MOORE Markhams

Accountants and Advisors

AUCKLAND LEGAL PRACTITIONERS' PERFORMANCE SURVEY 2021

A TALE OF TWO HALVES FOR SUBURBAN LEGAL FIRMS

The strong property market shows no sign of slowing down in the face of Covid-19, which has allowed some suburban general practice firms to perform exceptionally well in terms of profitability.

This year two of the top five firms ranked by profitability* were suburban firms, demonstrating that a city centre location is not a prerequisite for profitability. One of these firms ranked first across all the participants and achieved over 60 percent of gross fees as net income to the equity partners, which is a phenomenal result. On the flip side, suburban firms also recorded some of the lowest profits, making up four of the five least profitable firms.

Another trend that is apparent in this year's survey is the utilisation of a practice manager to assist with firm management. All the top ten firms* employ a practice manager, allowing equity partners to work more efficiently and focus on generating fees. Equity partner time that can be recovered earns a significantly higher margin (100%) compared to other staff.

GENERAL CHARACTERISTICS OF A PROFITABLE LEGAL FIRM

Average gross fees per equity partner in excess of
$1 MILLION

Partner charge out rates of
$500+

Staff salaries margin to gross fees generally between
30-35%
(however can be higher if gross fees are significantly higher)

Partnership of **2** or more equity partners with at least 1 non-equity partner

Overheads (excl. Interest and Salaries) to Gross Fees of
25% or less

PRACTICE MANAGER looks after firm management responsibilities

DO NOT SHARE profits equally among equity partners

*Firms ranked by profitability per equity partner

The Auckland Legal Practitioners' Performance Survey has been held regularly since 2006, by our specialist legal industry business development unit.

Headed by directors Sam Bassett and Belinda Young, the survey canvasses topics such as practice profitability, efficiency, work type, hours, salary comparisons and gender impact.

In 2021, 24 firms participated.

Sam Bassett and Belinda Young of Moore Markhams act for a large number of legal firms and barristers in Auckland.

They assist legal clients with firm mergers, partner admissions, retirement, and consult with legal practitioners on ways to improve profitability.

KEY FINDINGS

A total of 24 firms supplied statistics from the Auckland region. Five participants submitted results for the first time. The participating firms ranged from a sole practitioner to a firm with 28 partners. Overall, the number of equity partners included in the survey totalled 103, compared to 99 in 2019 and 80 in 2017.

Since our last survey in 2019, there has been a decrease in turnover and profitability. Legal firms are one of the less impacted industries by Covid-19 as many firms have good electronic systems that facilitate staff to work efficiently from home. However, firms still experienced a slowdown in trading as staff and clients alike adjusted to working from home in the first nationwide lockdown in April and May 2020.

The top five firms, ranked by profitability per equity partner, reported an average net equity partner income of $803,000 compared to $919,000 in 2019. However, it is worth noting that out of the 24 participants this year,13 firms (54%) recorded net equity partner income of over $500,000 compared to 43% in 2019, and 45% in 2017.

NEPs benefit continues

Continuing the trend from the 2017 and 2019 surveys, the most profitable firms have adopted the partnership model of having both equity and non-equity partners (NEPs). The top five ranked firms* have between two to six equity partners and three out of the five firms have one to two NEPs.

Our work with legal firms and the results from this year's survey continue to show that the lock-step partnership formula is a popular choice to retain and reward key talent in firms as part of succession planning and business expansion.

Firms that commit early to a lock-step succession plan allow for growth of the firm. Generally, these firms are rewarded with an overall increase in equity partner earnings through increased contributions from NEPs and younger equity partners as they progress towards a full equity partner status.

To illustrate this, we saw a participant firm experience a significant increase in their net equity partner income in the 2019 survey, when two equity partners exited the firm and were each replaced by two NEPs. The equity partners were able to enjoy higher net incomes due to the contributions of the NEPs. The participant's net equity partner income in 2021 has now reduced but overall, both the equity and non equity partners' incomes have increased, and the firm has grown during this period.

A summary of the 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	505	1294	82	6%
City fringe	4	505	1070	53	5%
Suburban	9	437	1160	47	4%

Location, location, location

Historically, we have seen the more profitable firms predominantly located in the central city. In our 2019 survey, eight of the top ten firms were based in the central city. This time results show that only six out of the top ten firms* are based in central city.

In 2021, there are two suburban firms and one city fringe firm in the top five firms*. In particular, the most profitable firm this year was a suburban firm earning $939,000 per equity partner. The three firms provide general legal services and have achieved increased profitability by having low overhead percentages ranging from 14 to 17 percent of gross fees. The buoyant property market and the growth in conveyancing and property law work has led to a significant increase in the profitability of suburban firms.

Consistent with 2019 results, participants ranked in the lowest five for profitability are in the city fringe and suburbs. Lower turnover, and high salary and overhead costs as a percentage of gross fees are the main reasons for the lower profitability. These participants had an average salary cost of 36 percent of turnover and an average overhead cost of 30 percent of turnover.

Higher rent costs in central Auckland continues to be the main driver for firms that have high overhead costs. As an example, despite two participants both being relatively large firms based in the central city with comparable turnover per equity partner, one pays $120,000 (8%) and the other, $54,000 (4%) of rent respectively. This difference in rent costs is key to the more profitable firm being able to keep its overhead costs to under 20 percent of gross fees.

In general, we consider 20 percent of gross fees for overheads the benchmark, and our survey confirms this is achievable for the successful central city firms.

*Firms ranked by profitability per equity partner

Gender imbalance slow to change

This year we again asked for information regarding the gender of the partners in each firm. The top five firms* had a total of 17 equity partners, 14 (82%) of the equity partners were male and 3 (18%) were female (2019: 92% and 8% respectively).

Of the 103 equity partners included, 79 (77%) were male and 24 (23%) were female. There were 29 NEPs included of which 14 (48%) were male and 15 (52%) were female.

Overall, the ratio between male and female partners across all the participants appears to be consistent with our 2019 survey, where approximately 75 percent of equity partners and 53 percent of NEPs were male partners. With slightly more women (52%) of NEP partners in this year's survey we would expect the ratio between men and women equity partners to become more balanced, however this is happening slowly.

Specialisation aids growth

Specialisation in employment law, commercial litigation and residential conveyancing are features of the top five firms*. The net income for the top three firms* was over $800,000 per equity partner, which is an excellent result.

Expectation for fee growth over the next 12 months averaged to five percent across all participants compared to nine percent in 2019. This reflects the reservations of firms surrounding the ongoing impacts of Covid-19 (at writing, we approach the third consecutive month of the August 2021 Auckland lockdown), along with an expectation that the property market will slow in 2022.

KEY PERFORMANCE INDICATORS (KPI)

Top 5 firms by profitability*

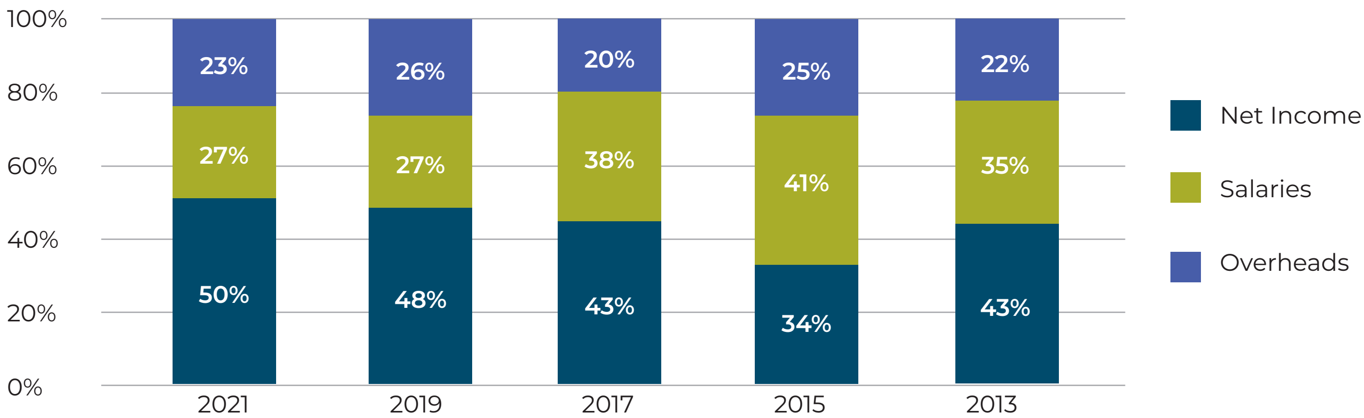
	2021	2019	2017	2015	2013
Average turnover	1,616,000	1,935,000	2,231,000	2,438,000	1,314,000
Average salaries	439,000	522,000	839,000	991,000	460,000
Average overheads	374,000	494,000	435,000	608,000	285,000
Average net income	803,000	919,000	957,000	839,000	569,000

The lower turnover observed for the top five firms* is due to two suburban firms recording lower turnover compared to central city firms but higher net income for their equity partners. The five most profitable firms* averaged $803,000 net income per equity partner in 2021, compared to $919,000 in 2019.

The above table highlights the average turnover, salaries, overhead costs and net income per equity partner in dollar terms.

The below graph highlights 2021 net income per equity partner as a percentage of gross fees at 50 percent being the highest across the period 2013 to 2021. Despite the decrease in dollar value of net income per equity partner, the overall percentage of turnover is the highest over the nine-year period since 2013.

Top five average Key Performance Indicators 2013-2021 (ranked by profitability per equity partner as a % of gross fees)



*Firms ranked by profitability per equity partner

Salaries impact on profitability

Salaries as a percentage of gross fees for the top five firms* has remained at 27 percent, which is consistent with 2019 survey results. Overheads as a percentage of gross fees have reduced from 26 to 23 percent.

A key factor to a profitability for small to medium sized firms is keeping salary cost low as a percentage of gross fees. This does not suggest paying low salaries to staff, but this percentage is a key indicator of overall efficiency of a firm, where staff work is priced correctly with a realistic allowance for time that is not able to be charged and recovered.

Good management allows firms to keep salary costs below 30 percent where the equity partners are successfully recovering more of their own time at higher charge rates in conjunction with legal authors being able to recover a higher margin on their time.

The gross margin on equity partner time charged is 100 percent as there is no salary cost associated with equity partner charged time. Therefore, higher recovery of equity partner time directly leads to an improvement in profitability and an overall reduction in staff wage cost as a percentage of turnover.

Overall, participants that recorded net income per equity partner of over $500,000 typically had salary costs of 30 to 35 percent (as a percentage of gross fees) and overheads costs of 15 to 20 percent, which gave net income to the equity partners of 50 percent. We are pleased to see that more participants have been able to achieve this level of net income for their equity partners compared to previous years.

SALARY COMPARISONS

	2021 range	2021 average	2019 average	2017 average	2015 average	2013 average
Non-equity partner / principal	$150,000 - $315,000	$220,000	$209,000	$237,000	$200,000	$173,000
Senior solicitor (5+ years' post admission experience)	$92,000 - $175,000	$ 134,000	$127,000	$134,000	$128,000	$122,000
Intermediate solicitors (2-3 years' post admission experience)	$55,000 - $158,000	$96,000	$84,000	$86,000	$77,000	$72,000
Graduate solicitor	$48,000 - $85,000	$58,000	$56,000	$53,000	$50,000	$49,000
Legal executive (5+ years' experience)	$65,000 - $155,000	$90,000	$86,000	$66,000	$60,000	$50,000
Legal executive (0-5 years' experience)	$45,000 - $113,000	$67,000	$83,000	$75,000	$79,000	$66,000
Secretarial (senior)	$60,000 - $80,000	$69,000	$69,000	$65,000	$63,000	$60,000
Secretarial (junior)	$42,000 - $70,000	$54,000	$50,000	$46,000	$44,000	$41,000
Research clerk	$40,000 - $60,000	$50,000	$50,000	$ -	$ -	$ -
Practice manager	$70,000 - $250,000	$120,000	$111,000	$ 118,000	$106,000	$94,000

Overall, salaries have increased slightly on average across the roles except for legal executives with 0-5 years' experience. NEPs and practice managers continue to receive a broad range in terms of remuneration depending on arrangements with the firm. Being paid higher than 2019 on average, confirms their significant contributions to the firms.

In general, the more profitable firms pay higher salaries to staff. The top five firms* pay an average salary of $150,000 to senior solicitors with five years or more post admission experience (2019: 131,000). The least profitable five firms pay $108,000 (2019: $119,000).

*Firms ranked by profitability per equity partner

Rent

We note that many landlords provided Covid-19 rent relief to tenants during the first lockdown in April and May 2020. Many participants received one month's rent relief, which helped maintain overhead costs and increased net income to equity partners in the 2021 financial year.

Practice efficiency

The combination of work in progress (WIP) and debtors, commonly referred to as 'lockup' per equity partner, is an important indicator of a firm's financial efficiency and general effective work practices. If a firm is not managing workflow, billing, and collection efficiently this is often an indication that other work processes are not being done efficiently. Reducing funds tied up in lockup improves cash flow and frees up capital to be invested in other areas of the business.

From the results received, lockup ranges from 0.7 months to 5.6 months (2019: 0.6 months to 5.1 months). The average lockup of all participants indicates that firms have 2.5 months' worth of fees tied up in debtors and WIP (2019: 2.6 months).

Partnership profit distribution

Out of the 24 firms surveyed, 15 reported that partnership profits are shared equally (2019: 13 out of 21). This could be a factor of succession planning where retiring partners exit on a lock-step basis allowing NEPs to enter the partnership.

Non-Equity Partners (NEPs)

NEPs continue to contribute significantly to the overall success of small to medium sized firms. Three of the top five and seven of the top ten firms* this year had NEPs. In monetary terms, NEP salaries range from $150,000 to $315,000 (2019: $150,000 to $280,000). We see an even wider range of remuneration for NEPs as they contribute heavily to firm profits and therefore are commanding remuneration to reflect their economic contributions. Overall, the strategy of employing NEPs has worked well to boost equity partner net incomes.

Practice manager contribution

Of the 24 participants, 19 firms employ a practice manager, representing 79 percent, up from 57 percent in the 2019 results. The top ten firms* all employ a practice manager. The survey confirms that more firms are recognising the efficiencies to be gained by utilising a practice manager as it allows partners to focus on business growth with a direct positive impact on profitability.

Practice manager salaries are increasing with a huge range from $75,000 to $250,000 (2019: $80,000 to $160,000) as some firms include a bonus based on a percentage of net income for further incentivisation.

Spread sheet notes

The survey results are shown firm by firm, i.e. each column shows individual practitioners' statistics. They are spread across the page in descending order of gross fees per equity partner. On the right side of the page are 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 will only be calculated for the firms that did have them.

Results are ranked by "Gross Fees per Equity Partner"; therefore, you can compare your results with several 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 from firm to firm, but interest may depend on external personal factors relating to how a firm is financed.

Please contact Moore Markhams Auckland should you wish to have a copy of this spread sheet.

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Accountants and Advisors

LEGAL & LITIGATION SUPPORT

Providing unique and specialist financial services for the legal profession.

In a complex and often challenging sector, our professionals understand the nature of our client's requirements and act for a significant number of legal firms and barristers throughout the country.

Our specialists provide a range of services including:

- advice on firm mergers, partner admissions and retirement
- law firm valuations
- litigation support
- expert witness support including valuation work and Income Diminution and Enhancement Calculations for the purposes of quantifying an award for an Economic Disparity claim under Section 15 of the Property (Relationships) Act 1976
- audit and forensic accounting.

SAM BASSETT

Director

I have built up significant expertise in business advice and taxation, with a particular interest in working with law firms and barristers and am involved with the firm's annual legal firm financial benchmarking survey.

I also have an interest in the aged care, and direct mailing and data management service sectors.

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In 2007, I joined Moore Markhams to focus on accounting and tax business advisory. I enjoy working with a range of clients and businesses.

From 2014, I have been providing business valuation and litigation support, including forensic accounting analysis and reporting. This has led to specialised experience in legal firm valuations and calculating economic disparity for relationship property including delivery of expert evidence at the Family Court.

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