

infocus

Profit Focus

Research shows law firms are using the five basic drivers to rack up the profits.

Neil Oakes takes a snapshot of the 2007 legal profession from the findings of the 2007 Law Firm Performance Benchmarks. He also promotes the 7 opportunities for lawyers to enhance their performance.

Profitability

Country practices tend to be efficient and profitable with the exception of South Australia where suburban practices are the most profitable.

Practices with 4 to 9 principals struggle to keep a high net profit and the biggest challenge facing small firms is improving their productivity.

Practices with more than 20 principals have the highest net profit at 34.21%. Generally the largest practices are most profitable because on average they record more hours, charge more per hour, realise more and are more effective at lock-up management.

There are five basic drivers of profitability, which we examine:

1. Leverage
2. Blended rate
3. Effective chargeable hours
4. Realisation
5. Total overheads

Leverage

In the simplest analysis, legal firms sell time. Staff leverage, which is the number of employed fee earners per equity principal, is critical to law firm profitability. These are the findings:

- Leverage in high profit firms tends to be at more than 4 employed fee earners per equity principal.
- 35% of firms have a leverage higher than 5.
- CBD practices tend to dominate in leverage regardless of State.
- Country and suburban practices struggle to secure strong leverage except in South Australia where country practices enjoy the best leverage.
- The best leverage numbers are found in single principal practices and in 10 - 20 principal practices.

Blended rate

Blended rate is price setting to ensure that you fully recover your cost of production. Proper pricing strategies will provide an environment where your practice will be fully and properly rewarded for work done by all fee earners.

The cost of production within your practice should underpin the price of your legal services. Therefore



you should determine the cost of production by author type and add sufficient profit margin to this cost of production in order to generate the income your owners require. The findings show:

- CBD practices enjoy the highest blended rate in most States with the exception of South Australia where suburban practices have the highest rate.
- All firms with a blended rate of more than \$350 per hour have a profit greater than 33%.
- As the number of principals in a practice increases, so does the charge out rate. Practices with more than 20 principals charge approximately \$100 per hour more than any other range.

Effective chargeable hours

Your objective is to ensure that all fee earners are appropriately productive. As a general rule, the most profitable firms aim at a minimum of 1000 billable hours per fee earner per year.

It is critical that all authors receive an indication of what you consider to be acceptable performance.

'Performance' will involve both subjective and objective factors and would include measures such as chargeable hours, file throughput as well as quality issues. The findings show:

- Practices with fewer than 7 partners struggle to generate 1000 effective chargeable hours per principal. The largest practices generate over 1100 hours.
- CBD practices tend to dominate in leverage in all States except Tasmania where major regional practices are best.
- There is a positive correlation between effective chargeable hours and net profit – the more effective a firm is in billing chargeable hours, the more profitable it will be.
- 74% of equity partners record less than 1200 effective chargeable hours, 12% record more than 1440 effective chargeable hours.

Realisation

The primary production objective is to ensure that work done is recorded, billed and collected. The findings show:

- Country practices tend to dominate in realisation in NSW, Vic and QLD.
- Country practices in SA and NZ have the worst realisation results.
- The "2 to 3 principal practices" have the worst realisation rate and the largest practices have the best realisation.

Total overheads

Your objective is to ensure that practice costs yield an appropriate return on your investment. Country practices tend to dominate in expense management in NSW, Vic, QLD and NZ. SA practices are carrying high expense overheads.

Comparison between CBD, suburban and regional high profit firms in '07.

	Mid Size CBD	Small CBD	Very Small CBD	Suburban	Regional	Country
Expense Margins						
Salaries (excluding principals)	38.79%	35.75%	31.60%	33.90%	36.94%	31.09%
Non salary overheads	25.61%	27.99%	29.14%	23.82%	25.09%	23.09%
Profit Margin (*bps)	35.60%	36.26%	39.25%	42.28%	37.97%	45.82%
Leverage	6.13	4.63	3.50	3.87	4.57	3.30
Effective Chg Hrs						
Equity Principals	1180	1136	1156	1108	817	1,342
Solicitors	1095	874	932	899	983	940
Paralegals	887	881	728	917	1051	914
Hourly Charge Rate						
Equity Principals	\$366	\$368	\$334	\$323	\$314	\$320
Solicitors	\$246	\$281	\$248	\$274	\$249	\$252
Paralegals	\$159	\$173	\$105	\$180	\$166	\$137
Blended	\$276	\$304	\$265	\$257	\$241	\$252

* bps = before principals salaries

FMRC Legal 'Law Firm Performance Benchmarks – 2007'. It is important to note that these are averages from the participating firms and not averages of the profession as a whole.

Comparison between work types of high profit firms in '07.

	Commercial Litigation	Plaintiff PI work	Defended Insurance	Family Law	Conveyancing and other property
Expense Margins					
Salaries (excluding principals)	34.06%	35.48%	40.42%	35.53%	36.22%
Non salary overheads	29.23%	33.07%	30.07%	29.07%	28.84%
Profit Margin (*bps)	36.71%	31.45%	29.51%	35.40%	34.94%
Leverage	3.59	3.91	5.31	3.73	4.07
Effective Chg Hrs					
Equity Principals	1195	1083	1240	1175	1026
Solicitors	986	1025	1199	941	882
Paralegals	755	731	937	718	992
Hourly Charge Rate					
Equity Principals	358	335	311	344	330
Solicitors	246	274	215	258	243
Paralegals	158	162	105	148	159
Blended	274	269	239	277	249
WIP Write offs					
Solicitors	17.27%	22.40%	15.38%	19.43%	20.06%
All professionals	14.62%	21.45%	13.03%	16.29%	18.18%

• bps = before principals salaries

Opportunities for law firms

1. Life balance versus performance ethic

Motivating young lawyers to perform at best practice levels is a function of engagement. Modern employees will only work well if they want too. They need to be engaged by the matters that they are working on and the talent that they are working with, all the while maintaining a healthy work life balance. In short, get ready to pay more for less!

2. Generational skill sets

The management and motivation of talent will become a significant differentiator. Good firms will always earn solid profits beyond partner salaries through staff leverage. Attracting talent, retaining and compensating them won't get easier.

Partners wishing to maintain success need to learn and practise new leadership skills, not the ones that they learned by being mistreated themselves. The old "it was good enough for us, it will do for them" approach won't work with talented employees.

3. The boutique emerges as the norm

Clients want specialists, even in commodity areas. Having made a decision not to be a large, general service firm the question begs, "What do you want to be?"

I think that we will see a growing number of top profit firms being quite boutique. Within five years boutique providers will, most likely, make up the entire top quartile of the high-profit sample population in all FMRC Legal performance surveys. These firms will out-perform the generalists in many areas, most critically in client quality and talent attraction.

4. Good firms combat commoditisation with client intimacy

As clients become more sophisticated, perceived value is becoming more important than brand. Know and like your clients, become an expert in your client's industry, their staff, suppliers and customers. Visit clients regularly and develop a keen awareness of the needs and wants of all critical individuals. It really isn't that hard. It is currently a differentiator but will emerge as the norm.

The mid-tier firms of the Australian profession have experienced excitingly rapid growth in total fees billed and profit in the last two years. Much of this growth has come at the expense of the top tier firms. Another symptom is price fatigue. As a result we have seen the growth of in-sourcing of legal work by significant corporate clients. It is only a matter of time until smaller corporate firms and small to medium-sized enterprises catch the bug.

5. New ownership and wealth building opportunities

There are many reasons why modern firms should explore incorporation. By 2010 many successful legal firms will have diverse ownership. The value placed on these firms will be a function of profitability, systems and management quality, and to an extent client quality.

6. Knowledge management a major differentiator

Maintaining a high performance culture, quality and steep learning curves is all about the effective management of knowledge. Smaller and mid-sized legal firms are starting to manage this better.

Good knowledge management is much more than a technology challenge. To work well it must be cultural. Partners and senior lawyers must embrace knowledge-sharing and owners must be prepared to see learning and lawyer skill building as an opportunity not an expense.

7. Flexible working arrangements retain talented individuals

Our analysis of the composition of solicitors in NSW confirms an increase in the number of women in the profession: The necessity to introduce more flexible working arrangements to retain talented individuals is likely to see the trend toward women dominating the profession gain momentum.

By 2010, firm size (lawyer numbers and gross fees billed) will be less important to the maintenance of profitability than flexibility, quality, leadership and client intimacy. Good firms should ready themselves now.



Small Firms, Big Winners

WORKSHOPS

This one-day intensive workshop provides practical, strategic advice to improve the profitability and enjoyment of your practice.

You will see how small firms are making big profits because they tenaciously implement no-nonsense management strategies. Our discussions are supported with industry facts from the latest benchmark research on the performance of small law firms.

DATES AND VENUE

Brisbane: Wednesday, 5 March Hilton Brisbane

Sydney: Monday, 10 March Hilton Sydney

Melbourne: Tuesday, 11 March Hotel Grand Chancellor

9:00am (coffee from 8:30am) to 5:00pm

YOUR INVESTMENT

The cost of this workshop is \$880 (incl. GST) for the first person. Additional people from the same firm are \$660 each (incl. GST).

MCLE / CPD POINTS

Subject to specific requirements of relevant State rulings. 6 MCLE points in NSW

Workshop Presenter



Neil Oakes

Neil has been working as a management consultant with the legal profession for 20 years.

He undertakes consulting assignments for law firms throughout Australia and New

Zealand, specialising in strategic advantage, profit growth strategies and change management. Each year he is involved with some 110 law firms of various sizes and speciality areas of practice.

Neil is one of the New South Wales Law Society's Best Practice auditors and consultants.

FMRC Legal - provides training, research and management advice to law firms. For the past 30 years it has been a major centre for training Australian and New Zealand solicitors in legal practice management. Today we act for major national law firms, mid-sized, boutique and progressive small firms.

Registration

TAX INVOICE

Please register me in the following:

Brisbane: Wednesday, 5 March

Sydney: Monday, 10 March

Melbourne: Tuesday, 11 March

YOUR INVESTMENT

The cost of this workshop is \$880 (incl. GST) for the first person. Additional people from the same firm are \$660 each (incl. GST).

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TAX INVOICE

Once completed this form constitutes a tax invoice from FMRC Legal Pty Ltd ABN 80 083 010 075

2 easy ways to register:

1. Fax this sheet to 02 9262 6749

2. Phone 02 9262 3377

Cancellation policy

Registrations cancelled within one week of a workshop will incur an administration charge. FMRC Legal reserves the right to cancel workshops due to insufficient registrations.

VISIT US @ www.fmrcllegal.com

Workshop Co-ordinator

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