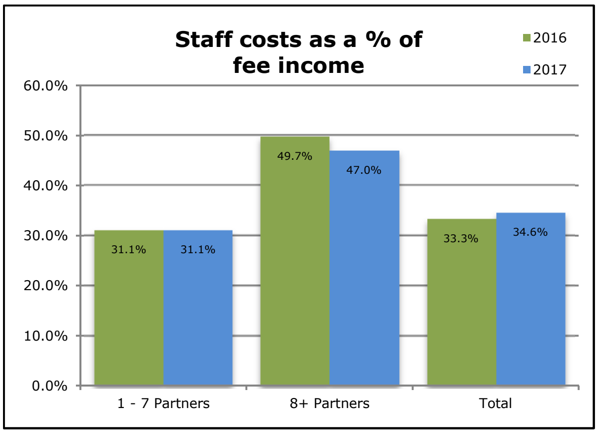
2. Overheads as a % of fee income

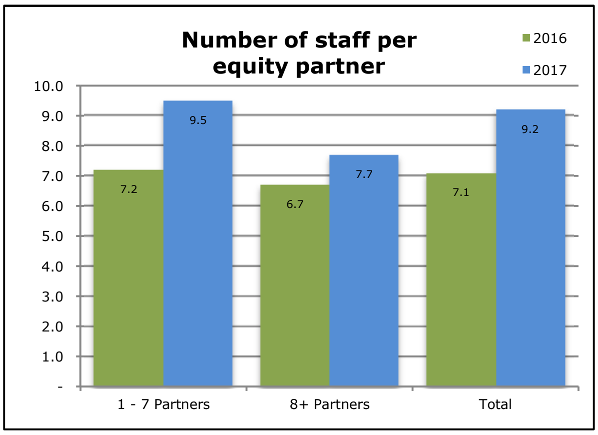


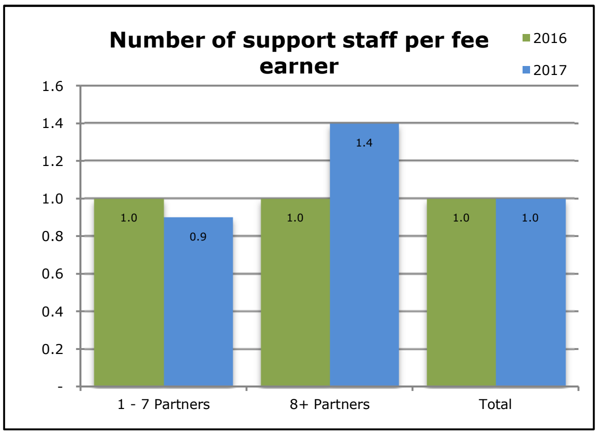
Overheads as a percentage of fee income have been rounded to the nearest percentage point. People costs are covered separately in the next section. Controlling overheads is particularly important when there is pressure on the levels of fees due to current market changes in the legal sector. The consistency from 2015/16 to 2016/17 shows how overheads are being closely monitored and controlled by law firms. PI insurance reduced from 2015/16 to 2016/17, which shows continued recovery in this overhead following difficulties firms had experienced when obtaining cover in recent years.

3. People







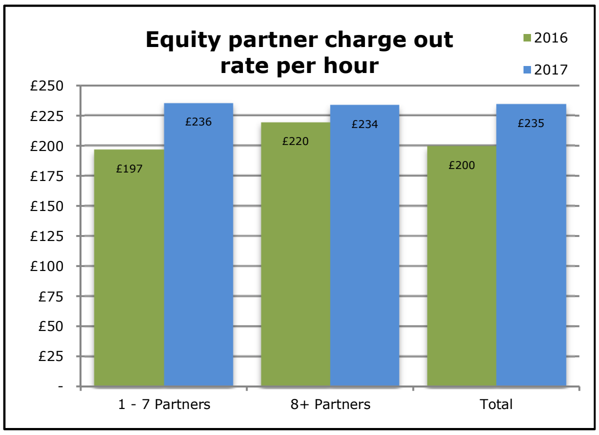


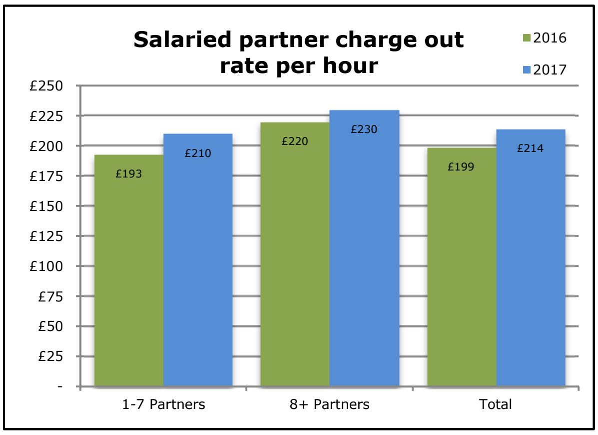
On average there are 4.1 fee earners for every equity partner across all firm sizes. Firms with 8+ partners show a reduction in the ratio from 3.2 down to 2.9 fee earners for every equity partner. This reduction may be due to an increase in the number of firms with a strategic model whereby the work will be undertaken at a higher level rather than the equity partners winning the work and passing the work down. For law firms with 1-7 partners, this ratio has increased from 3.0 to 4.3 people when comparing 2016/17 with the previous year. The number of changes in the legal sector market and partners exiting practices to start new, smaller, typically niche firms, has increased the rate of change in this ratio for firms of this size.

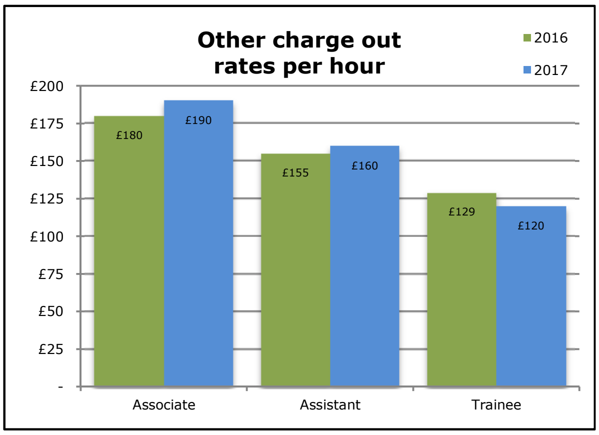
Staff costs as a percentage of fee income has increased by 1.3% across all firm sizes. Linked to the above for firms with 8+ partners this ratio has reduced from 50% to 47% which supports the changes in strategic thinking that we have seen.

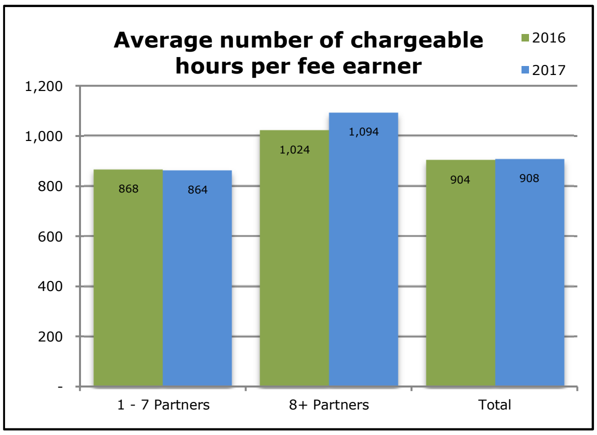
In total, the number of staff per equity partner has increased on average from 8 people to 9 people. Many firms are employing paralegals to improve efficiency and allow fee earners to focus on achieving higher levels of fees. The number of support staff per fee earner has remained broadly the same over the past two years.

4. Charge out rates









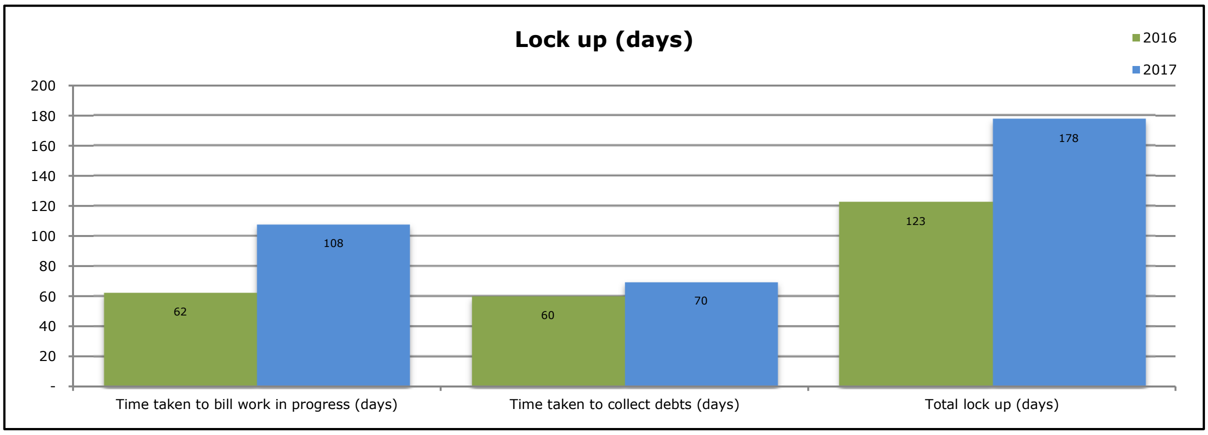
The equity partner charge out rates have increased for firms of all sizes from 2015/16 to 2016/17. Law firms with 8+ partners have shown a smaller increase in equity partner charge out rates than firms with 1-7 partners.

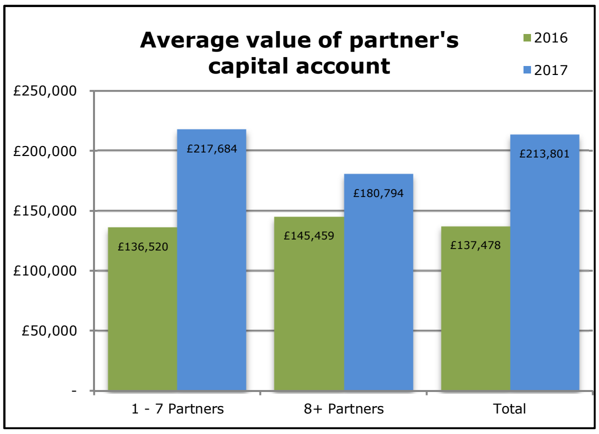
Salaried partner charge out rates show an inflationary increase across all firms.

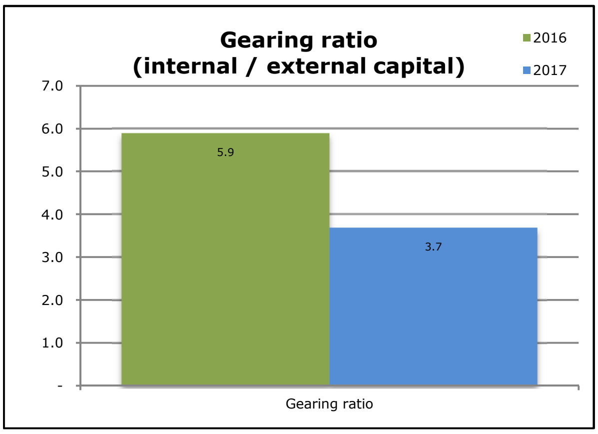
Associate, Assistant and Trainee charge out rates show very little movement across all firm sizes.

The average number of chargeable hours per fee earner on average has remained fairly stable. Firms with 8+ partners showing an increase of 7% to 1,094 hours per fee earner. At an average charge out rate of £167 per hour, this represents a potential increase in fee income of £11,690 per fee earner. However, given that the average level of fee income per fee earner has increased across all firm sizes by more than this, it would appear that even taking account of the increase in charge out rate fee earners are working more efficiently with the available chargeable hours. It also suggests that as fee earners become busier, they act more efficiently, recovery rates increase and write offs decrease. That is of course unless there is an element of under-recording of time.

5. Working capital







The average time taken to bill work in progress has increased from 62 days to 108 days when compared with the previous year. This shows that law firms are raising fees slower than previously which will cause a resultant strain on their working capital requirements. It also reflects a change in the mix of work types this may be linked to various uncertainties we have seen within the sector causing clients to delay proceedings.

The number of days taken to collect debts has increased from 61 days to 69 days when compared with previous years. Collecting debts from clients continues to cause difficulties as individuals and businesses look to stretch credit terms wherever possible.

The lock up days, which is the total of the time taken to bill and the time taken to collect debts, has increased by 55 days to 177 days when compared with the previous year. Based on an average fee income of £450,000 per equity partner, this represents a working capital commitment of £68,000 per equity partner. This is significant, especially for firms that are aiming to grow. Proactive steps need to be taken to implement controls and new systems to reduce this requirement.

The average value of an equity partner’s capital account has increased by 48% from the previous year. This may be due to a number of factors; changes in the partnership structure with new and exiting partners, a reduction in drawings levels, retention of reserves needed for working capital or refinancing of the practice. The gearing ratio of law firms has decreased from 5.7 to 4.0 when compared with the previous year. The increased lock up is resulting of a lack of cash preventing partners from drawing as much as they would like, thus increasing capital accounts. The banks have become more willing to lend and so the ratio of the amount the partners invest compared to the amount they borrow has decreased. It should be noted that this ratio doesn’t reflect “off balance sheet” finance, where partners have taken on personal debt to inject into the practice or as a part of a refinancing package.