Auckland legal practitioners' performance survey 2015

MOORE STEPHENS MARKHAMS

ACCOUNTANTS AND ADVISORS

Serious about Success

Partnership, including non-equity partners (NEPs), helps to boost profits

Equity partner net incomes are significantly higher across the board since our 2013 survey. The top five firms ranked by profitability reported net equity partner incomes ranging from $624,000 to $1,070,000 ($487,000 to $613,000 in 2013) and nearly half (eight firms) reported net equity partner incomes in excess of $500,000, a significant increase over our 2013 survey.

NEPs are helping to maintain equity partner incomes. However, we are seeing NEP remuneration increasing reflecting NEPs' increasing economic contribution and in some firms, NEPs are demanding equity; walking and taking their clients with them if they do not see a clear path to equity.

At the same time, senior lawyers are demanding NEP positions. Overall the NEP model seems to be working, assisting with succession and overall growth of firms.

The 2015 survey has highlighted a huge variance in performance of the 20 firms across Auckland. Firms that are not in the top five* should be looking at strategies to bring their results to within this range as a strategy for success.

We have seen in previous surveys that the more profitable firms are able to achieve net incomes of around 40 percent of turnover, salary costs of around 30 to 35 percent and overhead costs of approximately 25 percent. A summary of KPIs is outlined inside.

Overall, there is a clear trend that all firms have improved performance and it would appear this is due to the improved economy generally, and the 'overheated' Auckland property market with Unitary Plan, resource and environmental legal work driving profits in the market.

It is interesting to note that while central city firms suffered more during the GFC than those based in the suburbs, the tide has turned and central firms appear to be attracting a higher level of more profitable work now.

*Ranked by profitability as determined on a per equity partner basis

Characteristics of a profitable legal firm

- Average gross fees per equity partner in excess of $1,200,000
- Partner charge out rates of $400 plus
- Staff salaries to gross fees generally 30 to 35 percent (however can be higher if gross fees are significantly higher)
- Partnership of two or more equity partners with at least one non-equity partner
- Overheads (excl interest and salaries) to gross fees of 25 percent or less.

Sam Bassett

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The Auckland legal practitioners' performance survey 2015 is an initiative of the legal industry business development unit of the Moore Stephens Markhams chartered accountancy group.

It has been conducted regularly since 2006 in the Auckland marketplace, and covers topics such as practice profitability, efficiency, work type, hours, salary comparisons and professional indemnity insurance.

In 2015, 20 firms participated, ranging in size from sole practitioners to a firm with 12 partners (including non-equity partners).

Annual accounts and profitability

In total, 20 firms supplied statistics to us from the Auckland region. This year participant firm size ranged from 2 sole practitioners to a firm with 12 partners (including non-equity partners). Overall the number of equity partners included in the survey totalled 73 compared to 46 in 2013 and 46 in 2011; 8 out of the 20 firms submitted results for the first time.

Since our last survey in 2013, turnover and profitability have increased significantly. The top five* firms ranked by profitability reported net equity partner incomes ranging from $624,000 to $1,070,000 ($487,000 to $613,000 in 2013) and nearly half (eight firms) reported net equity partner incomes in excess of $500,000, a significant increase over our 2013 survey.

The benefit of working in partnership and the use of non-equity partners (NEPs) continue to have an influence on profitability. Four of the top five* firms had three to five equity partners (with additional NEPs) and although there were two sole practitioners included in our survey, it should be noted that even those firms had one or two non-equity partners working with them.

Over the last few years we have seen from our work with legal firms and reinforced by this survey, that the lock step partnership formula is still a popular choice not only for succession planning but for expanding the business.
To illustrate this, nine participants have submitted their results since 2011 and within these firms the total number of partners has grown from 33 to 40 partners over the four-year period (including NEPs).

Firms that commit to a succession plan early are rewarded with increased equity partner earnings through overall firm growth and increased contribution from NEPs or younger partners on a lock step to equity.

Specialisation and litigation also pay off with the top three firms* operating in specialised litigation areas. These three firms had net partner incomes in excess of $800,000, which is a phenomenal result.

For the first time, location is a key factor with the top 5 firms all being in the central city. Only one suburban firm is in the top 10. Central city firms in general have higher charge out rates and higher overhead costs, which in turn leads to higher turnover. Careful management, especially with rental / occupancy cost is extremely important for Central City firms.

In dollar terms, firms should aim to be paying no more than $60,000 p.a. rent per equity partner even if the firm is located in the central city and for a multiple partner firm, rent occupancy costs of no more than five percent of gross fees should be achievable.

A summary of average charge out rates, turnover and rent cost by location is below:

Location	No. of firms	Partner charge out rate	Turnover per Equity Partner ($000)	Rent per Equity Partner ($000)	Rent % of Turnover
Central Auckland	11	460	1710	91	5%
City Fringe	3	404	884	60	7%
Suburban	6	382	896	43	5%

Participants ranked in the lowest five for profitability were mainly suburban firms with the exception of one. The main factors for these suburban firms were lower turnover and high salary costs due to the employment of NEPs.

Location and specialisation is not the only answer as a good suburban firm can still achieve a good net income. Participants 15 and 13 ranked 10 and 11 in terms of profitability and were the highest ranked non central city firms; each had net equity partner incomes of $442,000 and $440,000 respectively. Both are generalist firms located in suburban areas and achieve profitably by having the lowest overhead percentages overall at 18 percent and 14 percent of turnover.

Non-equity partners (NEPs)

We have seen over the last four surveys that having NEPs in small to medium sized firms appears to be a successful strategy. Three of the top five* and six of the top ten* firms all have NEPs.

NEP salaries are increasing with a huge range in this survey from $140,000 to $320,000 ($107,000 to $285,000 in 2013). NEPs are contributing significantly to firm profits and therefore commanding higher remuneration to reflect their economic contribution. Overall this strategy is working to boost equity partner net incomes.

*Ranked by profitability as determined on a per equity partner basis

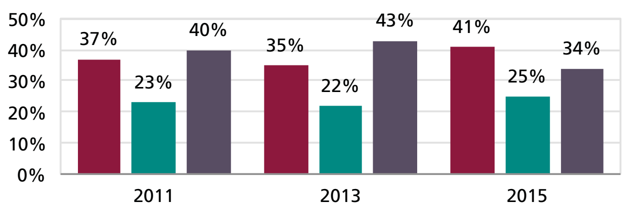
Key Performance Indicators (KPI)

The above three year trend for the top five* firms shows that turnover has increased significantly, almost doubling over the last two years. Despite net income as a percentage of turnover decreasing to 34 percent, the net income per equity partner for the five most profitable firms averaged $839,000.

It should be noted that salary costs were significantly higher for the top five firms than in previous years and this is largely due to the high number of non-equity partners included in these firms (11 out of 25 NEPs in this year's survey are included in the top five firms).

The average salary cost for the top five* firms was $124,000 compared to the lowest five* firms that had an average salary cost of $94,000. Despite higher salary costs, these firms were able to achieve higher profitability due to high turnover, which is a function of price and specialisation.

TOP FIVE AVERAGE KEY PERFORMANCE INDICATORS 2011 - 2015 (ranked by profitability per equity partner - as a % of gross fees)



TOP FIVE AVERAGE KEY PERFORMANCE INDICATORS 2011 - 2015 (ranked by profitability per equity partner - as a % of gross fees)

Staff salaries Overheads Net income

Overhead as a percentage of turnover has also increased to 25 percent and this is mainly due to all of the top five* firms being located in the central city where rent costs are higher.

A balance must still be achieved with regard to overhead costs in order to achieve profitability. For example, Participant 16 who is based in the city centre and was ranked 5 out of 20 based on turnover, is ranked 18 out of 20 based on profitability. This firm has significant overhead costs, mainly rent with overhead costs being 34 percent of turnover. If overhead costs were brought into line, equity partner net incomes could increase in excess of $120,000 per equity partner. We are surprised at the level of overhead costs continuing to be incurred by some firms, particularly in the modern business environment.

Overall across the 20 firms surveyed, turnover and profitability are generally higher than in previous years. All of the nine participants who have submitted since 2011, have had increases in turnover. Firms ranked 6 to 15 based on profitability were able to achieve, on average, salary costs of 31 percent and overhead costs of 24 percent resulting in average net income for this group of $444,000 (or 45 percent of turnover). These are efficient firms retaining a significant percentage of fee revenue as profit, which we consider to be excellent results. Of the 73 equity partners surveyed, 50 were each able to take home more than $400,000 of net income.

Practice manager contributions

In 2013, we asked for the first time whether firms engaged a practice manager. Of the 20 firms surveyed this year, 11 employed practice managers. Salary for a practice manager in our survey ranged from $70,000 to $177,000 ($68,000 to $140,000 in 2013). Of the top 10* firms, 7 employed practice managers. It has been noted that a good practice manager should be able to pay for themselves in terms of efficiency gains.

Practice efficiency

The combination of work in progress (WIP) and debtors, which is commonly referred to as 'Lockup' per equity partner, is an important indicator of a firm's financial efficiency and is usually also an indicator of general efficiency with work practices. If a firm is not managing work flow, billing, and collection effectively, this is often an indication that other work processes are not being done efficiently.

From the results that we have received, lockup varies from 0.8 months to 6.3 months (1.1 months to 6.8 months in 2013). However, all firms in the sample had an average lock up of 3.1 months (2.91 months in 2013) worth of fees tied up as debtors or WIP.

Reducing funds tied up in lockup increases firms' net incomes by reducing funding costs and freeing up capital to be invested elsewhere. The average lockup for the five most profitable firms in our survey was 3.6 months compared to 1.9 months for the lowest five* firms.

Lockup for litigation and dispute resolution work is likely to be higher and can explain the increase in the overall average, given there are eight litigation firms (or firms with significant litigation sections) included in our survey.

Interestingly, the 11 firms employing practice managers had an average lockup of four months compared to two and a half months for those firms without a practice manager.

Salary comparisons

In general, the more profitable firms pay staff slightly more. The top five* firms pay on average $156,000 ($119,000 in 2013) to a senior solicitor with five years or more post admission experience. For the bottom five*, the average is $114,000 ($115,000 in 2013). The overall average of participants here is listed as follows:

The table right shows average salaries were slightly higher than the previous year. In particular, non-equity partner and senior solicitor salaries have increased. The range of salaries in this small sample is also important.

	Range	2015	2013	2011
Non-Equity Partner/Principal	$140,000 - $320,000	$ 200,000	$ 173,000	$ 160,000
Senior Solicitor (5 years +) post admission	$90,000 - $180,000	$ 128,000	$ 122,000	$ 112,000
Intermediate Solicitors (2-3 years PA experience)	$60,000 - $120,000	$ 77,000	$ 72,000	$ 68,000
Graduate Solicitor	$38,000 - $60,000	$ 50,000	$ 49,000	$ 41,000
Legal Executive (0-5 years' experience)	$55,000 - $70,000	$ 60,000	$ 50,000	$ 58,000
Legal Executive (5+ years' experience)	$61,000 - $105,000	$ 79,000	$ 66,000	
Secretarial (Senior)	$50,000 - $80,000	$ 63,000	$ 60,000	$ 55,000
Secretarial (Junior)	$30,000 - $67,000	$ 44,000	$ 41,000	$ 44,000
Practice Manager	$70,000 - $177,000	$ 106,000	$ 94,000	

Professional indemnity insurance

The average professional indemnity insurance premium per partner for the top five* firms was $36,000; 1.5 percent of gross fees (2013: $6,300, 0.48 percent of gross fees) per equity partner. While the top five* firms in each survey are different, our survey has confirmed a significant increase in PI premiums from 2013 to 2015.

Profit distribution

Eight of the twenty firms surveyed report that partnership profits are not equally shared. This could be a factor of succession planning where retiring equity partners exit on a lock step basis similar to a NEP entering the partnership. We have also seen a trend toward unequal profit share models being introduced. Only one of the top five* firms, shares profit equally.

Disclaimer

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Spreadsheet notes

In the separately supplied Excel spreadsheet, the survey results are shown firm by firm, i.e. each column shows individual practitioner's statistics. They are spread across the page in descending order of profitability per equity partner. On the right side of the page is the average statistics for the firms listed on that page, providing a 'peer group' average. Averages were adjusted where necessary to provide a more meaningful comparison, for example if a firm did not have a Senior Solicitor, then the average charge-out rate for a Senior Solicitor was only calculated for the firms that did have them.

The second spreadsheet is ranked by 'Gross Fees per Equity Partner'; therefore you can compare your results with other participants in the survey that have a similar gross fee level per equity partner.

Overheads exclude interest paid, which has been added back into net profit, because almost all other statistics are directly comparable firm to firm, but interest may depend on external personal factors relating to how a firm is financed.

Please contact Moore Stephens Markhams Auckland should you wish to have a copy of this spreadsheet.

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