2014
MHA Professional Practices Benchmarking

Report

Professional Practices Introduction

Karen Hain
Head of the Professional Practices Group at MHA

Welcome to the MHA benchmarking review of legal practices for 2013. It was a further year of pressure on firms, from a number of angles. Financial stability became the buzz word, with the SRA completing a series of risk reviews and reports on where they see problems in law firms. Interventions and business failures became much more frequent.

The Jackson Review impact on personal injury lawyers has radically changed that sector, with some firms closing down, merging with others, being bought out by ABS funded entities, or in extreme cases becoming insolvent. The pre April 2013 matters may not have all been settled by the end of the year but this stream of more profitable work is fast coming to an end.

Legal aid funds are shrinking and this has impacted on both criminal practices and family practices that had funded work. There has been a move to generate private work, but limitations on individuals own funds have left a hole in this income stream.

Our report shows limited growth in fee income across most sizes of firm except the larger practices. Net profits on the whole fell. Even those firms recording improvements in fees billed showed little growth in profitability.

We have introduced a new section this year covering overheads which I am sure you will find useful to benchmark against your own expenditure.

There is also a section covering lockup showing that many firms have felt cash flow pressures during 2013. Lockup improvement must be at the top of every COFA's to-do list.

We are now well into 2014 and on a more positive note, many practices are reporting an upturn in new matters. The economy is picking up with conveyancing departments busy, and corporate and commercial departments also seeing a surge in work. Firms need to keep control of finances to ensure that profits are generated and cash keeps coming in.

Thanks again to my MHA Professional Practices sector group for their input and contribution, and I hope you find this report interesting.

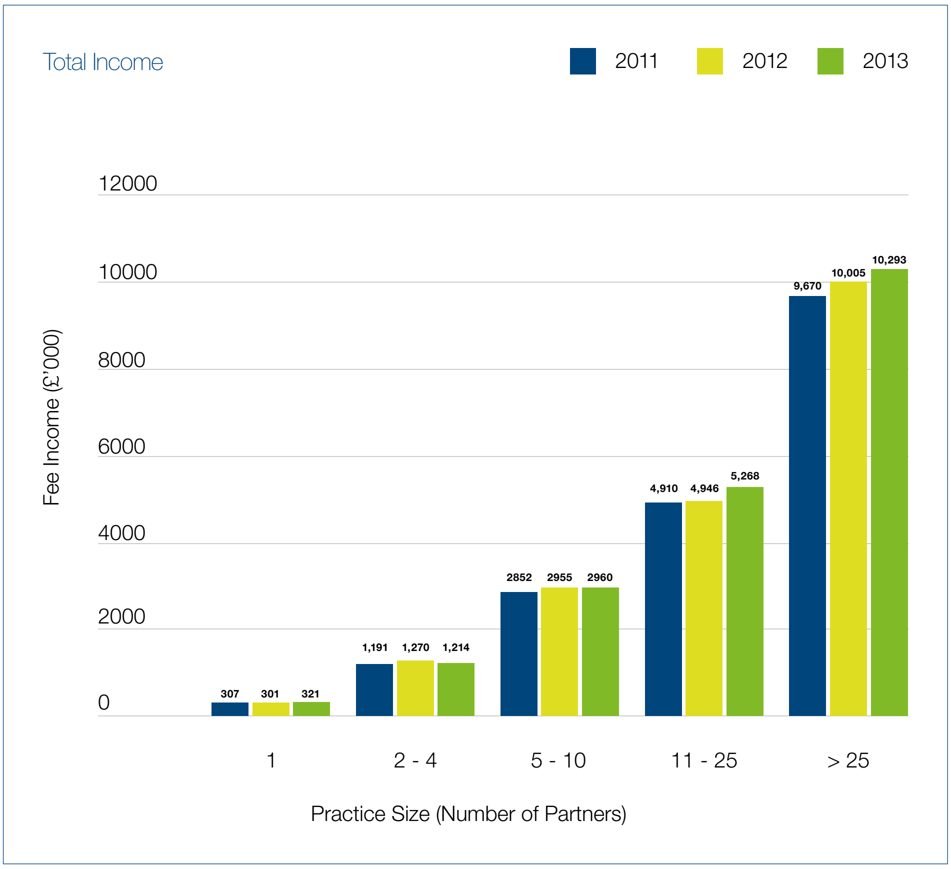
The MHA View:

Income

Written by Seamus Gates

Partner, MHA Member Firm, Broomfield & Alexander

The results of our survey show that smaller practices of up to 10 partners have experienced limited or no growth in the last year and this continues the trend over the previous 2 years.



The growth in larger practices would also suggest activity at the corporate and commercial level with bigger mergers and acquisitions and larger property transactions taking place.

The most successful group in our survey are the 11 - 25 partner firms who have seen growth of over 6% on average. This demonstrates an emergence from a flat market for them over the previous 2 years.

Firms with more than 25 partners have also grown but by just less than 3%. However, as this group also experienced growth last year of 3%, they have achieved 6% growth over a 2 year period rather than one.

There is also likely to be an element of merger activity in these two groups as they seek to grow by acquisition as they emerge from the recession.

Single partner practices have an income level per partner equivalent to 50% - 60% of that achieved by the larger firms. This demonstrates the difficulty for a sole trader in growing their practice as all the pressure of doing so falls on one person.

The MHA View:

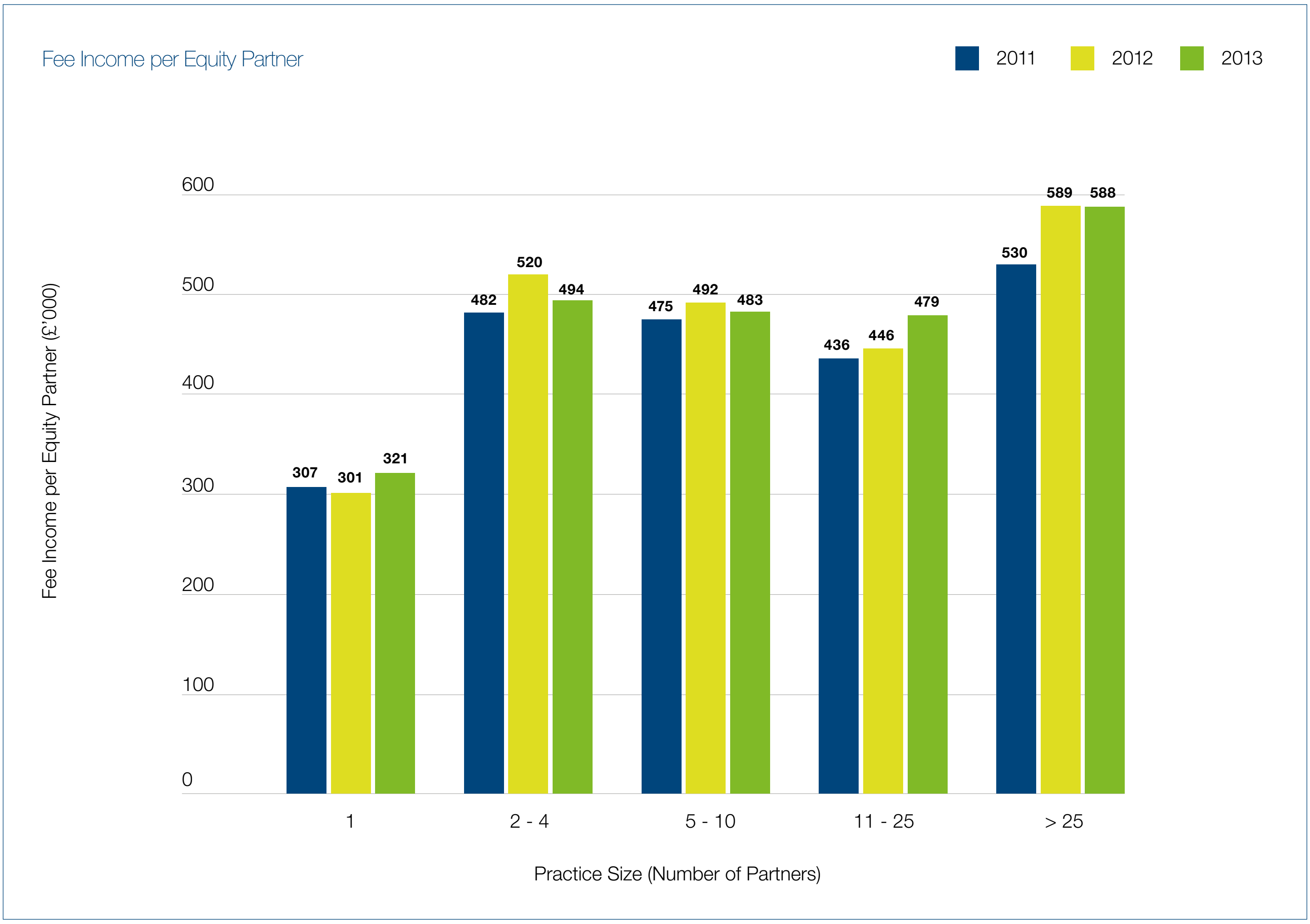
However, with 2 - 4 partners the average fee income per partner jumps and indeed on average competes well with larger practices of up to 25 partners. The 2 - 4 partner firms include some specialist niche players where profit per partner is on a par with the larger firms.

The fee income per partner in the 11 - 25 partner firms has suffered most during the recession with levels three years ago falling below all other groups except sole traders.

However, the recovery in the last year has seen the average per partner recover with the expectation of further growth ahead. This reflects the tendency for this group to retain partners in the recession and "baton down the hatches" ready for the recovery which now appears to have arrived.

The overall picture is a positive sign that the "value added" services are now being sought again by clients as the UK economy emerges from a long recession.

Our experience is that this growth will be further reflected in next year's survey.



The MHA View:

Profitability

Written by Harmy Gill

Partner, MHA Member Firm, MHA MacIntyre Hudson

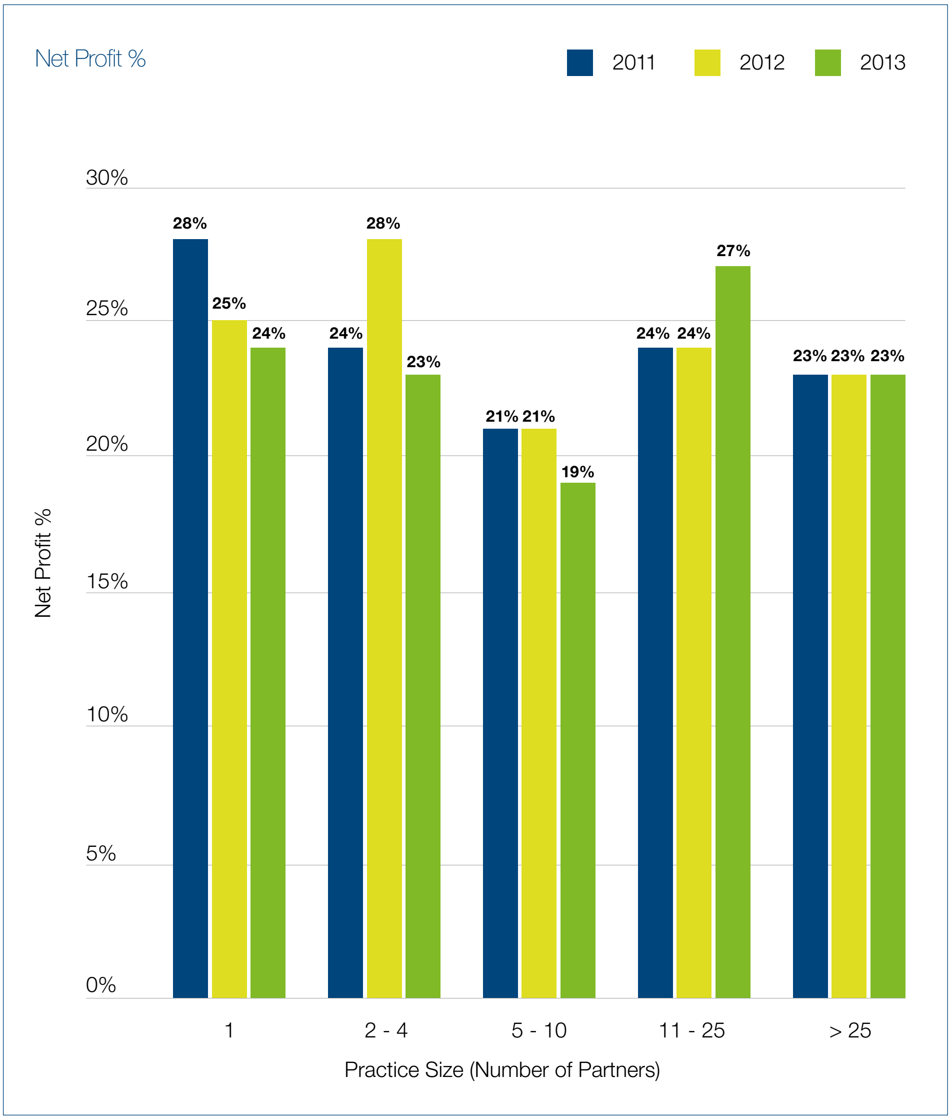
Net Profit

Surprisingly, practice profitability did not show an improvement, in fact it declined, over this last year, except for the 11 - 25 partner firms which appear to have bucked the general trend. The larger 25+ partner firms, whilst not making less profit only managed to hold steady at the same level as for the previous two years.

The results for smaller firms of less than 10 partners come as a surprise because whilst they showed little or no growth, their conscientious efforts to reduce staff costs and other overheads (which have achieved genuine reductions as a percentage of fee income), have not managed for these to bring about increased bottom line profitability.

The 11 - 25 partner firms which showed the greatest fee growth have managed to turn that growth into increased bottom line profit and it may be that one reason for this is partners taking on and delivering more of that 'new' work themselves.

A further 'shock' from this years findings has been the turnaround in fortunes of the 2 - 4 partner firms. They appeared to have been the most agile previously in managing costs against the back drop of limited growth and yet their profitability has plummeted as dramatically as it had risen last year, and now stands a percentage point lower than in 2011.



The MHA View:

Profit per Equity Partner

As identified in our findings last year, one would generally expect to see a correlation between PEP movement and fee income per partner and this years findings continue to prove no different.

Single partner practices continue to struggle to generate adequate levels of return for the degree of work and risk undertaken.

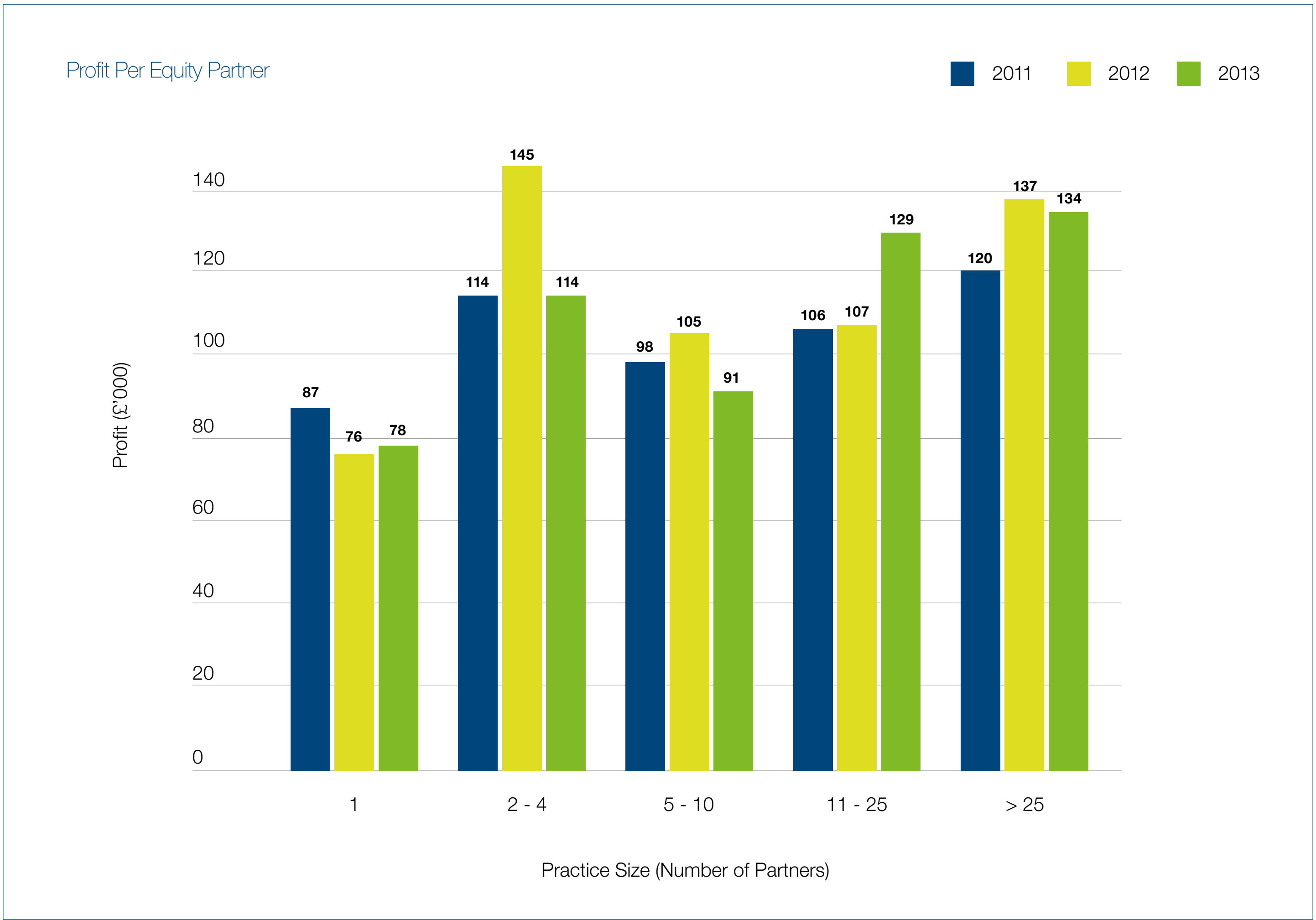
Having seen the 11 - 25 partner firms benefit from the biggest top line growth it comes as no surprise that PEP for that group also showed a similarly impressive 20.5% increase on the previous two years.

A little surprising is that the 25+ partner firms were unable to turn their 3% growth in fees over this last year into increased PEP, which in fact fell 2.2% compared to the previous year. But then, as identified in our review of fee growth for such firms, they did deliver top line growth in 2012 as well as 2013 and so, overall PEP is still up 11.7% when compared to the 2011 position.

The PEP findings for the 2 - 10 partner firms suggest a continued state of flux. With little or no growth at a firm level, but fee income per partner at levels which fair well comparatively to firms up to 25 Partners, PEP remains at similar levels to 2011 or worse. Measures taken to reduce staff costs and overheads have not proved as fruitful as would have been hoped and this must point to the continued pressure of reduced margin on jobs brought about by market competitiveness and pricing generally, and change within Legal Aid work (including 'Contract Bidding') for those involved with such work. Whilst the creation of niche market firms allows fees per partner to compare favourably with bigger firms, there is the need to secure a bigger slice of market share if PEP is to rise.

To what extent mergers and the coming together of firms has impacted so as not to lead to increased bottom line profitability, perhaps due to the 'getting to know you' period, remains to be seen at this smaller firm end of the sector but there clearly has been a pick up in market activity and transactional work and as things stand, it would appear to be the 11+ partner firms who are set to 'profit' best.

All things said, there is a perception of buoyancy and optimism in the sector aligned with an upturn in the economy and increased corporate activity, which was previously missing. It is also likely that the impact of change thus far and the further changes which will inevitably follow the new entrants to the market place following deregulation, will become clearer. This together with the impact of a loosening of the purse strings by the banks, if not necessarily directly to law firms, to their corporate and private clients may in turn help release 'lock-up' pressures which should help underlying practice profitability.



The MHA View:

Other Practice Costs

Written by Mary Maher,

Financial Matter Management trainer at MacIntyre Hudson Advisory Services

Premises

Expenditure on premises costs are, as expected, a substantial non-salary cost for all firms. All practices spent 6 - 11% of their total fee income on rent and premises. At the top end of the scale, the larger firms of more than 25 partners continued to share the highest burden of 11%, the same share of fee income as 2012. The average expenditure across 2 - 25 partners remained fairly consistent at 6 - 9% with the previous year's averages of 5 - 9%. The largest change was for sole traders who have targeted this expense category to produce reductions in costs from 9% in 2012 to 7% in 2013.

Marketing / Referrals

Another major expense for firms is the amount spent on marketing costs and referral fees. The percentage share of total fee income for these costs did vary across the size spectrum. Firms between 2 - 25 partners were consistent at 3%, sole traders incurred costs of 1% and the larger firms of more than 25 partners spent 6% on marketing/referral costs.

PII

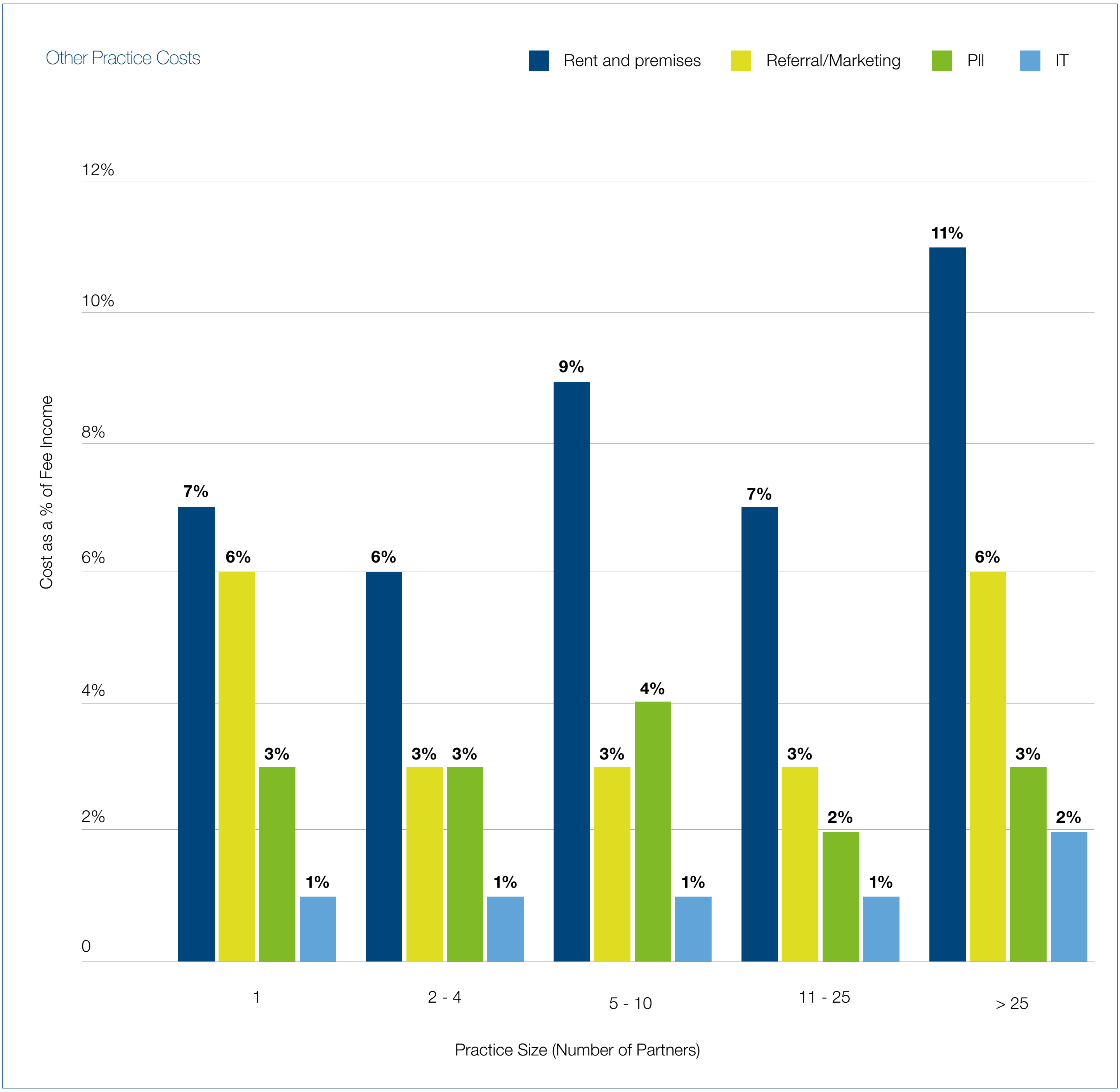
The spending on PII costs were, on average, 3% of a firm's fee income. The only slight variations in the current year to the average were an increase to 4% for 5 - 10 partner firms and a reduction to 2% for 11 - 25 size firms. This overall average remains fairly consistent with previous years. However one notable change is the reduction of the PII cost for sole traders from 5% in the previous year to the current level of 3%.

IT

One other important overhead cost for the firms was expenditure on IT. For firms of between 1 - 25 partners, this expense remained unchanged from the previous year at 1% of fee income. For the larger firms with 25+ partners, the IT expenditure reduced from 3% to 2% in the current year.

The MHA View:

We at MHA feel that the continual review and justification of overhead expenditure should be a focus of a firm's drive to increase profitability. This would ensure that historical costs are not merely accepted in the current year but challenged in order to assess the benefit they provide. This could result in measures such as targeting marketing costs to those areas with the highest return on investment, optimising the use of premises space, investing in IT to speed up processes or re-negotiating supplier contracts. Efficiencies can be realised for each expense type by undertaking value for money analysis and adopting a zero-based budgeting approach.



The MHA View:

Employment

Written by Simon Tombs

Partner, MHA Member Firm, Monahans

Employment costs remain the major cost of any solicitor practice. The control of this expense and profitable utilisation of this resource is therefore fundamental to the professional practice.

This measure compares the solicitor practice's employment costs against total practice fees. In order to make all practice styles and structures comparable and give this measure meaningful perspective, partners have been included using a notional salary of £100,000 per partner.

During recent years and particularly during recession, most firms have undergone, in one form or another, a restructuring of staff levels as they have battled to control costs.

While our survey covers the whole of the UK and a variety of different sized practices, the results, as in previous years, not unsurprisingly vary little between regions demonstrating a trend country wide to reduce costs.

If we look at the relative size of the practices based on partner numbers, in all sized practices from 1 partner to 25+ partners, salary costs as a percentage of turnover have decreased. This does not necessarily mean expenses have been cut but could be a reflection of the fact fee income has increased at a faster rate than salaries, this appears to be particularly true for practices of 1 partner, 11 - 25 partners and 25+ partners as their average fee income has increased. In reality, however, it is likely that in many cases this is a result of strict expenditure controls remaining in place and increasing fees per fee earner.

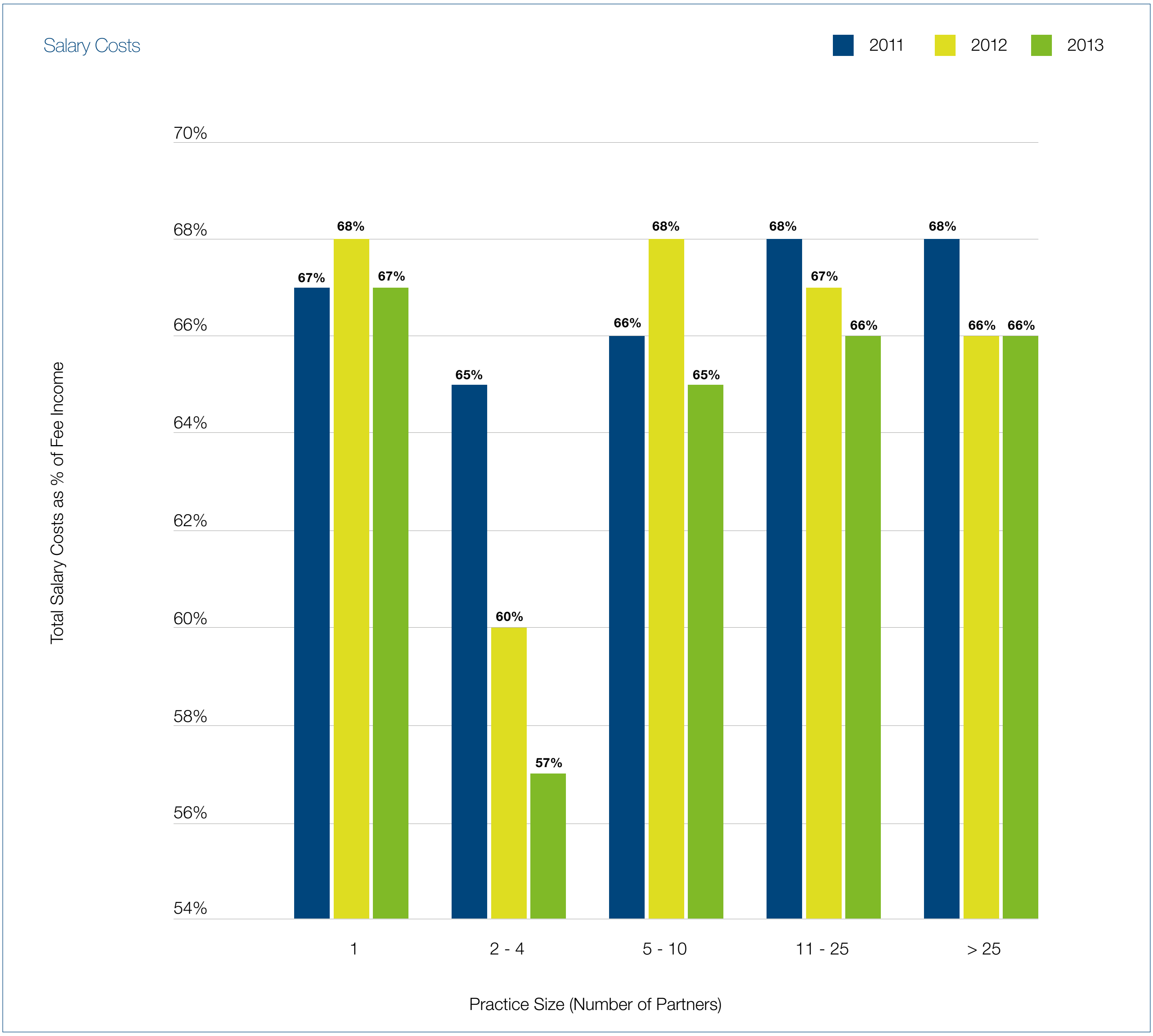
The MHA View:

In respect of practices with 2 - 4 partners and 5 - 10 partners there is the most significant drop in salaries as a percentage of fees, 3% in each case and on average either decreasing or stable fees. This indicates either further cost cutting or that cost savings made in the previous year have taken effect, while on average this sized practice has not seen an increase in fees.

This ratio is key for the successful financial management of any sized practice particularly as firms seek to restore or improve profitability, it has for many years in the profession been felt that a reasonable ratio, to target, including partners notional salaries, is 60% of fees or less.

It should be remembered that while cutting staff numbers is one way of improving this ratio it is only part of the answer and other factors need to be considered:

- Could fees be increased by more effective marketing, networking, and social media campaigns?
- Could productivity be increased by outsourcing, investing in technology or changing working practices?
- Is the use of junior and support staff, targeted rewards based on KPIs, encouraging fee earners to increase their contribution?



The MHA View:

Lockup

Written by Charlie Eve

Partner, MHA Member Firm, Carpenter Box

In the still challenging economy for solicitors, where financial stability is very high on the agenda, control of lockup (unbilled work in progress and debtors) is something that firms can not afford to dismiss lightly. The collection of debts and earlier billing of WIP is something that the practices' COFA's will have been focusing on in the last 18 months since their appointment.

It is, therefore, encouraging to see that sole practitioners, 2 - 4 partner firms and 11 - 25 partner firms improved on their lockup days. What is disappointing, though, is 5 - 10 partner practices and 25+ partner practices' lockup days increased. A 5% increase for 5 - 10 partner practices and an 8% increase for 25+ partner practices. A decent lockup target is 110 days and in our survey any practice with more than 4 partners had average lockup that exceeded this target by at least 30 days.

Sometimes putting the lockup days into some monetary perspective can be an eye opener.

If firm ABC had turnover of £2million and lockup of £767,000 then its lockup days would be 140. If lockup was reduced by 30 days to the target of 110 days, then the cash in bank would improve by £164,000.

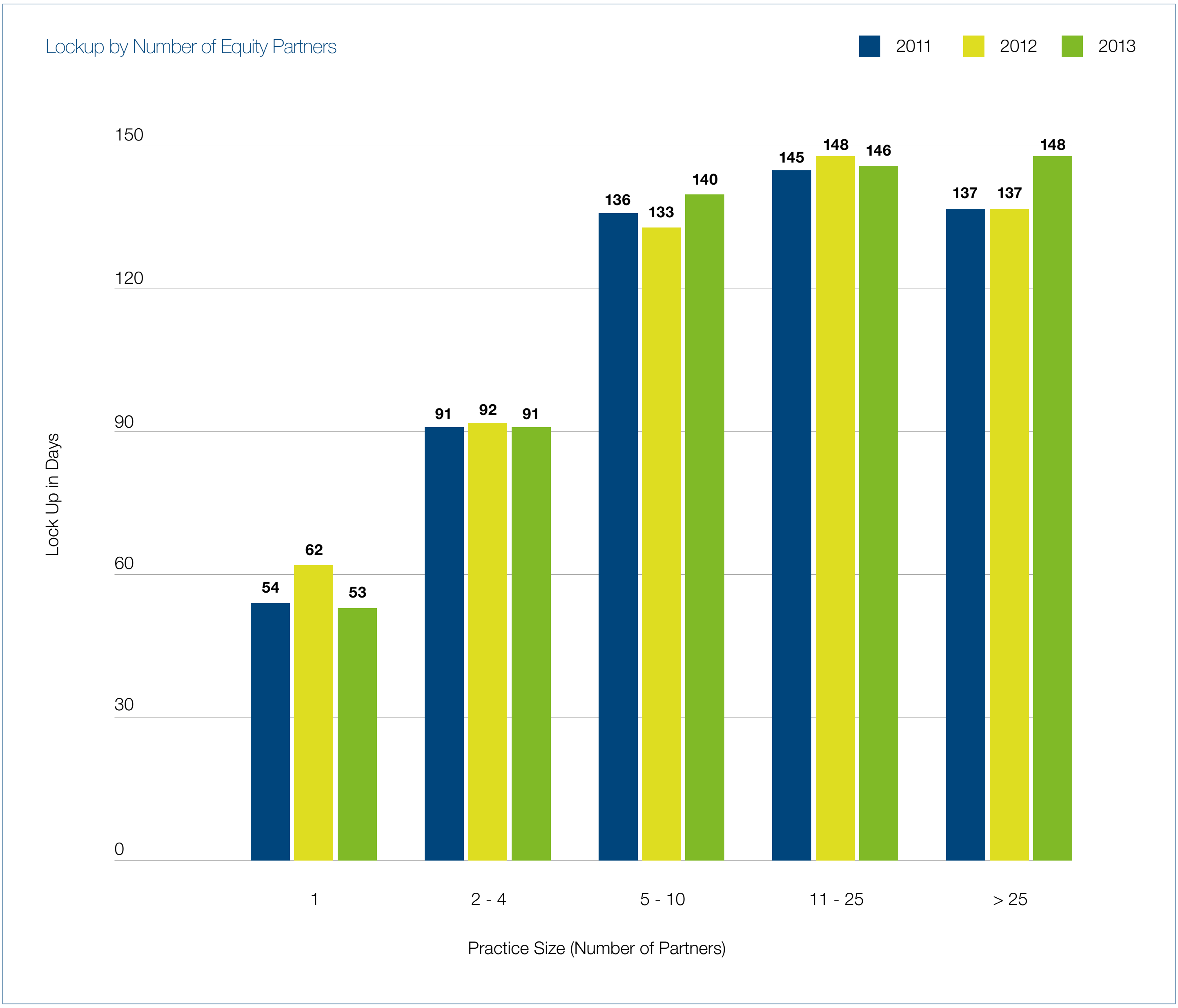
Lockup, generally, has an impact on the size of the equity partners current and capital accounts. Fluctuations in these balances, though, are not always a good guide to changes in working capital as partners could also be funding acquisitions, property and other fixed assets through their current and capital accounts.

The MHA View:

It is worth mentioning, though that in our survey a partner in a firm of 2 - 4 equity partners would be expected to provide finance to the practice at an average balance of £176,000. This is in excess of £79,000 higher than the other firm sizes which include sole practitioners, 5 - 10 partners, 11 - 25 partners and over 25 partners.

The size of the practice and number of equity partners, has a big impact on lockup with lockup being harder to control as the number of partners grows. The lockup graph displays this well with the sole practitioners' lockup at only 53 days growing to the 25+ partner firms with a lockup of 148 days. The larger practices appear to have had more pressure on lockup during 2013 increasing from 137 on average in 2012 to 148 days. This amount of increased lockup will have had a significant impact on the cash reserves of those practices.

We, at MHA, continue to feel that there will be increasing pressure on lockup in the years to come. There are techniques available to assist with reducing lockup. It will be an increasing role of the COFA and other valued advisors to ensure that lockup does not become a serious problem.



Concluding Statement:

Karen Hain
Head of the Professional Practices Group at MHA

Which section conclusions rang true for you? Did your firm do better or worse than the averages? But more importantly what changes do you need to make now to improve your 2014 results?

Review of your current position and results against your business plan should always be an important assessment. But making necessary changes may be far more stressful. New matters may be picking up but make sure that a busy office does not mask underlying financial issues. Sometimes you just need a fresh pair of eyes.

Our national accountancy association, MHA, has put together a team of legal sector specialists with the knowledge and experience to assist firms in the ever demanding legal market place. We understand what is important to our clients and how we can help. Please do not hesitate to contact your local MHA member firm for practical advice and guidance.

About MHA

MHA is a UK wide association of progressive and respected accountancy and business advisory firms. MHA is not a membership organisation, accountancy firms are invited to join MHA only when they meet the standards and culture of the organisation, which includes a commitment to helping our clients to succeed by supporting them above and beyond what might normally be expected from an adviser.

Each MHA firm offers a broad range of services including accountancy, tax and corporate finance as well as sector specialisms. They work collaboratively under the MHA banner when clients have multiple locations or specific national needs. MHA firms are characterised by their strong regional reputation for providing outstanding accountancy and business advice to entrepreneurial businesses.

With 47 nationwide offices MHA is able to balance national access and capability with the local insight and perspective that individual member firms offer their clients. As well as our national presence MHA is a member of Morison International, giving access to a global network of trusted advisers.

MHA Member Firm Offices

Bloomer Heaven
www.bloomerheaven.co.uk
Birmingham (Head office)
Rutland House,
148 Edmund Street,
Birmingham
B3 2FD
Tel: 0121 236 0465

Broomfield & Alexander
www.broomfield.co.uk
Cardiff (Head office)
Ty Derw
Lime Tree Court
Cardiff Gate International Business Park
Cardiff,
CF23 8AB
Tel: 02920 549939

Additional offices: Newport, Swansea

Carpenter Box
www.carpenterbox.com
Worthing (Head office)
Amelia House
Crescent Road
Worthing, BN11 1QR
Tel: 01903 234 094

Additional offices: Gatwick

Henderson Loggie
www.hendersonloggie.co.uk
Dundee (Head office)
Royal Exchange
Panmure Street
Dundee
DD1 1DZ
Tel: 01382 201234

Additional offices: Aberdeen, Edinburgh, Glasgow

Larking Gowen
www.larking-gowen.co.uk
Norwich
King Street House
15 Upper King Street
Norwich
NR3 1RB
Tel: 01603 624181

Additional offices: Bungay, Colchester, Cromer, Dereham, Diss, Fakenham, Holt, Ipswich.

MHA MacIntyre Hudson
www.macintyrehudson.co.uk
London City
New Bridge Street House
30-34 New Bridge Street
London EC4V 6BJ
Tel: 020 7429 4100

Additional Offices: Bedford, Canterbury, Chelmsford, High Wycombe, Reading, Rochester, Leicester, North London, Maidstone, Milton Keynes, Northampton, Peterborough

Moore and Smalley
www.mooreandsmalley.co.uk
Preston (Head Office)
Richard House
9 Winckley Square
Preston
Lancashire
PR1 3HP
Tel: 01772 821021

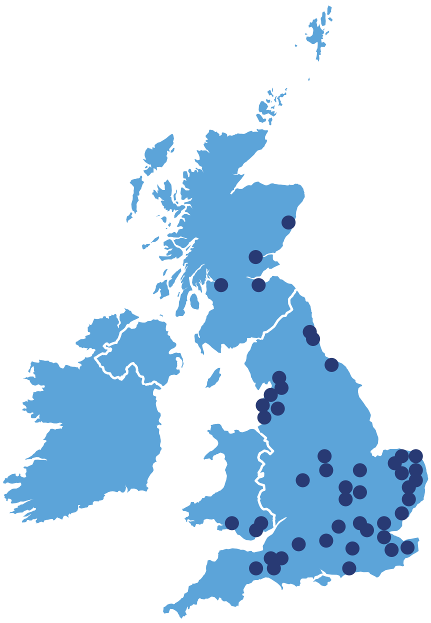
Additional offices: Blackpool, East Midlands, Kendal, Kirkby Lonsdale, Lancaster, Southport

Monahans
www.monahans.co.uk
Swindon (Head office)
38-42 Newport Street
Swindon
Wilts
SN1 3DR
Tel: 01793 818300

Additional offices: Bath, Chippenham, Glastonbury, Trowbridge

Tait Walker
www.taitwalker.co.uk
Newcastle (Head office)
Bulman House
Regent Centre Gosforth
Newcastle Upon Tyne
NE3 3LS
Tel: 0191 285 0321

Additional offices: Northumberland, Tees Valley



Notes

Thank you

2014 MHA Professional Practices Benchmarking