

The law firms' survey 2008



Executive summary

At the time of publication of this year's survey, we are experiencing turmoil in global financial markets with the UK heading into probable recession. Law firms will not be immune from the impact of these macro-economic events, and much has been written recently with respect to law firm redundancy programmes and other cost-saving measures as a direct consequence. On the one hand there will be opportunities for firms in areas such as litigation and insolvency, but there will be real challenges in other disciplines such as real estate and transactions. There will clearly be winners and losers and it is likely that there will be structural change in the UK legal profession as there will be in financial and corporate markets, once economic conditions stabilise.

Our 2008 survey presents another year of record results, and against the backdrop of the above more recent events, it would be easy to think that this year's survey may be less relevant to financial and operational planning than in prior years. However, this is not the case. More than in any other year, the survey results are striking in that they highlight how effective financial and operational planning have enabled some firms to move significantly ahead of the competition. With difficult economic conditions already prevailing, it is these firms that will be best placed to manage through the downturn.

Our survey shows 2008 was a year of strong fee income growth, although a positive first half performance masked a significant weakening in the second half of the year. As noted last year, the Top 10 firms are breaking away from other firms and this year's survey shows an even stronger continuation of this trend. Average fees per partner for Top 10 firms reached almost £2.9 million with the next category, the Top 11-25 firms, managing an average of £1.8 million. This trend was also repeated with respect to fees per fee earner, with the average for the Top 10 of £360,000, some 35% higher than for the Top 11-25 firms.

Partner headcount continues to be managed carefully, although we note a relaxation in 2008. As a consequence, equity partner headcount increased for a significant number of firms this year. The Top 11-25 firms, however, showed a fall, although this was probably a consequence of these firms being slower to manage equity partner numbers down in previous years. Looking at a four year trend, only the Top 11-25 firms have on average more equity partners than in 2005.

International expansion continued during 2008 and almost two-thirds of the Top 10 firms now generate more than 30% of their profits from international operations. The survey shows a clear divide in focus, with the larger firms concentrating on expansion into emerging or growing markets (Russia, Singapore, Hong Kong and the Middle East), whilst the mid-tier firms' focus has been to grow and consolidate in Western Europe (Germany, The Netherlands, Italy, Spain and Portugal).

2008 saw, for the first time in a number of years, a real focus on reducing staff costs. Again, the greatest success was amongst the Top 10 firms who recorded on average a staff cost to fee income ratio of 38%, down from 41% in 2007. In contrast, the Top 11-25 and Top 26-50 firms only managed a ratio of 42%.

Average chargeable hours for firms, as a whole, were either flat or showed only a small increase for all size categories of firms. This, at first sight, seems a surprising result. However, we believe that the marked decrease in activity in the second half of the year impacted chargeable hours for the year as a whole. It has clearly proven difficult to keep busy the increased staff recruited in prior years.

Looking at utilisation, chargeable hours have increased significantly for lower cost fee earners (salaried partners, paralegals and trainees), no doubt contributing to the reduction in staff costs. Another factor has also been salaries. Amongst the Top 10, salaries for newly qualified staff have remained static. Likewise, bonuses have generally dropped in comparison to 2007, although Top 10 firms still paid on average a bonus of 15% of base pay to non-equity partners and 14% to qualified lawyers.

Perhaps not surprisingly, staff turnover declined during 2008, although attrition rates for 3-5 year ppe level, in particular, remained high at 27% in the Top 10 firms. The high staff turnover rates in prior years had a real impact on firms' profitability.

Another surprising result from the survey has been the increase in secretarial support numbers, which has outstripped the increase in fee earner numbers at a time when many firms have been trying to reduce support costs. This clearly will need to be an area of focus in a downturn.

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Flexible working arrangements as part of a focus on “work-life balance” have been a feature of recent surveys. The 2008 survey shows that take-up of these arrangements has been much higher amongst the Top 11-25 firms than in the Top 10.

Taking these results together, it is clear that strategically the Top 10 firms in 2008 have focussed on increasing leverage from partner and fee earners alike, at the same time as managing staff costs down. The results in terms of profits per partner have been positive. Average profits per partner for Top 10 firms were in excess of £1.1 million (an increase of almost 28% from 2007), compared to an average of £614,000 for Top 11-25 firms and £457,000 for Top 26-50 firms.

An area that will be of key importance to firms during the economic down-turn is lock-up. With the notable exception of the Top 10 firms, our survey shows slow but consistent improvement with regards to firms’ lock-up performance over the last four years. The best performing category of firms has been the Top 11-25 firms, where a year end lock-up of 106 days was achieved (an improvement of some 6 days from 2007). In contrast, the Top 10 saw a deterioration in their lock up with a year end position of 132 days. Average performance throughout the year is consistent for debtors, but significantly worse for work in progress. We are aware that firms are already experiencing real pressure on their lock up as clients defer payment. This will be a key area for Finance Directors to focus on in the coming months.

Turning to some of the other non-financial aspects of our survey, the subject of Sustainability has become an increasingly significant part of firms’ strategic planning. Many firms now believe that sustainability and corporate reporting are an integral part of their business strategy. That said, the survey shows that whilst many sustainability initiatives are in place, the external reporting of these is still not an embedded part of the management reporting process.

With regards to risk management, we are seeing a much greater acceptance that limitation of liability on engagements is an effective way of managing assignment risk. 75% of Top 10 firms now say they routinely limit liability, compared to just 25% last year. With an increasingly international perspective for firms of all sizes, the effective control of risk across firms is receiving greater attention. The use of internal audit is now also a feature for three-quarters of the Top 10, although the uptake in mid-tier firms is low.

Looking ahead to 2009, it is clear that firms were viewing the future with increasing pessimism (even at the time when the survey questionnaire was completed in the Summer of 2008). Profits per partner and the ability to convert profits to cash were expected to come under pressure by many firms, with the largest firms viewing the future with most caution.

Firms are actively seeking to reduce their cost base and we expect this to continue into 2009, with many management teams embarking on a fundamental review of their business models and internal functions.

It appears likely that 2008/9 will see reductions in headcount, particularly with regard to support staff, although with fee earner recruitment at record levels for many in 2008, no doubt fee earner headcount too will be reviewed. At the very least, there will be targeted reductions at both staff and partner levels.

Management teams are now facing the most challenging economic environment for a generation. Whilst there will undoubtedly be opportunities for firms, there will also be those that are proportionately more exposed or less prepared to deal with the rapidly changing environment. Management focus for the last few years has been on rapidly growing revenues and profit per partner. The focus now will be on protecting firms’ relative positions, to be able to come out of the downturn in a position to exploit what, will undoubtedly be, a very different landscape for law firms in both the UK and internationally.

