Australian Legal Industry - Financial Performance Survey

Financial Re-entry

Annual financial performance survey for Australian law firms

Resilience through the pandemic

In partnership with the Australasian Legal Practice Management Association (ALPMA) we present the FY2021 financial performance benchmarking report which studies the financial performance of Australian law firms within this period.

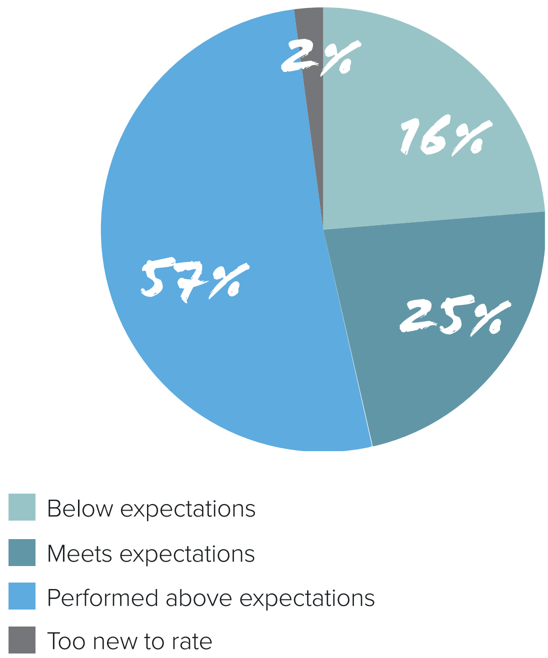
The financial benchmarking survey was conducted in late November 2021 and was open to all Australian law firms to participate. Overall, 100 firms participated in the survey with **62%** of those firms falling within the $2m to $10m revenue band.

During the challenging pandemic environment, we saw law firms navigate and respond to achieve their financial best and how they chose to position their financial operations for a financially resilient 2022 year ahead.

The practice areas that were predominantly represented in the report are commercial, property and construction, litigation, family law and wills and estates.

2021 performance

The law firms rated their financial performance for FY2021 on a positive note with **57%** of firms showing a performance above expectations:



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Numbers count

Despite the uncertainties around COVID-19 and the economy, law firm financial performance was strong as indicated in the table.

Overall for all firms the average Gross Profit was **52.8%** and Net Profit **35.4%.** Profitability was strong across the firms surveyed, and for firms above $2m revenue.

Measures from the 2021 survey

	Gross Profit %	Overheads %	EBIT %	Net profit %	Revenue/ Partner $Mil	Debtor days	Rent %
Overall for all firms average	52.8	43.3	9.5	35.4	$1.5	60	7.3
By revenue							
$1m to $2m	45.2	55.0	-9.7	28.4	$0.9	57	8.7
> $2m to $10m	53.7	42.5	11.1	36.5	$1.7	57	7.0
> $10m to $20m	55.8	38.2	17.7	39.2	$1.6	72	6.6
$20m +	55.0	38.2	18.4	34.6	$1.7	64	7.7
By head count							
1 to 20	54.2	45.5	8.7	35.3	$1.6	57.4	7.4
> 20 to 50	50.9	46.7	4.2	33.9	$1.5	53.7	7.8
> 50 to 100	52.7	15.6	15.6	39.1	$1.6	68.2	5.9
100+	52.7	38.9	13.8	30.7	$1.6	63.8	8.2
Locations							
CBD	53.9	42.5	11.4	36.7	$1.5	66	8.1
Regional	51.3	43.9	7.4	35.1	$1.4	44	6.2
Outside CBD of capital city	51.6	44.5	7.1	32.8	$1.6	62	6.5

Note:
** Net Profit is calculated as total income less total expenses.*
*** All other measures exclude Government grants and include a notional partner/principal salary of $250,000.*
**** All salaries in the analysis include superannuation and on-costs.*

Measures from the 2021 survey (continued)

	Marketing %	IT/Technology/ Internet/ Consumables %	Travel %	Training & CLE %	Insurance %	Printing & stationery %	Licences-software & technology %
Overall for all firms average	1.9	2.3	0.2	0.4	1.7	0.6	1.2
By revenue							
$1m to $2m	1.3	2.4	0.3	0.4	2.2	1.0	1.7
> $2m to $10m	2.3	2.3	0.3	0.5	1.6	0.6	1.0
> $10m to $20m	1.7	2.0	0.2	0.2	1.6	0.5	1.3
$20m +	0.7	2.2	0.1	0.3	1.2	0.5	0.9
By head count							
1 to 20	2.2	2.3	0.3	0.5	1.9	0.7	1.2
> 20 to 50	2.2	2.5	0.3	0.5	1.6	0.5	1.0
> 50 to 100	1.3	1.8	0.2	0.3	1.3	0.5	1.1
100+	0.7	2.4	0.1	0.3	1.3	0.5	1.0
Locations							
CBD	2.1	2.2	0.2	0.4	1.7	0.6	1.2
Regional	1.3	1.8	0.3	0.4	1.7	0.7	1.4
Outside CBD of capital city	2.0	3.0	0.2	0.5	1.5	0.6	0.8

Note:
** Net Profit is calculated as total income less total expenses.*
*** All other measures exclude Government grants and include a notional partner/principal salary of $250,000.*
**** All salaries in the analysis include superannuation and on-costs.*

The COVID-19 context

For most law firms, the past few years have been challenging, however as a collective, they have shown their agility and ability to adapt to the changing landscape and operating environments. Some key takeaways seen from a financial lens include:

- **90%** of firms surveyed had accessed Government grants and financial support, such as JobKeeper.
- The impact on cash-flow was mixed across firms where 1/3 had a negative impact, 1/3 had a positive impact, and 1/3 had no impact.
- It was evenly split on whether COVID-19 had impacted financial performance on billable fees, profitability, and overhead expenses.
- Changes in firms happened swiftly and regularly due to the Government's COVID-19 regulations and restrictions.

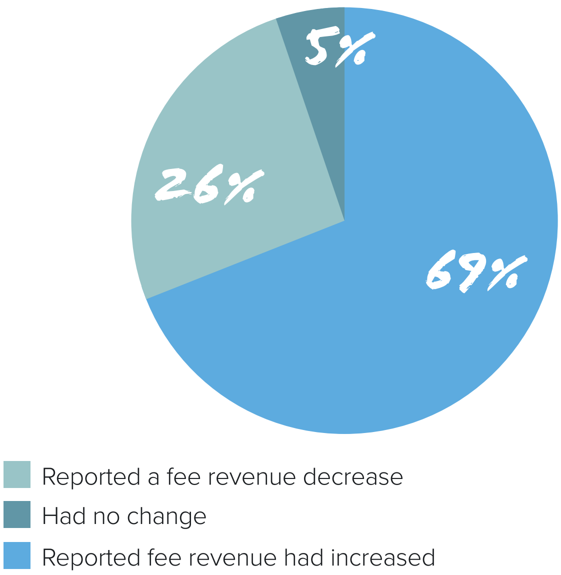
Performance snapshot

Even though the uncertainty of FY2021 continued to impact the conditions and financial performance of many law firms, it was also a year of financial achievements. **69%** of particpating firms report that their fee revenue increased in FY2021 whilst a further **5%** reported no change. Positively, only **26%** of firms reported a revenue decrease for the 2021 financial year.

The revenue story

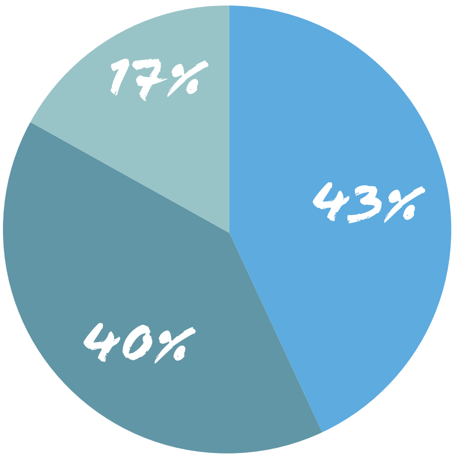
Positive increases in fee revenue for law firms was a clear sign that firms had developed strategies to face any fee revenue challenges presented by the pandemic.

- Not surprisingly, and in uncertain times, only **13%** of firms had introduced a new practice area into their firm as a way to create new revenue streams. Most respondents instead choosing to focus on existing and established service offerings.
- The biggest negative impact to fee revenue were COVID-19 lockdowns. Positive impacts on fee revenue were increased workload on existing clients and winning of new large matters.
- Only **8%** of firms generated revenue through a standalone online services offering.
- Hourly rate billing prevailed again this year as the most popular way to account for time spent on client matters, with hourly rate billing accounting for **81%** of the total fees billed by participating law firms. Only **12%** of total revenue billed was based on a fixed fee arrangement.



100% of firms who participated in this survey reviewed their charge out rates in FY2021 with **60%** of firms either increasing all charge out rates or increasing selected charge rates, and the remaining **40%** rates stayed the same within their firms.

This suggests that the majority of firms adjusted their charge out rates as a strategy to improve revenue generation.



Increased all charge out rates
Rates remained the same
Increased selected rates

The charge out rates

Average hourly charge out rates and the ranges were:

	Rate	Range
Partner / Principal	$540	$350 - $1100
Special Counsel	$430	$320 - $715
Senior Associate	$450	$280 - $600
Associate	$380	$280 - $475
Solicitor	$335	$210 - $490
Graduate	$230	$110 - $370
Paralegal	$200	$100 - $350

The profit story

Maintaining gross profit margins was a priority across all firms, and many law firms had the support of government grants and other financial means to maintain net profits.

- The average profit margin was **53%.**
- The average net profit was **35%.**
- **72%** of firms increased net profit in comparison to FY2020.

The cashflow story

As expected stabilising cashflow was a major focus for all firms throughout the year. Firms responded early with a focus on debt collection and rigorously improved their processes and procedures where able. The most notable interruptions to cashflow seen were as a result of the numerous lockdowns experienced.

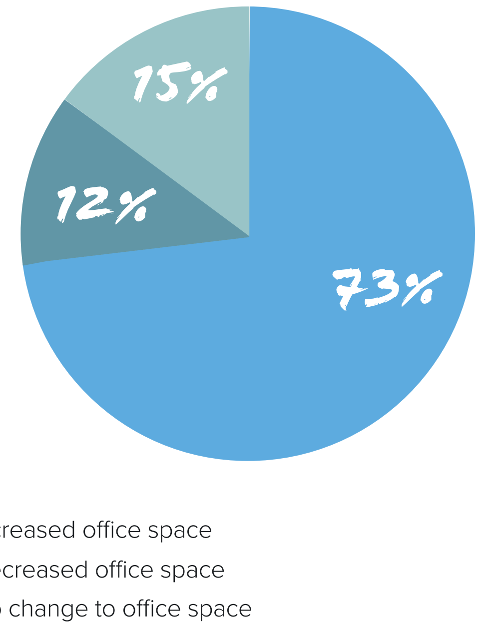
- For FY2021, firms indicated that **40%** of fees billed were in debtors for more than 30 days, with **28%** of fees remaining uncollected in debtors for more than 90 days.
- The average debtor days measured across all participating firms was 60 days.
- In terms of collecting outstanding fees there were no drastic measures or changes in the approach taken by firms to collect outstanding debt. The collection process for the majority of firms remain as an inhouse function, that is debt has not been sold externally to improve cashflow. This is likely a result of firms focusing on client relationships and client retention.
- Of the firms that had bank debt to support their working capital requirements, most found their banks supportive of their cashflow needs during the year.
- Outstanding tax liabilities are typically a signal of cashflow difficulties. Fortunately, **72%** of firms indicated that their tax bills were manageable, and only **2%** of the surveyed firms had difficulty paying their outstanding tax liabilities.

The expenditure story

Firms adopted a cautionary approach to their costs relative to fee revenue to manage the risk of declining gross profit margins. Unexpected changes to the operational environments due to COVID-19 resulted in **66%** of firms stating their staff costs had increased with only **26%** of firms stating their staff costs decreased.

However, major compensating cost saving strategies were implemented across all overheads with further reductions in rent and non-lawyer salaries occurring. The average overhead percentage across all firms was **43%.**

There continues to be ongoing discussions about the future of the law firm working environments with **15%** of firms increasing their office space, **12%** decreasing their office space and **73%** experiencing no change to the size of their office space within FY2021. This will be interesting to watch over the coming year with firms moving to return to the office and employees enjoying the ability and flexibility to work remotely.



Outsourced accounting functions were mainly utilised for annual tax compliance and complexity in outsourced payroll services. Accordingly, other accounting functions were performed in house.

The people story

As the employment market and conditions changed, staffing numbers fluctuated for many firms.

- **26%** decreased the number of staff.
- **44%** of firms increased their staff teams.
- The remaining firms had no change.

Staff retention was another significant concern raised by firms.

86% of respondent firms indicated that salary increases was the major staff incentive adopted in FY2021 along with other incentives which included bonuses, days off and parking provisions.

The message of productivity was a familiar theme as the average billed hours across all levels were similar. Solicitors to partners landed at 4.5 to 4.8 hours per day, and graduates and paralegal had billed hours of 3.7 and 3.4 hours a day.

The age profile of partners and principals:

- **50%** of firms had partners aged 40 – 50.
- **20%** of firms had partners aged > 50 – 60.
- **20%** of the firms were looking to retire partners in the next 18 months.

What lies ahead?

How do firms see their future? Whilst there is still a sense of uncertainty, the responses were encouraging and optimistic as most firms indicated an intent to pivot and reset operationally and financially pointing to a promising year ahead.

61% of firms indicated they were in a growth phase in their business cycle and **38%** looking to protect their positions.

75% expected revenue to grow, sourced from new clients and new matters from existing clients. **12%** of firms planned to increased charge out rates rates to boost revenue to cover increasing costs.

50% of firms are expecting to grow between 10% and 25% and **30%** of firms by less than 10%.

30% of firms expect partner remuneration to increase but the majority said there would be no change.

72% of firms stated they had no plans to retire partners in the next 18 months and 17% of firms said they expect one partner retirement.

By far the biggest challenge and risk factor raised on financial performance was staff retention other factors included salary costs and productivity of staff.

To the question of living with COVID-19 and what it means financially for law firms, we received mixed responses. Most responded with none or very little change. The other responses revolved around the themes of being agile and flexible, higher costs in remote working environment, greater technology support and protecting staff and their productivity.

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ALPMA Australasian Legal Practice Management Association

About ALPMA

The Australasian Legal Practice Management Association (ALPMA) is the peak professional body for managers of law firms and legal departments in Australasia. ALPMA provides an authoritative voice and extensive Learning and Development offerings on issues relevant to legal practice management.

Members include Managing Partners, Partners, Directors, C-Suite Executives, Practice Managers, General Managers, Specialist Managers (e.g. HR, Marketing, Finance, IT), Sole Practitioners and Lawyers with management roles.

If you currently hold a position, with management responsibility, within a private law firm, legal department or government agency within Australasia, then an ALPMA membership is for you.

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About Findex

Behind every person is a story. At Findex – we start with understanding your reason to get up in the morning. When we understand your story, we can help you through every step of your journey today, whilst helping you prepare for the challenges of tomorrow.

As one of Australasia's leading integrated advisory firms, we provide uniquely tailored, integrated solutions for people, businesses, government organisations and institutions that transform and grow as their needs do. We pride ourselves on a high touch, personalised approach to help our clients achieve their financial, professional and life goals.

With over 100 offices throughout Australia and New Zealand, our vast geographical footprint provides you direct access to our expert advisers who understand local and national issues and provide access to competitive solutions in your location.

Talk to one of our advisers

For more information please contact Andrew Chen to find out how we can assist you.

Andrew is a partner in the Findex Business Advisory team and has significant experience providing advisory, tax and accounting services to businesses of all sizes. He specialises in advising legal and professional service firms.

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