



Shifting financial matters

Annual financial performance survey for Australian law firms

That was then, this is now

Findex is pleased to partner with the Australasian Legal Practice Management Association (ALPMA) to present the 2020 annual benchmarking study for the financial performance of Australian law firms.

The study released in March 2020 using Findex's proprietary benchmarking tool, Open Measures (www.openmeasures.com.au), surveyed 120 participating firms about their 2019 financial performance and 2020 financial vision, enabling them to rank and compare their performance relative to other participating firms on key financial measures.

When we set about surveying law firms in November 2019, no-one could have envisaged the COVID-19 pandemic and the financial impacts and challenges that were about to take place.

The impacts of COVID-19 were unforeseen and unprecedented, and immediately highlighted any weaknesses in a law firm's cashflow and prior technology investments, as both quickly surfaced as critical tools a firm required to carry on business.

Time will tell how firms have ultimately responded and reshaped their priorities to a new normal in light of COVID-19. As firms assess their 2020 financial performance against what they originally set out to achieve, and attempt to forecast for 2021 and beyond, how firms bounce back and thrive will largely be a function of their financial strength and position pre-COVID-19.

What a difference a year can make

In the space of a few months, the world has changed and the financial resilience of firms leading into the COVID-19 period has significantly heightened in importance.

Over several years, the annual Findex and ALPMA financial performance survey has examined the financial resilience of law firms through a financial resilience index that shows the relationship between:

- A firm's fee revenue.
- Its level of funding.
- Net asset position.

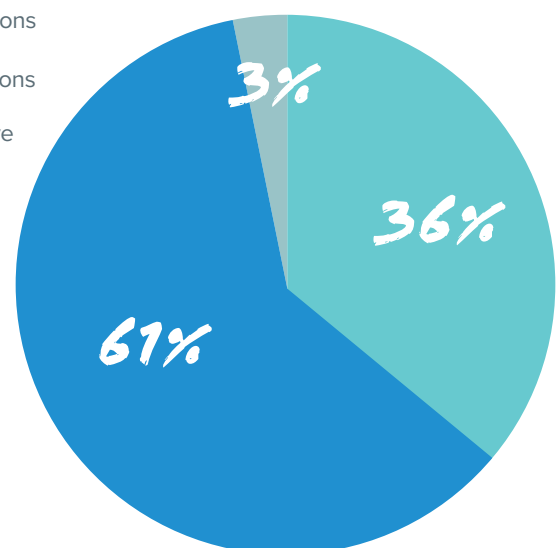
A higher index rating indicates a more resilient firm. A rating of five or more is considered financially resilient.

In 2019, the average rating across 100 firms surveyed was 2.8, which indicates an average financial resilience overall. When asked to rate their 2019 performance, most firms said they met their expectations, indicating those firms have a solid financial foundation.

2019 Performance

Percentage of firms

- Below expectations
- Meets expectations
- Performed above expectations





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In hindsight, the challenge for legal firms will be how fast they can bounce back to their 2019 position or to where they once were as a starting point. Furthermore, will the financially resilient firms be able to seize the opportunities and point their firms to a financially optimistic future despite these uncertain times?

Strength in numbers

As firms start to examine their outcomes and trends for 2020 and navigate the future after potential fee declines and cost cutting, more than ever their financial strength will be shown through their profitability.

Prior to COVID-19, profitability was strong across the firms surveyed.

Size of firm by revenue	<\$5M	\$5M < \$10M	\$10M < \$20M	\$20M+	Total Population Ave
Gross Profit	55%	62%	61%	61%	60%
Net Profit	13%	17%	26%	21%	19%
Profit / Partner	\$433,000	\$550,000	\$529,000	\$567,000	\$520,000
Revenue / Partner	\$1.4m	\$1.8m	\$1.2	\$1.6m	\$1.5m

Profitability 2019					
Indirect staff cost	14%	14%	7%	11%	12%
Rent	7%	7%	6%	10%	8%
IT	3%	3%	4%	3%	3%
Marketing	2%	2%	2%	1%	2%
Overheads (excluding rent)	37%	38%	30%	32%	34%

Costs 2019

To avoid a cash crisis in the future, law firms continue to store up cashflow in 2020. As many firms start to see “lock-up” days drift out compared to last year, the conversion of Work in Progress (WIP) and debtors into cash is now a major focus.

WIP Days	68	104	39	47
Debtor days #	51	63	92	62

Cashflow and Working Capital 2019

73% of surveyed firms had up to 40% of debtors in 90 days

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Aspirations v reality for 2020

When we surveyed firms, the growth outlook for 2020 was optimistic at nine percent. With the impact of COVID-19 and many firms accessing Government Stimulus and Job Keeper programs, we expect this will no longer be a reality for many firms.

Prior to COVID-19, 70% of firms said they expected to grow in 2020, however, 50% of firms also said they did not expect to appoint new partners in 2020.

Interestingly, succession of firms was high on the agenda. 55% of the partner/principals we surveyed were aged 30 - 40 and 33% were aged between 40 -50. In the current environment, we would expect many retirement plans to be deferred.

As clients seek certainty on fees, many firms continue to bill on hourly rates with 42% of firms billing on hourly rates and 30% of firms using fixed fees.

Top 5 fact or fiction for 2020

Before COVID-19 hit, we asked firms where they saw the world heading in 2020. These top 5 responses gives us clues on what their focus was in 2019 before the world changed.



Top 5 biggest challenges

- Productivity of staff
- Revenue Growth
- Cashflow / Lock up
- Staff retention
- Retiring Partners



Top 5 biggest impacts on FY2020 financial position

- Productivity Improvements
- Revenue changes
- New Partners
- Cutting staff costs
- Partner Retirements



Top 5 sources of competition

- Mid-tier firms
- Boutique specialist firms
- Local firms in your location or region
- Online firms and legal services
- In house lawyers



Top 5 new practice areas introduced

- Litigation
- Conveyancing
- Immigration
- Employment
- Insurance



Top 5 sources of the new revenue

- New clients
- New matters from existing clients
- New service offerings
- New market segments
- Increased rates



Top 5 source of savings

- None - No Cost Savings Initiatives
- All Overheads
- Technology and systems
- Non-fee earner salaries
- Premises



Top 5 factors to recruit

- Growth requiring more staff to be employed
- Replacement
- Creation of new role/ position
- New expertise required for specific practice areas
- Expansion e.g. new office



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Financially Reshaping

The financial impact from COVID-19 is starting to emerge for law firms as they recalibrate their financial positions.

After initially taking evasive action to sure up profitability and cashflow in response to an acute change in their financial situation, many firms are responding by planning for the best despite the restrictions placed upon them.

As we have engaged with law firms and practitioners about what they have been financially thinking about, it's evident from their responses the challenges and financial impacts have been significant yet varied.

5 + 5 Insights

1

The financial experience has varied depending on how financially resilient law firms were prior to COVID-19 and the practice areas exposed.

2

The take up of the JobKeeper subsidy and other Government stimulus measures has been a key indicator for declining fees suffered by firms.

3

In response to declining fees, firms have explored new or expanded services to drive demand for their services and continue to grow in areas such as property lease negotiation, debt recovery and litigation services.

4

As expected, firms aggressively shed discretionary expenses and negotiated terms with suppliers, seeking discounts, cancelling and deferring arrangements.

5

Negotiating with landlords was an immediate step met with mixed outcomes for discounts and deferred rent for firms.

6

As profit margins eroded, the focus turned to staff costs. Plans included stand downs, redundancies, period pay reductions and use of leave entitlements carefully balanced against the need to deliver services to clients. Partners and principals of firms cut their draws and bonus draws to varying degrees to conserve cash while keeping open the option to pay actual profits arising later.

7

The realisation of cash from firms' balance sheets was at the forefront as debtor collection days inevitably drifted out when client invoices remained unpaid.

8

As banks assessed their risks, finance arrangements and relationships with financial institutions were tested as firms negotiated terms, extensions of loan facilities and interest reductions.

9

Preserving and reserving of cash has been an intentional strategy to protect against unpredictable business conditions and financial uncertainty.

10

Financial adversity creates opportunity. Facilitated by technology and lower barriers to entry, the number of start-up law firms where physical premises is no longer the norm has spiked, helping them to compete.



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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 and tax accounting services to businesses of all sizes.

He specialises in advising legal and professional service firms on establishing business structures, entry and exit of partners, remuneration models, financial management in areas of internal accounting, functions, financial reporting and KPI performance measurement, budget setting, tax management and preparation of tax returns.

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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 110 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.

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 on issues relevant to legal practice management.

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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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