



The session was presented by Alistair Rose, the co-author of the PwC Law Firms' annual survey and drew upon the 2007 survey results. The firms that participated in the survey comprised:

- 90% of the top 10 law firms
- 84% of the top 25
- 70% of the top 50

and the information submitted related to those year ends up to 30 April 2007.

The focus of the presentation was those firms in the 11-25 bracket of the Lawyer top 100 firms.

For these firms, the headlines were:

- fees were up, but growth was not as strong as in the prior year
- profit per equity partner was also up but not to the extent of the top 10 firms
- the performance of these firms was more flat/stable than those above and below them
- there is a significant gap between these firms and the top 10 in respect of staff utilisation (less effective gearing for these firms)
- staff retention continues to be a challenge
- there is an increased use of bonuses, flexible working and benefits but not a readily apparent increase in staff loyalty as a result
- there is an increased use of outsourcing.

It would appear that the top 10 firms are beginning to break away from the chasing pack, but staff retention remains a challenge and there is significant uncertainty over the economic climate and banking environment.

Alistair then took the audience through the following areas of interest - the salient points being:

### **Strategy:**

- these firms feel there is a real need to differentiate themselves from the competition - at present the perception is that these firms are very similar and finding a distinguishing offering remains a challenge
- concerns exist over the credit crunch (note this survey was done in summer 2007 so recent events are likely to have increased the level of concern)
- the legal services act is a hot topic and firms are looking at ways they may structure themselves more effectively to take advantage of this
- mergers and lateral hires continue to dominate the minds of senior partners
- there is a need to be clear in the communication of strategy to the partners and broader firm and use of KPIs for the purpose of partner objectives and reward structures is seen as key.

### **UK fees per equity partner:**

- these only increased by around 3% in the year to 2007 which is not much more than an inflationary fee increase and significantly down on the 17% increase in the prior year
- average fees per equity partner were £1,555k (2006: £1,516) but still significantly lower than the top 10 firms figure of £2,422k.

### **Total UK fee income:**

50% of firms in the 11-25 bracket increased their total fees by more than 10% which remains lower than the 66% of the top 10 firms that achieved the same.

However, some 42% of the 11-25 firms reported increases of less than 5% from the prior year (2006: 8%) which would indicate that many more firms in this space are finding it difficult to sustain anything other than minor growth rates.

### **UK profit per equity partner:**

the impressive 21% growth seen in 2006 has slowed dramatically to only 4% in 2007 and average profit per equity partner is now £497k. This is markedly lower than the £866k for the top 10 firms.

### **Fees and profits per equity partner:**

average total fees increased by 29% and the number of equity partners by 10%. Interestingly, the 11-25 firms are the only sector to show an increase in the number of equity partners and it is not clear that this increase in new partners and lateral hires is being converted into higher fees and growth for the firm. It remains true that the top 10 firms' tight management of equity is one of the major reasons for the significantly higher profits per partner in those firms.

### **Profit margin, staff costs and property costs:**

there are small increases in profit per equity partner and net margin in 2007 but margins are under increasing pressure due to:

- lower levels of staff utilisation
- market salary pressures
- higher staff turnover levels.

For the firms in the 11-25 bracket, it is clear that they are having to bear the same market increases as the top 10 firms but are not managing to leverage this and generate the same increased profits.

### **Total overseas fees:**

International operations appear to be returning their investment with 60% of the 11-25 firms increasing their overseas (i.e. non UK) fees by more than 16% (2006: 56%).

That said, the levels of profit being made in different regions of the world range from 19% in Eastern Europe and Asia, through to 27% in Western Europe. Compared to the top 10 firms, the major difference in regional profits arises in Western Europe where the 11-25 firms achieve only a 27% margin compared to 36% for the top 10 firms.

### **Proportion of fees and profits generated overseas:**

33% of 11-25 firms generated more than 20% of their fees outside of the UK but this is low when compared with the 77% of the top 10 firms (note only 9 of the top 10 responded so the % is correct!).

When the focus moves to the level of profit made by these overseas operations the gap widens with only 28% of 11-25 firms making more than 20% profit as opposed to 77% of the top 10 firms.

Perhaps not surprisingly then, the 11-25 firms put 'improving profitability from overseas operations' high on the list of their areas of focus.

### **Partner remuneration systems:**

As would be expected, a fundamentally unchanged approach toward partner remuneration structures although there is a slow increase in the number of firms operating a purely merit based system - 25% vs. 17% in the prior year.

### **Staff utilisation:**

staff utilisation remains lower than for the top 10 firms but the gap is widening with the top 10 firms increasing the average chargeable hours by 9% whilst the 11-25 firms remained flat.

The survey clearly demonstrates that those firms with a highest profit per partner are those with the highest chargeable hours but before the 'work more hours' mantra

sets in, beware that there is a direct correlation between the higher chargeable hours and a higher staff turnover.

Given the cost of replacing quality staff and partners (in terms of recruitment costs and the 'down time' in terms of fees during the wind down and then introduction phases) it is clearly a fine balancing act in this area.

### **Staff turnover:**

this continues to be a major issue for firms with around 10% of firms experiencing staff turnover levels of 26-30% at the post qual level (a 'norm' would be in the region of 18-20% turnover).

Respondents to the survey appear to have introduced a range of flexible working arrangements to try to address this but at present, the take up of these has been poor. There is a general sentiment that whilst flexible benefits and working are seen as valuable offerings for staff, the staff themselves are not yet demonstrating that these measures alone will be likely to lead to higher retention.

### **Fee earner bonuses:**

92% of the 11-25 firms operate a bonus scheme compared to 75% only a year earlier. Of these, 20% pay a bonus of between 11% & 15% to qualified lawyers - the corresponding figure for 2006 being nil. The general feeling in the room was that a bonus in the region of 10% of salary was not likely to be instrumental in retaining staff.

### **Support functions - annual spend per fee earner:**

Alistair caveated some of the data on show but the key trends emerging were that there had been increase in secretarial support and marketing but in all areas, the 11-25 firms lagged behind the top 10 firms in terms of spend per fee earner - most noticeable in the area of IT where spend was less than 50% of that in the larger firms.

Use of outsourcing continues to increase with the objective being costs saving (as opposed to smaller firms where it is seen as a way to improve service to clients). Many firms see outsourcing as key to their future with plans to increase usage going forward.

### **Working capital management:**

Improved working capital management was evident with the key areas of focus being:

- improving partner and fee earner accountability for working capital
- formalisation of matter inception and incorporation of billing arrangements into this process
- firm wide appreciation of the working capital management approach
- solid reporting and management support for the initiative.

It was noted that the top 10 firms have achieved good results through the use of credit control 'chasers' and through introducing sanctions for poor performing

partners. It is felt that restricting a partners draw based on them not hitting cash collection targets is a particularly effective way of focusing the mind.