AUDIT • TAX • ADVISORY

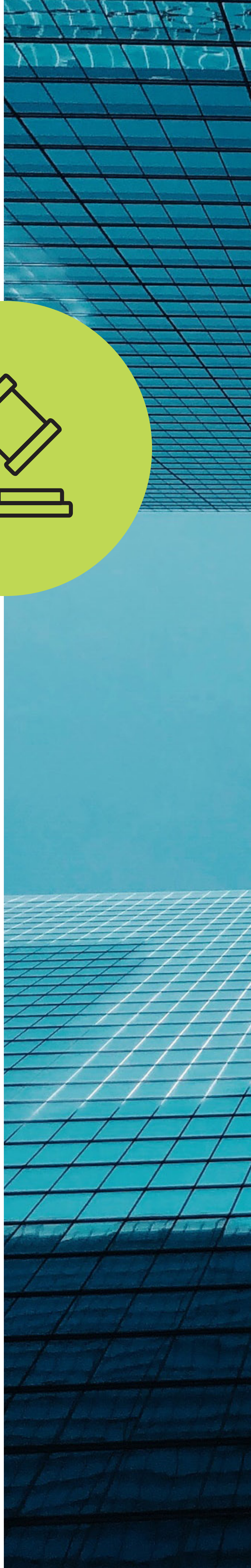
Legal Benchmarking Annual Report

2022

Now, for tomorrow

An independent member of bakertilly INTERNATIONAL

Welcome to the 9th MHA legal benchmarking report.



This report considers data from 2021, as well as survey responses from legal firms across the country.

The data featured in this report includes part of a year when the country was still working in lockdown during the original outbreak of the Covid-19 pandemic. In some firms it will therefore represent how well the business dealt with the transfer to working from home, how soon offices reopened, what changes were forced upon those legal practices and what strategic changes were made.

We also look forward to 2022 identifying some key strategic measures that legal firms will be focusing on this year to improve overall performance.

We hope you find the report useful and are able to use the information to support your own business plans.

The MHA Professional Practices Team

Key Findings

1 Partner Firms

71%
Total Equity Partner capital and current account value as % of fee income = 71%. Up from 64%

25%
Net profit 25%, an increase of 5%

10%
Fee income down 10%

52%
% of Fee Earning staff up 1% to 52%

2-4 Partner Firms

£21.3k
Average Equity Partner capital invested more than doubled to £21.3k

150
Lock up days increased from 142 to 150 days

£167k
Profit per Equity Partner increased by 23% to £167k

7.3%
Non salary overheads as % of fee income increased by 7.3%

5-10 Partner Firms

£260k
Total funding per Equity Partner more than doubled from £103k to £260k

4%
Profit per Equity Partner fallen by 4%

£1.302m
Fees per Equity Partner increased from £1.186m to £1.302m

4%
Salary costs as % of fees increased by 4%

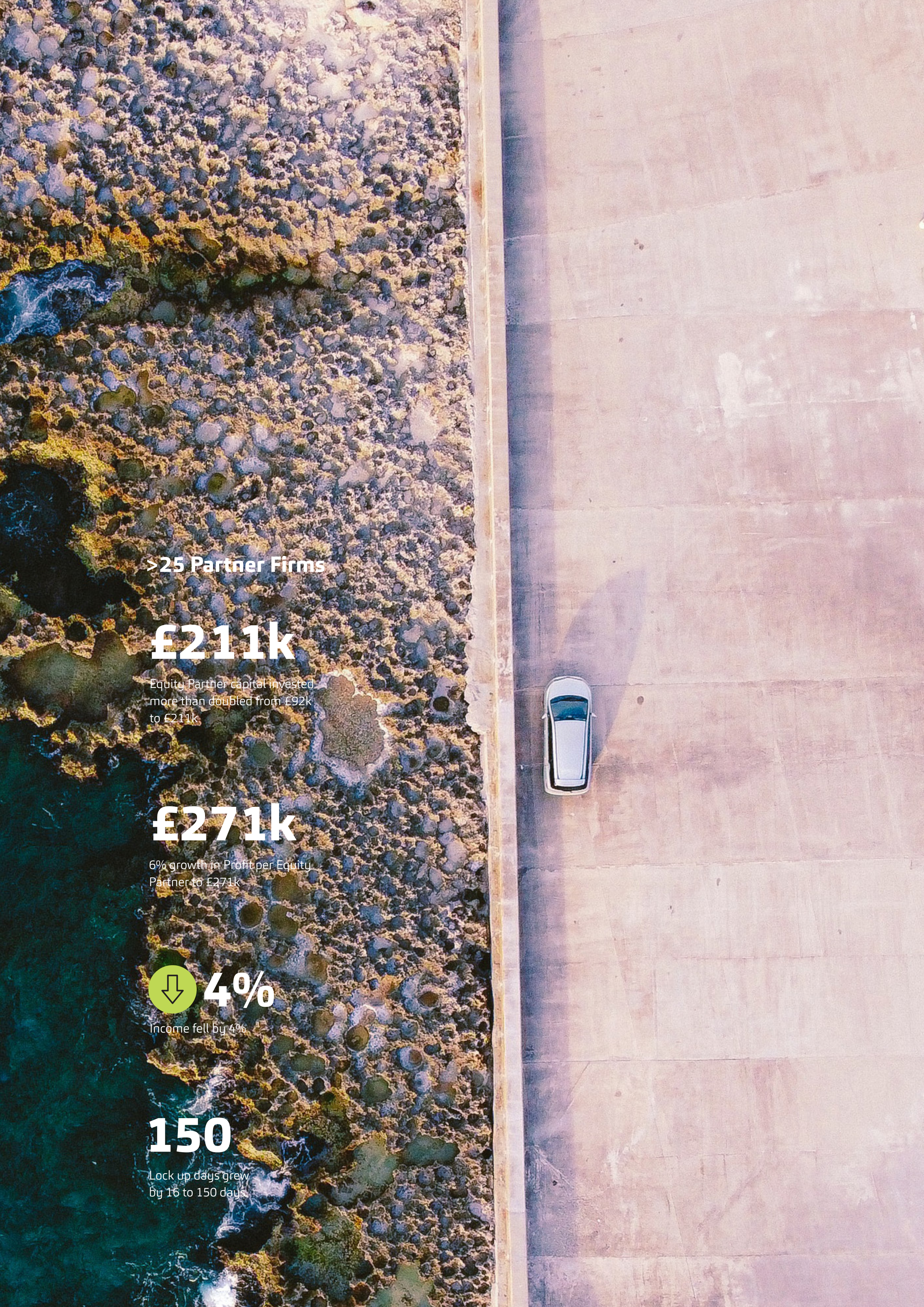
11-25 Partner Firms

£65.4k
Total external funding per Equity Partner down £19k to £65.4k

£281k
Profit per Equity Partner grew by 45% to £281k

4%
% of fee earning staff fell by 4% to 59%

28%
Net profit increase from 22% to 28%



>25 Partner Firms

£211k

Equity Partner capital invested more than doubled from £92k to £211k

£271k

6% growth in Profit per Equity Partner to £271k

4%

Income fell by 4%

150

Lock up days grew by 16 to 150 days

Income

Number of fee earners and partners

	Fee earner numbers	Partner numbers	Equity partner numbers
1	Static	Static	Static
2-4	Rising	Static	Falling
5-10	Falling	Static	Falling
11-25	Falling	Rising	Falling
>25	Falling	Falling	Falling

↑ 4% **↓ 10%**

The impact on top line income was negative in % terms across all sized firms except **5-10 partners** who recorded an increase of **4%. Sole practitioners** saw a fall by **10%.**

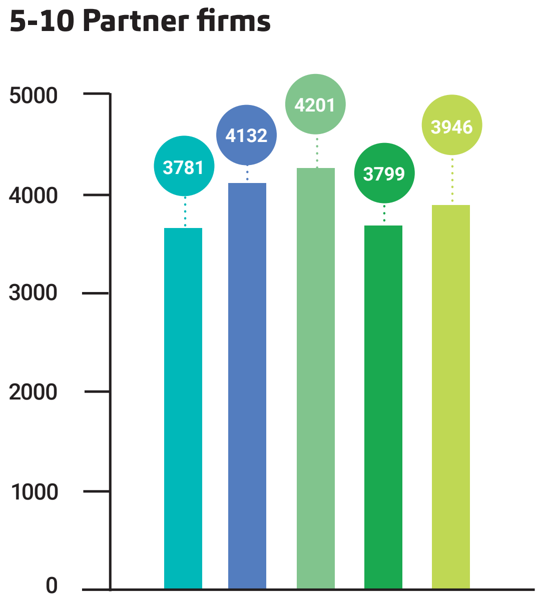
This was due in part to the ratio of fee earners to Equity Partners falling across all firms except **5-10 partners.** The ratio of fee earners to Equity Partners ranges from **2.6 to 4.2.**

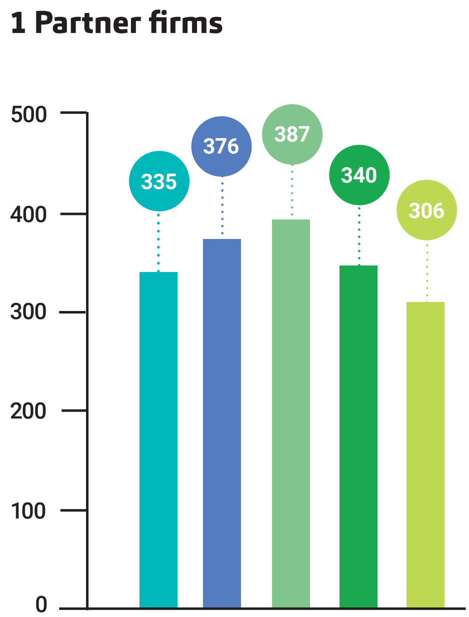
There was some lost income due to the pressures falling out of the national lockdown, where staff had been furloughed, Courts and other government agencies were closed or running at much reduced capacity, and deals were put on ice.

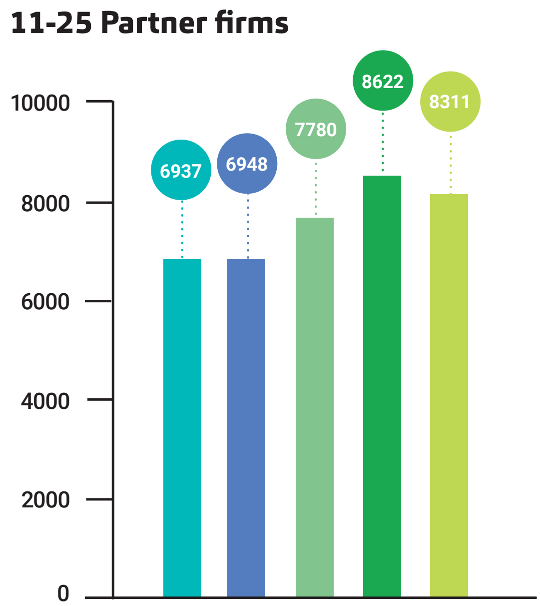
2022 is seeing more pressure on staff retention which impacts on the available chargeable hours pool. But there is a growing demand for legal services in the marketplace, and as inflationary pressures are coming to the forefront, firms will need to increase their prices in order to generate either sustained or improved fee levels.

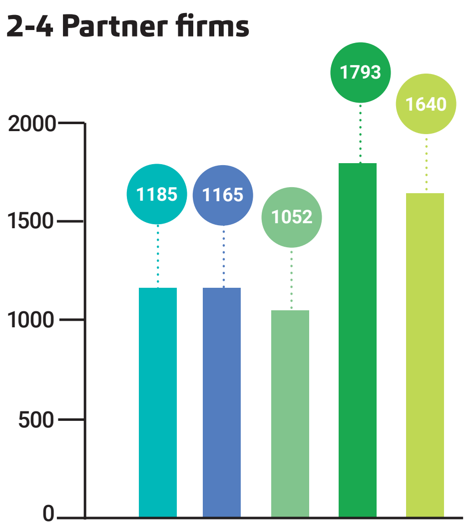
Total Fee Income
(£'000)

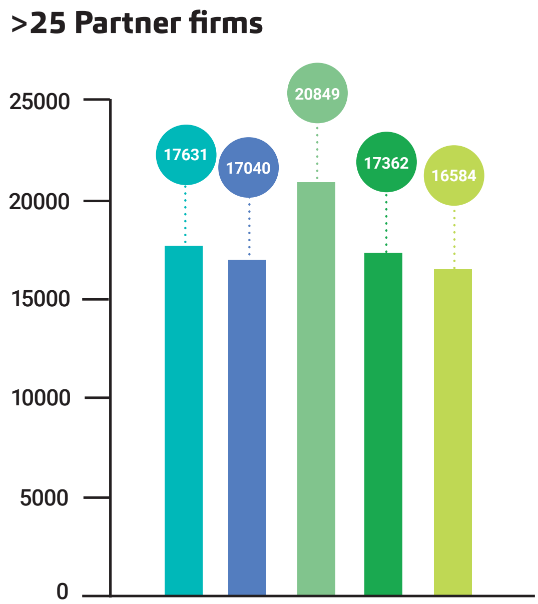
- 2021
- 2020
- 2019
- 2018
- 2017







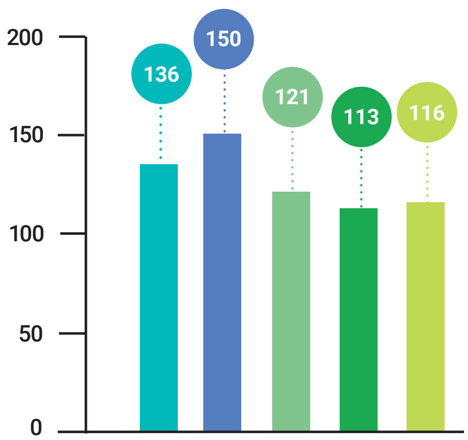




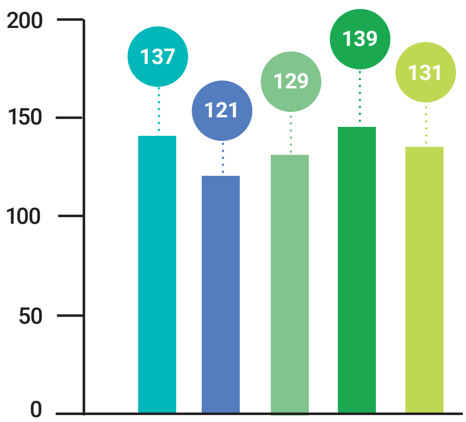
Income per Fee Earner
(£'000)

2021
2020
2019
2018
2017

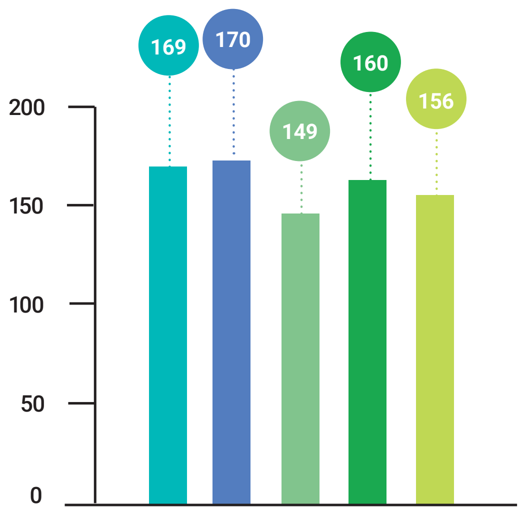
1 Partner firms



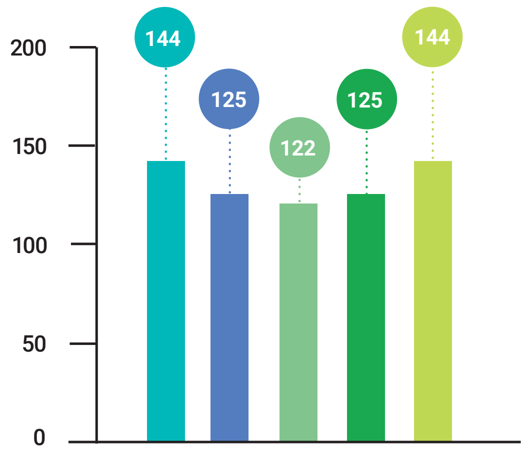
2-4 Partner firms



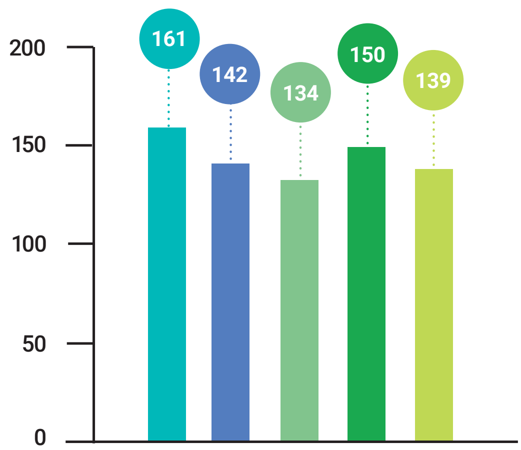
5-10 Partner firms



11-25 Partner firms



>25 Partner firms



2022

Only 23% of firms are planning on expanding into new service lines in 2022.

Only 8% are planning on removing services that they currently offer.

Key Actions

1. Review your pricing strategy.
2. Consider the types of work that your fee earners are undertaking to ensure that the right level of work is being completed by the appropriate individual.
3. Generate chargeable time capacity for your fee earners by removing administrative tasks from them.

Profit

31% - 39%

Fee earner contribution rates ranged from **31% to 39%** except in extreme circumstances where **5-10 partner fee earners** contributed **46%** and **sole practitioner fee earners** contributed only **19%.** These results are mirrored in the increase and decrease in fee income in those different sized firms.

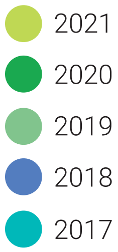
Net profit % has increased between **4%-6%** except for the **5-10 partners** who have fallen by **4%.**

Profit per Equity Partner has fallen by **4%** in the **5-10 partner firms.** The other sized firms have all increased, with **11-25 partner firms** recording an increase of **45%.** This was in part the impact of a fall in Equity Partner headcount.

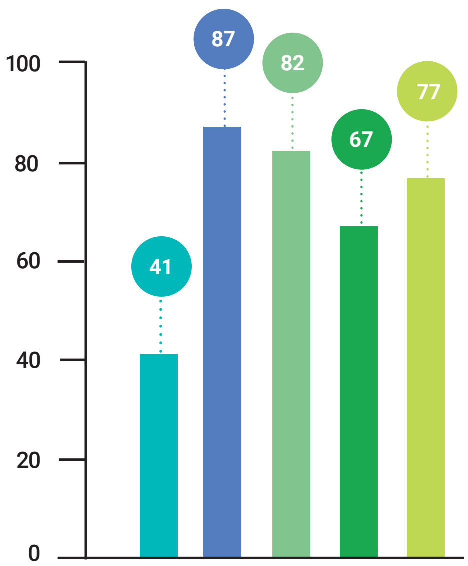
Some of the increased profit this year is due to the Coronavirus Government support that Firms received. There were also savings made in staffing costs and premises costs which directly improved profits.

2022 is expected to be a tough year for profitability as salary and other overhead costs see huge inflationary pressures.

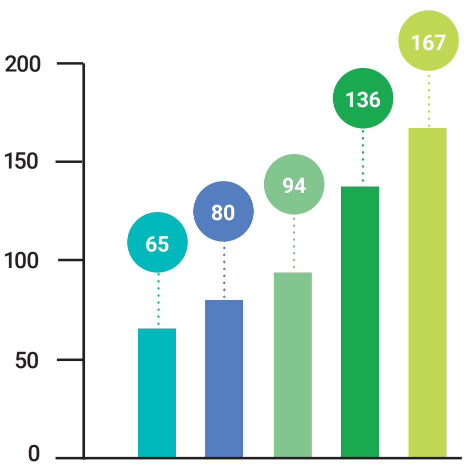
Profit per Equity Partner
(£’000)



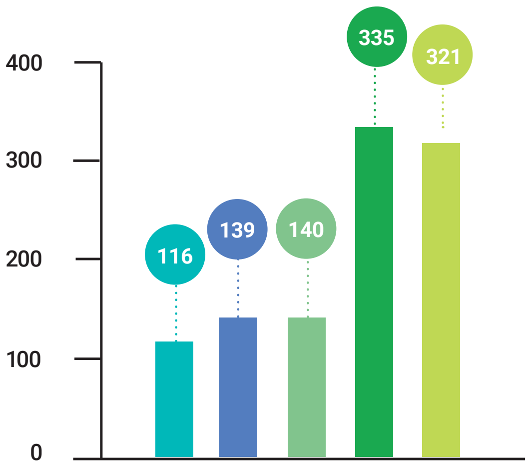
1 Partner firms



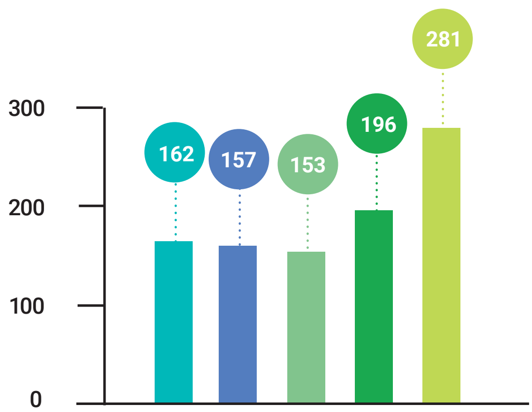
2-4 Partner firms



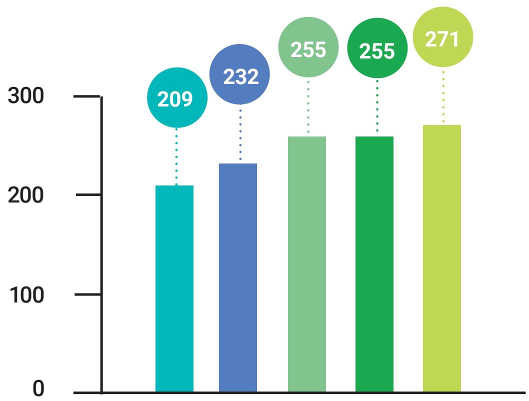
5-10 Partner firms



11-25 Partner firms



>25 Partner firms

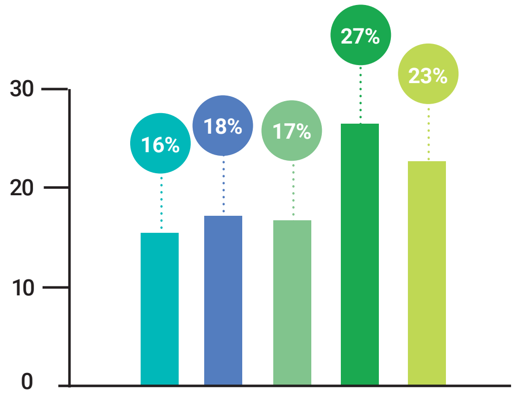


Net Profit

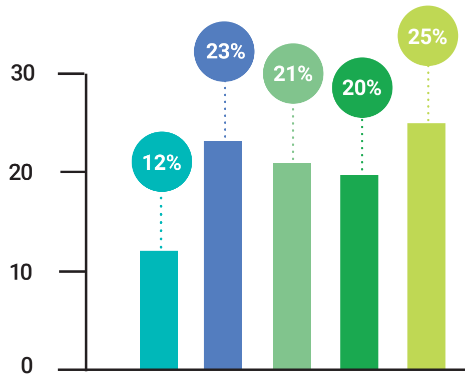
%

- 2021
- 2020
- 2019
- 2018
- 2017

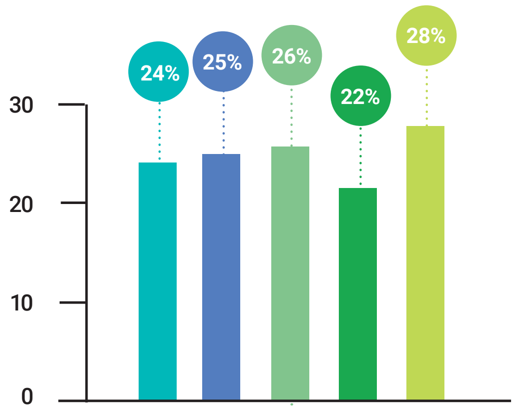
5-10 Partner firms



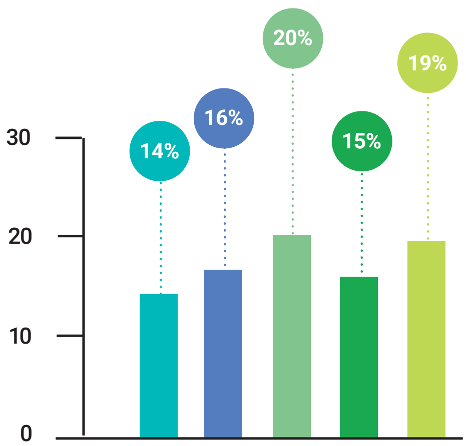
1 Partner firms



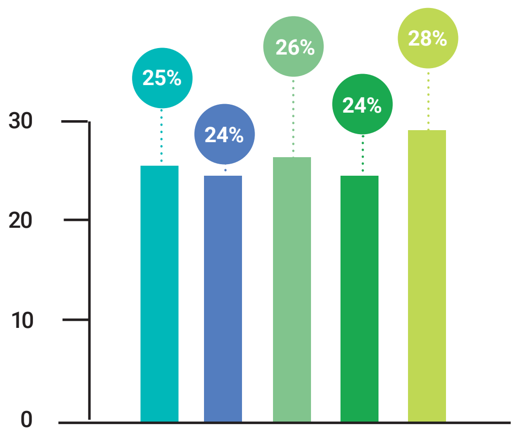
11-25 Partner firms



2-4 Partner firms



>25 Partner firms



2022

All of the headline strategic plans for 2022 centre around profit improvement strategies.

Firms expect some years of investment to see a short term fall in profits. Taking into account the plans across the other sections of this report, it looks like there is an expectation of a lower level of profit for 2022.

Key Actions

1. Check your billing recovery rates to make sure that your fee earners are profitable, and train where there needs improvement.
2. Set productivity targets for chargeable hours expected to be generated by fee earners.
3. Review current working practices to ensure that efficiencies acquired during lockdown working have been retained.
4. Set out your investment plans with a return on investment review, to ensure that you are maximising a positive impact, and can make fast decisions where required.
5. Set budgets on income and expenditure, with targets to staff, and monthly reviews and action plans to check these are on track.

Employment costs

Total Salary Cost Per Fee Earner (£'000)	2017	2018	2019	2020	2021
1	87	93	87	82	94
2-4	86	85	87	91	93
5-10	88	94	83	90	85
11-25	89	83	83	88	105
>25	95	89	82	95	93

% of Fee Earning Staff

	2017	2018	2019	2020	2021
1	37%	36%	50%	51%	52%
2-4	39%	45%	46%	45%	47%
5-10	41%	42%	52%	46%	55%
11-25	53%	55%	56%	63%	59%
>25	58%	54%	63%	73%	53%

The cost of employing a fee earner ranges between **£85k and £105k.** Last year this range was between **£82k to £95k** showing an overall increase. *

Total salary costs as a % of fee income ranges from **60% to 72%.** Last year this range was **56% to 73%. ***

The % of staff who are fee earners ranges from **47% to 59%.** The high element of fee earning staff has helped the **11-25 partner firms** (at 59%) improve their profitability.

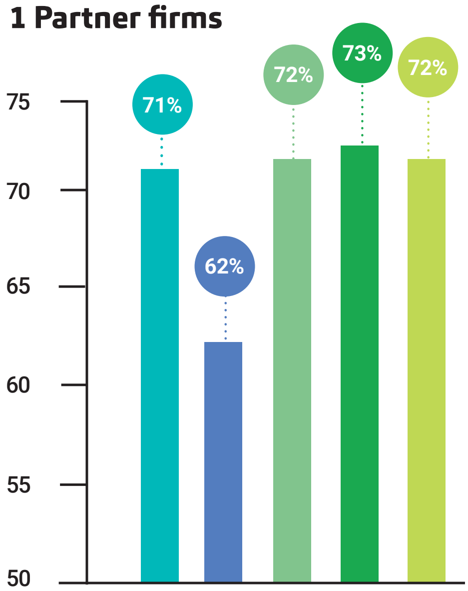
*see earlier point on pricing strategy.

Total Salary Costs

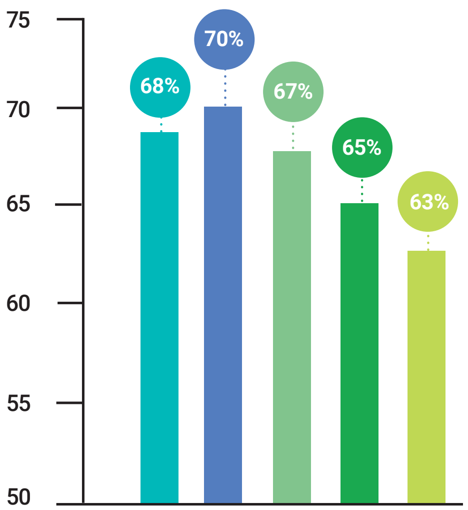
% of fee income

- 2021
- 2020
- 2019
- 2018
- 2017

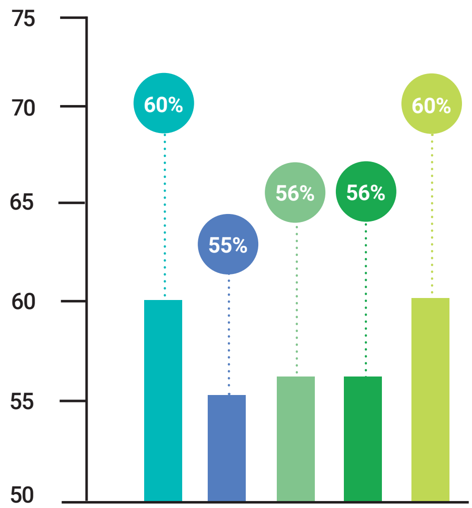
1 Partner firms



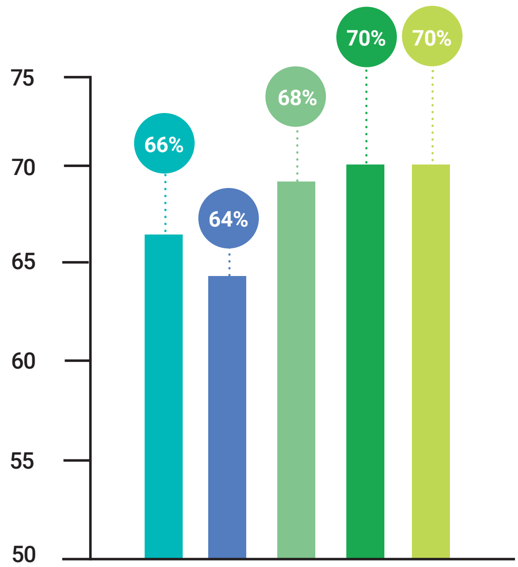
2-4 Partner firms



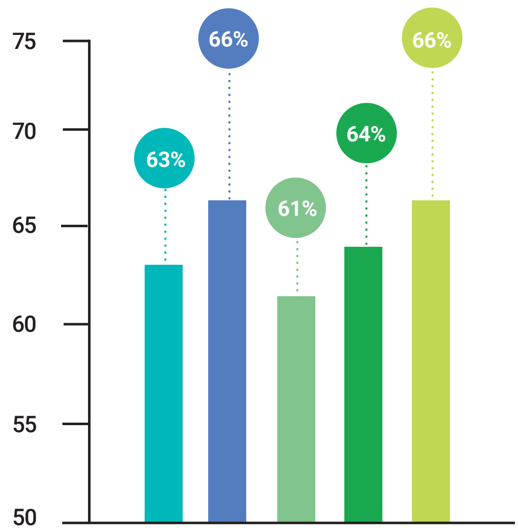
5-10 Partner firms



11-25 Partner firms



>25 Partner firms



2022

85% of survey respondents are planning to increase staff numbers in 2022. Some of this is due to growth plans in current service offerings, and some recruitment is planned into new service lines.

A resounding 93% of firms are not planning to make any staff reductions. Many firms made reductions to headcount during the initial period of lockdown, and then reviewed staffing once the Government furlough support was withdrawn.

The massive change in approach since the pandemic hit, is that in 2022 96% of firms will offer some form of agile working to their staff. This is mainly a mixture of office and home working, but also incorporates flexible hours and part time contracts.

2022 is seeing more pressure on staffing levels where there have been fee earners leaving the sector or taking new roles with higher salaries or flexible working packages. The talent pool is shrinking with the resulting pressure on rates of pay. Firms may see a bidding war for fee earners.

Key Actions

1. If salary rates increase, make sure that your client chargeout rates are reviewed too.
2. Undertake a staff survey to assess what is important to them so that you can review employment packages as a whole and not simply a salary increment.
3. Automate as many of your systems that you can to reduce the impact of admin time, or non-chargeable time.

Practice Expenses

2.7%

11-25 partner firms made the best savings in their non-salary overheads with a **2.7%** reduction compared to the prior year. At the opposite end of the spectrum, **2-4 partner firms** spent **7.3%** more. Many of the smaller practices made very little change during the period of lockdown (work from home), in some cases keeping offices open during the period which resulted in no saving on overhead spend.

2.5%

The biggest saving in rent and premises costs was made by the **sole practitioners,** who saved **2.5%** on the previous year. The other firms all made a very small saving of up to **0.3%,** or spent slightly more, up to **1.0%.**

1.9%

Perhaps unsurprisingly, the spend on **marketing** fell from **2.6%** of fee income to **1.9%.** This was due to the restrictions being placed on group gatherings, where seminars, entertaining clients or other event attendance was curtailed in some way in 2021.

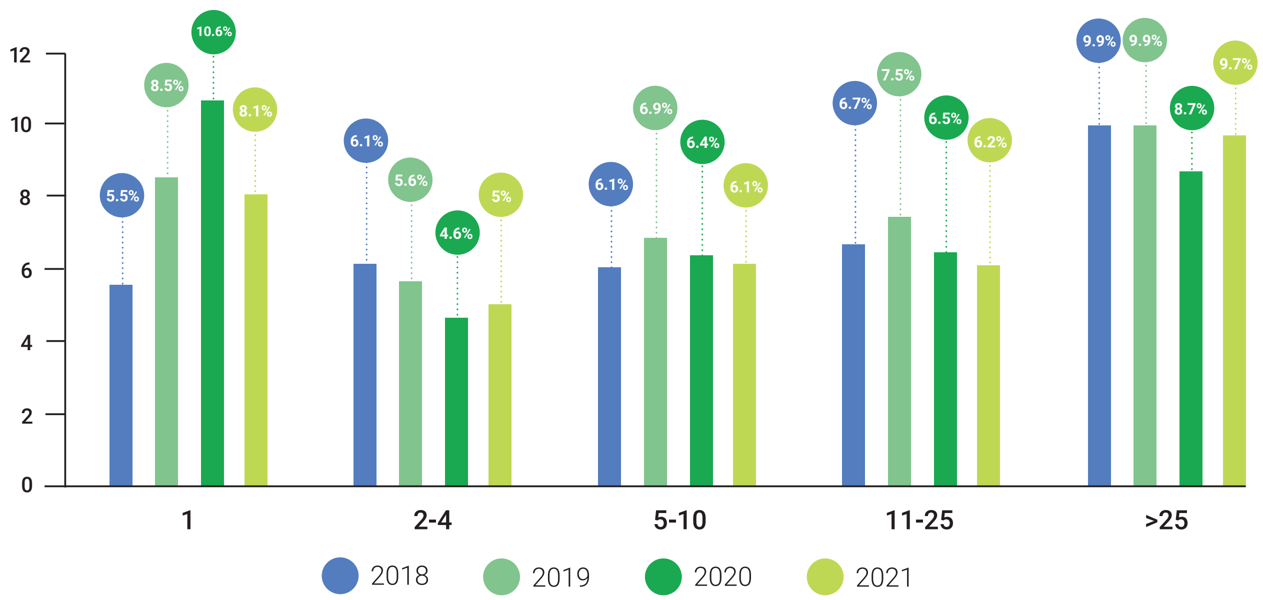
⇧0.5%

Spend on PII increased from **3.0%** of fee income to **3.5%** of fee income. We are seeing the PII market hardening further into 2022 and expect that premiums will increase once again.

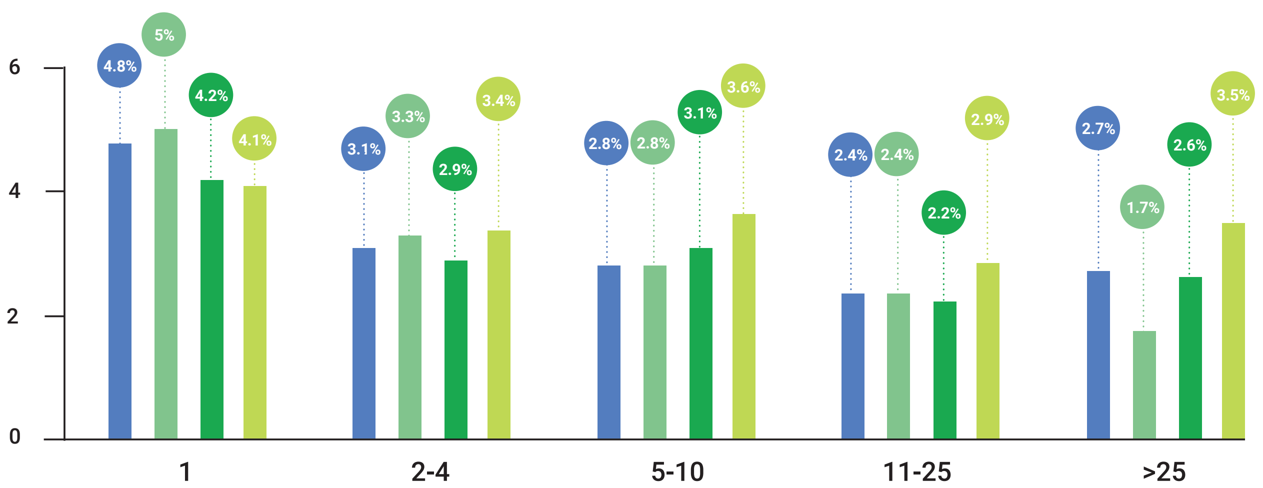
⇧0.2%

IT spend on average only increased by **0.2%** of fee income to **2.7%.**

Rent and Premises as a % of Fee Income



PII Cost as a % of Fee Income



2022

31% of firms are planning a change in their office space in 2022. Plans include redesign to open plan, hotdesking and modern workspaces.

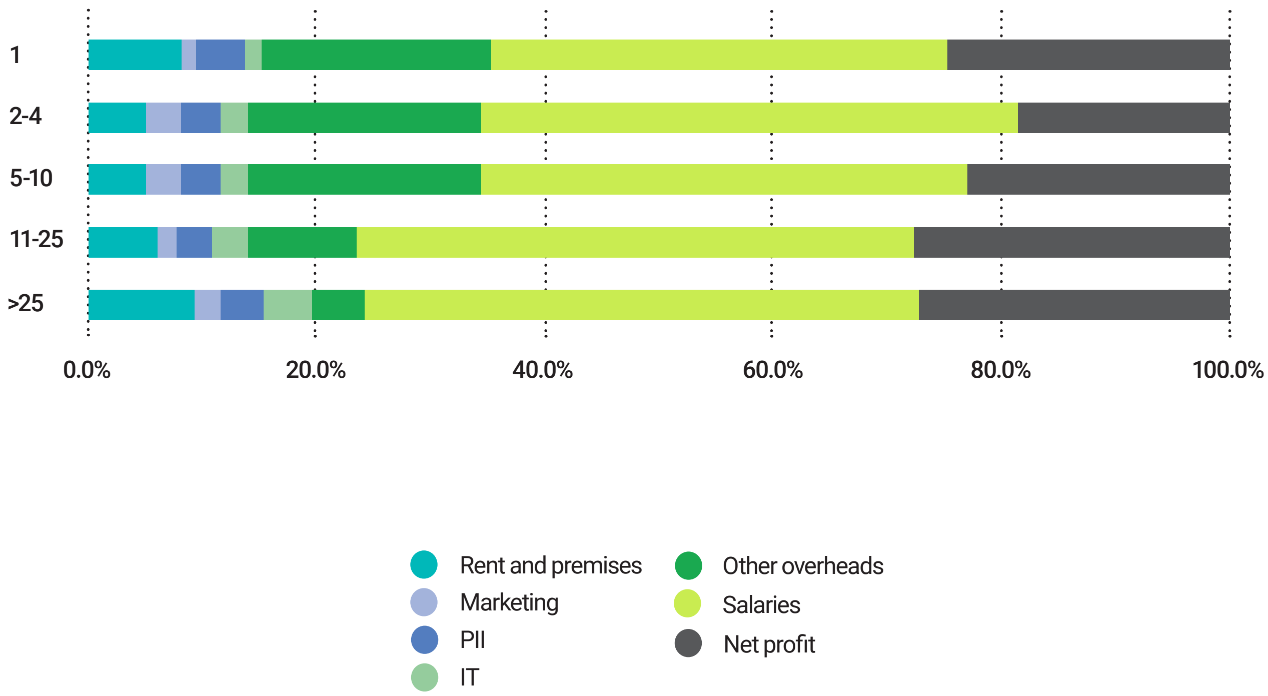
43% of firms plan to change how they use IT in 2022. This is probably a somewhat low percentage because many firms already made drastic changes during lockdown in Spring 2020 to enable their staff to work from home.

Plans for 2022 include more laptops, better security, KPI reporting modules, IT platform reviews including case management systems, and more data analytics.

Key Actions

1. Don't go backwards – if your staff learned how to cope working from home and not printing documents, then discourage them returning to the printer.
2. Reassess your office space requirements to ensure your teams can work effectively without having expensive empty rooms.
3. Before you commit to a business development event, calculate a return on investment to assess how much it will cost in pounds spent and chargeable time lost, versus anticipated work wins.

2021 Expenditure and Profit



The graph gives the representation of how a firm uses the fee income that it generates, on a percentage basis.

1. In marketing and PII there is very little difference what each size of firm spends.

2. Premises costs are hit hardest in the smallest and the largest sized firms. This will be the impact of a fixed cost office to sole practitioners, and the likely multiple city centre sites in largest firms.

3. IT spend is almost 4 times as much in the largest firms compared to smallest. As the move to a per capita charge for IT usage, this is a rational conclusion. But the largest firms also seem to have more IT options to spend upon and this could well be driving them towards the higher end of the profitability margin.

4. There is almost a 9% difference in actual salary costs in the smallest versus the largest practices.

5. The biggest split in expenditure ranges is with other overheads. This picks up all of the expenses not specifically mentioned individually on the graph. All the firms sized from 1 partner up to 10 spend around 20% of their fee income on these other overheads. But the two largest sizes of firms spend between 4% and 9% and this is what helps to generate better profit margins.

Finance and Funding

⇧ £157k

Equity partner capital invested in firms has risen across all sized firms. One of the reasons for this is that lock up has also increased.

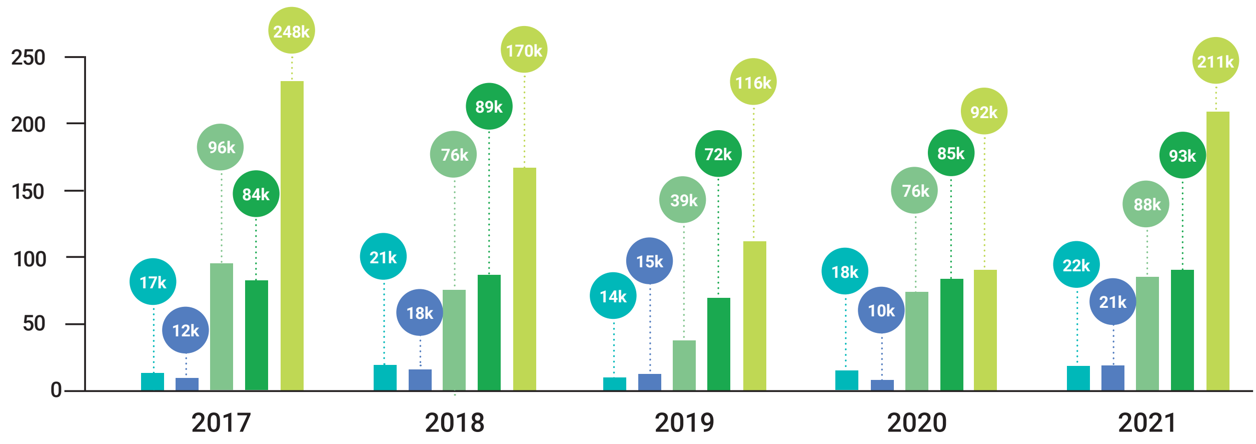
The cash demands of the business were being met by Partners, rather than funders, in part due to the difficulty of obtaining finance in early days of lockdown.

Equity Partner capital has **more than doubled in 2-4 partner firms and over 25 partner firms.**

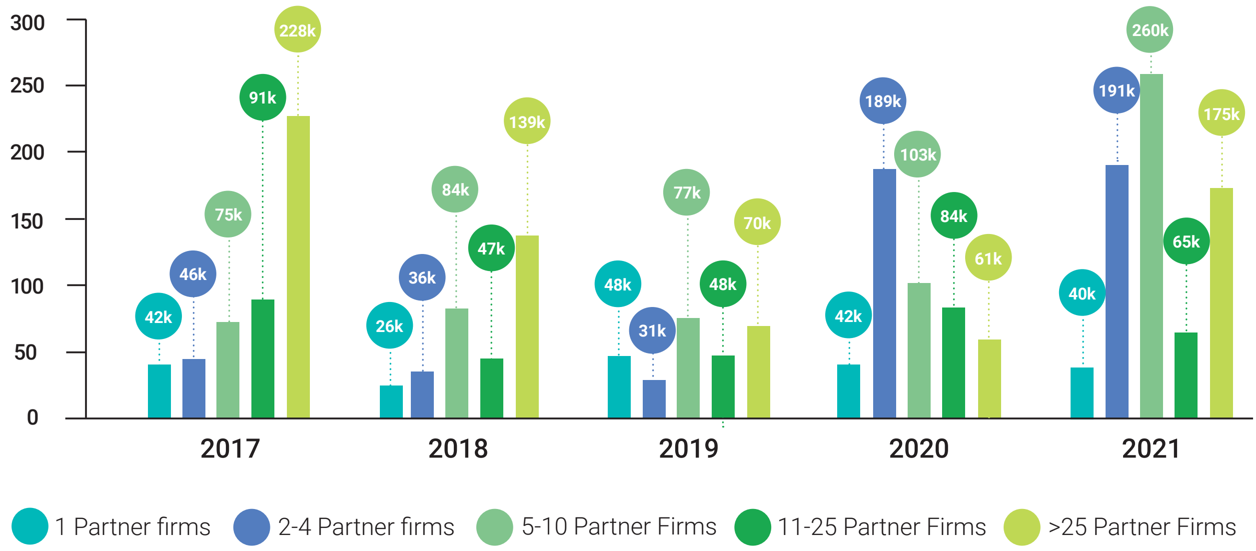
Where firms were able to take account of the Government backed Coronavirus business support loans, we can see that total funding has increased in **5-10 partner firms from £103k to £260k**.

Some of these firms actually repaid this debt before the commencement of the interest charge period, and this is likely to fall into next years statistics.

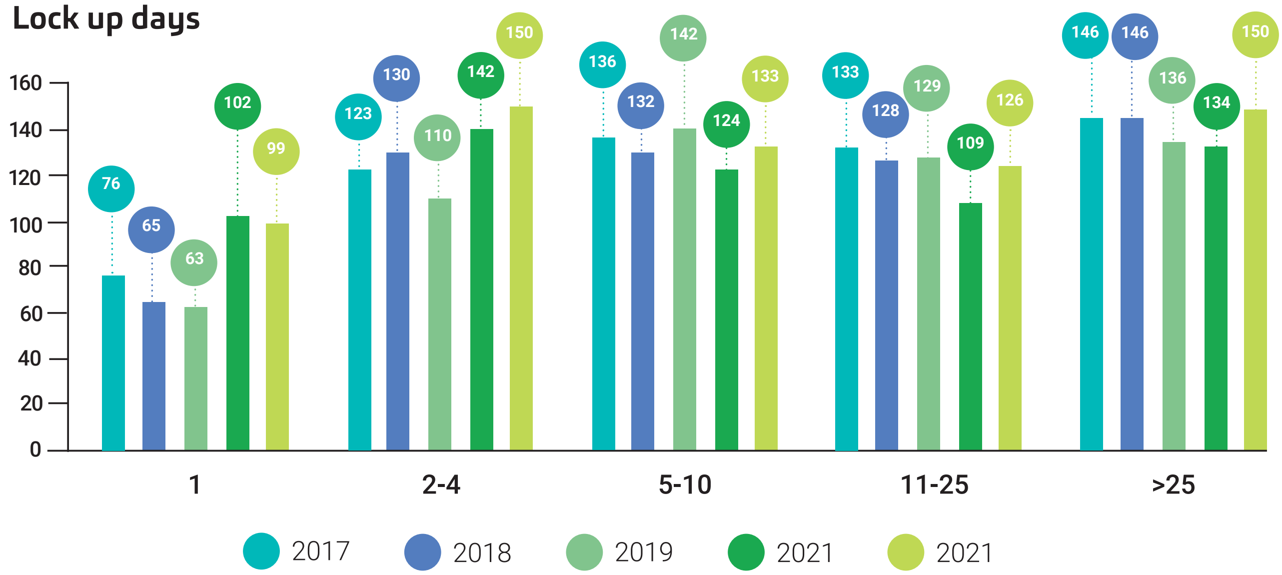
Average Equity Partner Capital Invested (£'000)



Total External Funding per Equity Partner (£'000)



Lock up days



Lock up has risen in all **but the sole practitioner group.** This is due to work in progress taking longer to bill, rather than unpaid client debts. During lockdown, many firms found it challenging to complete work assignments to billable stages, and then to actually get a bill prepared and delivered to clients.

2022

61% of our survey respondents are aiming to improve lock up in 2022. They aim to do this by directing resource to credit control practices on the debtor side, and also requesting fees on account from clients. Then for work in progress (WIP) to be billed faster, there are plans to change WIP reporting procedures, interim bill more, and provide assistance on unbilled time reviews.

Average WIP has increased by 10 days over the year and by £197k. If the billing period was shortened by just one 1 day then £18.5k on average would be released from WIP into debtors, where firms do not have difficulties in collecting bill payments.

Key Actions

1. Automate billing processes and bills delivery to speed up the process.
2. Set monthly billing targets for fee earners.
3. Review client payment options, including taking payments on account and investing in online payment portals.
4. Ensure that your external funding period matches what it is investing in, so your asset purchases are not funded out of cash reserves.
5. Review your one to three year financial cash flow to ensure that it includes all investments planned or other changes in your business.

The future

2022 plans for business growth and profitability

1. **Recruit new staff**
   General recruitment is planned, but there is also a note to recruit specialists, together with future partners, as well as to look for expertise in the planned new growth specialisms.

2. **Retain staff and focus on their wellbeing**
   There are detailed plans around staff engagement and retention of staff in a competitive environment. Directly related to the pandemic are plans around staff wellbeing. There are also plans to initiate leadership and development programmes.

3. **Investment in IT hardware and systems**
   There are detailed plans that include investment in client facing technology and practice management software, as well as training for staff and investing to generate efficiencies.

4. **Business development and marketing activity**
   This includes an improved online presence around digital marketing, as well as plans to attract a better quality of client. Plans are also noted around branding, sector specific marketing and a push in new geographic regions.

5. **Growth**
   Plans include organic growth and acquisition with specific aims including revenue improvement. There are plans to expand into new service lines and also expand current service capacity.

What does the future hold for the legal sector?

Across the sector as a whole there is optimism for 2022 to be a year where there are positives in a number of areas. There is new work flowing in across all disciplines and further growing demand for legal services, rather than a peak, the like of which we saw following the stamp duty exemption that boosted the residential conveyancing market.

Teams are happy to be back working in their office environments, or have taken advantage of new agile working procedures that have been offered by employers. Whilst there was a productivity drop in chargeable hours as everyone re-acclimatised to office working, there seems to be a surge in hours matching demand for services. We are hopeful that some of the efficiencies that were learned by home working through the different lockdown periods will be continued into future working practices.

Whilst we see demand increasing, the critical issue for firms is staffing for the workloads. The economics of supply and demand are generating huge salary increments and staff requesting more benefits, including flexible working procedures that may have not been available to them in the past. The competition for staff will get harder in 2022. Firms will need to understand exactly what they need to do to retain their staff.

As accountants, it is easy to say that the numbers don't lie. And what we see in the financial results is the gulf between sole practitioner firms getting wider each year, compared to the other sizes of practices. The regulatory burden increases, but the financial benefit does not. To be a sole practitioner now seems to be more of a lifestyle choice.

Disclaimer

mha-uk.co.uk

To find out more about the accountancy and business advisory services MHA can offer, please contact

T: +44 (0) 207 429 4147

Follow us on:

Now, for tomorrow

An independent member of bakertilly INTERNATIONAL