AUCKLAND
LEGAL PRACTITIONERS' PERFORMANCE SURVEY 2017

MOORE STEPHENS MARKHAMS
ACCOUNTANTS AND ADVISORS

Surge in suburban and city fringe legal firms' profitability

Suburban and city fringe firms have performed very well over the past two years, demonstrating that a city centre location is not a prerequisite for profitability. We suggest this has been driven by the strong property market but there is a clear trend that smaller general practice firms located outside the city centre, who monitor their overheads and work efficiently, can perform exceptionally well financially.

Another strong trend is an increase in non-equity partner income; NEPs are helping to maintain equity partner incomes and this significant contribution is being rewarded.

In some firms, NEPs are demanding equity and walking, taking their clients with them, if they do not see a clear path unfolding. At the same time, senior lawyers are demanding NEP positions. Overall, the NEP model seems to be working, assisting with succession and overall financial growth of firms.

Salary costs

Salary costs are significantly higher across the board since our 2013 survey. In particular, non-equity partner, senior solicitor, and practice manager salaries have increased, with the more profitable firms paying staff more.

The 2017 survey has highlighted a huge variance in performance of the 22 participating firms, which are located across Auckland.

Firms that are not in the top five* should be looking at strategies to bring their financial results to within the top firms* range as a strategy for success.

*Firms ranked by profitability per equity partner

Characteristics of a profitable legal firm

- Average gross fees per equity partner in excess of $1 million
- Partner charge out rates of $450 plus
- Staff salaries to gross fees generally 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 (excluding interest and salaries) to gross fees of 22 percent or less
- Do not share profits equally amongst equity partners.

Sam Bassett

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The Auckland Legal Practitioners' Performance Survey 2017 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 2017, 22 firms participated, ranging in size from sole practitioners to a firm with 12 partners (including non-equity partners).

Annual accounts and profitability

A total of 22 firms supplied statistics from the Auckland region. The participating firms ranged in size from two sole practitioners to one firm with 12 partners. Overall the number of equity partners included in the survey totalled 80, compared to 73 in 2015 and 46 in 2013. We have seven firms who have submitted results for the first time.

Since our last survey in 2015, there has been a slight increase in turnover and profitability. The top five firms ranked by profitability reported net equity partner incomes ranging from $609,000 to $1,250,000 (2015: $624,000 to $1,070,000). Ten out of the 22 firms (45 percent) reported income greater than $500,000, compared to eight out of 20 firms (40 percent) in 2015.

The benefits of working in partnership and the use of non-equity partners (NEPs) continue to have an influence on profitability. Three out of the five top firms* have two to five equity partners (with additional NEPs), and although there were two sole practitioners included in the survey, it is worth noting that those firms had one or two non-equity partners working with them.

In our work with legal firms and through preparation of this survey, we have seen the lock step partnership formula still being a popular choice, not only for succession planning but for also expanding the business. To illustrate this, nine participants have submitted their results since 2011, and of these nine, the total number of partners has grown from 33 to 39 partners over the six-year period (including NEPs).

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

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

We saw in 2015 that location was a key factor for profitability with the top nine firms* being based in the central city. In 2017, city fringe and suburban firms reported excellent results. There is one general practice suburban firm in the top five* and four city fringe or suburban firms in the top 10 firms* with all reporting profitability per equity partner in excess of $500,000 per annum.

Central city firms have higher charge out rates and higher overhead costs, which in turn leads to higher turnover but not necessarily profitability. In dollar terms, firms should aim to be paying no more than $60,000 per annum 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.

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	Rent per equity partner	Rent % of turnover
Central Auckland	11	490	1,700,000	89,000	5%
City fringe	5	458	867,000	57,000	7%
Suburban	6	386	1,042,000	42,000	4%

Participants ranked in the lowest five for profitability were also a mix of city centre (one), city fringe (three), and suburban (one).

The main factors for these suburban firms were lower turnover and high salary costs as a percentage of gross fees. The buoyant property market and the growth in conveyancing and property law work has led to a significant increase in suburban firms' profitability.

Participants 19 and 17 were highest ranked suburban firms in terms of profitability per partner of $609,000 and $579,000 respectively. Both firms provide general legal services located in suburban areas and achieve profitability by having the lowest overhead percentages overall at 10 and 19 percent of turnover respectively.

*Firms ranked by profitability per equity partner

Key performance indicators (KPIs)

Top 5 firms key performance indicator statistics (ranked by profitability per equity partner)			
	2017	2015	2013
Salaries	38%	41%	35%
Overheads	20%	25%	22%
Net income	42%	34%	43%
Turnover	2,231,000	2,438,000	1,314,000
Salaries	839,000	991,000	460,000
Overheads	435,000	608,000	285,000
Net income	957,000	839,000	569,000
Average staff per equity partner	7	8	5
Average salary	$107,000	$124,000	$86,000
Non-equity partners	2	2	1

The above three-year trend for the top five firms* illustrates that turnover has significantly increased from 2013. Between 2015 and 2017, turnover decreased from $2,438,000 to $2,231,000. Despite the eight percent decrease in turnover, the firms have seen an improvement of 14 percent in net income between the years. This is a direct result of reduction in salaries and overheads in 2017, with net income representing 42 percent of turnover.

Overheads as a percentage of turnover has decreased to 20 percent in 2017, and this is mainly due to the top five firms* now including a firm in a suburban location. In 2015, all the top five firms* were located in the city centre where rent costs are considerably higher. A balance must still be achieved with regard to overhead costs in order to achieve profitability.

For example, participant number 5, who is based in the city centre and was ranked 12 out of 22 based on turnover, is ranked 17 out of 22 based on profitability because of significant overhead costs and salary costs. We are surprised at the level of overhead costs continuing to be incurred by some firms, particularly in the modern business environment.

Turnover for the top five firms* has decreased by eight percent, however, with firms now focusing on reducing overheads and salary costs, profitability is being sustained. All but one of the nine participants who have continuously submitted their statistics since 2011, have had increases in turnover.

Firms ranked 6 to 17 based on profitability achieved an average salary cost of 35 percent and average overhead costs of 25 percent, resulting in average net income for this group of $477,000 or 40 percent of turnover; still a good income result. Fifty out of eighty two equity partners took home more than $400,000 of net income each.

*Firms ranked by profitability per equity partner

Practice manager contribution

Of the 22 firms surveyed, 11 employ practice managers. Salaries for practice managers are increasing with a huge range in salaries from $95,000 to $190,000 (2015: $70,000 to $177,000). Six of the top 10 firms* employ practice managers and as a result, are benefitting from the increased efficiency and therefore profitability.

Non-equity partners (NEPs)

Over the last five surveys we have seen that having NEPs in small to medium sized firms appears to be a successful strategy. Three of the top five* and five of the top ten firms* have NEPs. NEP salaries are increasing with a huge range in this survey from $150,000 to $350,000 (2015: $140,000 to $320,000). NEPs are contributing significantly to firm profits and therefore are commanding higher remuneration to reflect their economic contribution. Overall this strategy is working in boosting equity partner net incomes.

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 0.7 months to 4.7 months (2015: 0.8 months to 6.3 months). However, all firms in the survey have an average lockup of 2.7 months' worth of fees tied up in debtors or WIP (2015: 3.1 months).

Reducing funds tied up in lockup increases a firm's net income 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 3.2 months compared to 3.1 months for the lowest five firms*.

Professional indemnity insurance premiums

The average professional indemnity insurance premium per partner for the top five firms* is $25,000, 1.1 percent of gross fees (2015: $36,000, 1.5 percent of gross fees) per equity partner. While the top five firms* in each survey year are different, our survey has confirmed a decrease in PI premiums from 2015 to 2017.

Salary comparisons

In general, the more profitable firms pay staff slightly more. The top five firms* pay on average $161,000 ($156,000 in 2015) to a senior solicitor with five years or more post admission experience. For the bottom five firms*, the average is $106,000 (2015 $114,000). The overall average of participants is listed to the right.

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

	Range	2017	2015	2013
Non-Equity Partner/Principal	$150,000 - $350,000	$237,000	$200,000	$173,000
Senior Solicitor (5 years +) post Admission	$70,000 - $225,000	$134,000	$128,000	$122,000
Intermediate Solicitor (2-3 years PA experience)	$65,000 - $140,000	$86,000	$77,000	$72,000
Graduate Solicitor	$45,000 - $60,000	$53,000	$50,000	$49,000
Legal Exec (0-5 years' experience)	$45,000 - $90,000	$66,000	$60,000	$50,000
Legal Exec (5+ years' experience)	$50,000 - $95,000	$75,000	$79,000	$66,000
Secretarial (Senior)	$55,000 - $80,000	$65,000	$63,000	$60,000
Secretarial (Junior)	$45,000 - $60,000	$46,000	$44,000	$41,000
Practice Manager	$95,000 - $190,000	$118,000	$106,000	$94,000

Partnership profit distribution

Thirteen of the twenty two firms surveyed report that partnership profits are not shared equally. 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 by firms. Only one in the top five firms*, share profit equally.

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.

*Firms ranked by profitability per equity partner

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