NatWest

Legal Report 2023

Tomorrow Begins Today

Contents

Foreword

The UK legal sector continues to be hugely important within NatWest. We have a long and proud history of supporting legal firms throughout the UK, helping them develop successful and sustainable businesses.

I'm delighted to present our ninth edition of the NatWest Legal Report. This year PKF Francis Clark have been commissioned to write the report. I'd also like to recognise Robert Mowbray for his vital contribution and ongoing development to the NatWest Legal Report in prior years. I'm incredibly grateful to all the firms who've contributed and provided insights that will help others within our sector during these challenging times.

Our report focuses primarily on firms that operate at the SME level across England, Scotland and Wales. By comparing the financial performance of firms from across the UK, we've identified some interesting trends and valuable insights. Firms can use these findings to target areas of improvement, with the aim of enhancing profitability and management of working capital.

I think the challenge for everyone in the current environment is finding the time to focus not just on the immediate now, but also on longer term vision, thinking about sustainability in its widest sense and having a future proof mindset – which, ultimately, I believe helps build better businesses as a result.

With this in mind, we've concluded this report with a top tips for business success and growth, which we hope will give you a useful framework to help navigate challenges and leverage new opportunities to pivot, innovate and grow your business.

It's encouraging that despite the recent and ongoing challenges, the legal sector continues to show remarkable resilience, with many firms demonstrating record profitability in the last three years.

I hope you enjoy this report.

David Weaver
Head of Professional
& Business Services

Contents

Introduction and key findings

1:1 Introduction

In our 2023 survey, we're aiming to provide a reflective analysis of law firms' financial results from 2022 and consider the current commercial and financial outlook affecting firms today.

We published our last legal report in 2021, focusing on the results from a pre-pandemic legal sector and financial results from 2020.

Since our last survey, we've seen firms navigate through the pandemic – which presented significant financial and operational challenges for most.

At the same time, law firms have faced enormous pressure on demand for their services, along with the war on talent – which has raged alongside general inflation – presenting further commercial pressures to manage.

Let's not forget, during this same period law firms have managed the challenges of Brexit and several changes in Prime Minister too – all of which, at times, have delivered degrees of economic challenge.

So much has changed during the last few years for law firms and the legal landscape in the UK.

Just as a snapshot:

- 2021, the most financially successful year for law firms in at least 25 years, followed by the tax bills in January 2022 and 2023.
- 2022 was another extremely strong financial year by long-term sector average.
- Newly qualified salaries exceeded £100,000 for the first time in London.
- Acceleration of consolidator and private equity investment.
- Consultancy models gained traction.
- Employee ownership trusts arrived and developed a presence.
- Environmental, Social and Governance (ESG) and diversity gained importance in law firm management.
- AI became a subject of significance in the legal market, and ChatGPT emerged.
- Basis period reforms for income tax enacted are presenting future funding challenges.
- Interest income made a resurgence in law firms following UK base rate rises.

Contents

Introduction

Despite the ever-present challenges, we can still reflect on the last three years as being the most financially successful times we have seen in the last 25 years. This is the ninth legal report prepared by NatWest and, after a break in 2022, we're keen to ensure the report and its contents continue to evolve.

Naturally, we have recent financial information to set context. But we aim to explore both the financial and non-financial issues affecting the sector and put those into context for our readers.

We're also seeking to get the most up-to-date financial and strategic thoughts from law firm finance and management leaders to give readers an overview of the state of the legal sector.

This report is based on contributions from 68 firms (most of which have a fee income of between £1m and £75m). We're grateful for their time and efforts in working with us, including the various managing partners and finance partners we interviewed while collating this report.

The information has been broken down into two sizes of firm – large and small – and the firms taking part are from across the whole of the UK.

1.2 Your author

Andrew Allen
BSc (Hons) FCA

In our survey, Andrew draws on his own experiences of the legal sector and provides supplementary analysis alongside the results from NatWest's 2023 survey. Andrew is a chartered accountant and graduate in statistics, with significant experience in the analysis of financial results for law firms.

As a partner, Andrew leads PKF Francis Clark's national legal sector team and personally advises over 100 law firms across the UK, ranging from top 50 firms to successful niche law firm businesses.

Having advised law firms for over 25 years, Andrew's developed a national reputation for practical and specialist advice to law firms.

Andrew is also a well-known adviser in the national UK legal sector. In particular, his contributions to the sector include the following:

- Current vice-chair of the Law Society Leadership and Management Section.
- Past chair of the ICAEW Solicitors Special Interest group.
- Co-author of the Law Society's Solicitors Accountants Rules Manual, published in 2021.

Contents

Introduction

1.3 Key findings from the survey

a) Fees

- Median fee income growth in 2022 was 8%, consistent with our experience in the sector, where typical results were in the region of 5% to 10%.
- Fees per equity partner reported a median result of just over £1m compared with our 2021 survey result of £744,000.
- Fees per fee earner, a key measure of productivity in law firms, reported a median result of £141,000, which again is consistent with our own experience – which typically falls between £120,000 and £160,000 for most firms outside the top 100.
- Private client work was cited as the most buoyant sector by law firms in 2023, while employment was noted as the most problematic at a fee income level in 2023.

b) People costs and related issues

- Employee costs as a percentage of fees reported a median of 42%. This compared with our expected range, based on typical sector levels of between 45% and 55%.
- People costs as a percentage of fees is a more important statistic, adjusting for notional salaries of self-employed owners. The median result was 61% (lower quartile 56% and upper quartile 70%). This compares favourably with our expected range, based on typical sector levels of between 55% and 65%.
- The most common hybrid working arrangement was for fee earners to work at home for two days per week.
- During 2023, 27% of firms are anticipating a static or declining headcount position, while 59% are expecting headcount to increase by up to 10% in 2023.
- Over half of firms are expecting to increase their client charge-out rates by less than 5%, and only 10% of firms anticipate increasing their rates by over 10%.
- 53% of firms expected an increase in total payroll costs in 2023 of up to 5%, 46% anticipated costs rising by between 5% and 10%, while only 1% anticipated a rise in costs of over 10%.

c) Profits

- Median Profits per Equity Partner (PEP) reported in the survey for 2022 came in at £246,000, broken down as £148,000 for small firms and £302,000 for large firms.
- The median PEP in 2022 reflected a decline of 3% on 2021 levels for small and large firms in the survey.
- 25% of firms reported growth in PEP of 18% or more, and 25% reported declines in PEP of 20% or more.

Contents

Introduction

d) Lock-up debt and funding

- There were modest movements in lock-up in 2022 compared with 2021, with median lock-up days reported at 136 days in 2022 compared with 134 days in 2021.
- For every £1 of Members' Funds/Net assets in the business, the median level of debt was 24p (upper quartile £54p), appearing to be comfortable in relation to debt availability to law firms.

e) People structure

- Gearing (fee earners per equity owner) reported a median result of seven, with the upper quartile commencing at 12.
- The median ratio of support staff per fee earner for the survey was 0.8, with the upper quartile commencing at 1.2 and the lower quartile ending at 0.6.
- 61% of firms primarily focused on fees issued as a mechanism to monitor fee earner performance.

f) Other topical issues

- 46% of firms see the attraction and retention of talent as the key challenge they face in 2023. The economic outlook followed this issue at 21%, then cashflow (10%) and inflation (9%).
- 41% of firms cited their practice management system as the biggest IT investment priority, with case management investment falling second at 29%. While only 2% of firms cited Artificial Intelligence as a key area of investment for them, it seems likely this will become an area of increasing interest for law firms over the next few years as AI becomes more widely adopted.
- 32% of firms reported they were either likely or very likely to seek merger/acquisition as strategy in the short term, and 22% of firms reported they've been approached by a consolidator in the last year.
- 19% of firms placed a high priority on diversity and inclusion. 62% of firms reported over 60% of their fee earners were female. 24% of firms reported over 60% of their equity owners were female.
- 10% of firms reported they place a high priority on ESG in their business, and 37% of firms have invested in renewable energy solutions in their business.

"46% of firms see the attraction and retention of talent as the key challenge they face in 2023."

Contents

Section 2: Geography and constitution

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2.1 Firms by size

The survey has divided the firms into two sizes of firm. Those with annual fees of less than £5m are described as “small”, while those with fees of more than £5m are classified as “large”.

Our sample in 2023 extends to 68 firms, where 29 firms have annual fees of less than £5m and 39 firms have annual fees of more than £5m.

2.2 Firms by constitution

The split of firms taking part in the survey by constitution is as follows:

- 44 LLPs (65%).
- 17 companies (25%).
- Seven (10%) unincorporated businesses (partnerships and sole practitioners).

This mix of constitutions is largely unchanged from our 2021 survey.

2.3 Popularity of constitution

Trading structures are frequently discussed in relation to law firms. Whether the focus is on commercial or taxation issues, there are often many aspects to consider when making decisions in this area.

There have been various headlines citing the growth in the use of limited companies in the legal sector and, in volume terms, various statistics are available suggesting limited companies now account for over 50% of the UK legal market as a constitution.

Keep in mind that in recent years limited companies have become the favoured vehicle for sole practitioners (often for tax planning reasons), and the advent of the consultancy model has created more company law firms – because these often require incoming members to operate through a legally regulated limited company to join the consultancy network.

The current popularity of Employee Ownership Trusts, which require a company structure, has also led to an increase in the use of limited companies in law firm models in the last few years.

Contents

Section 2: Geography and constitution

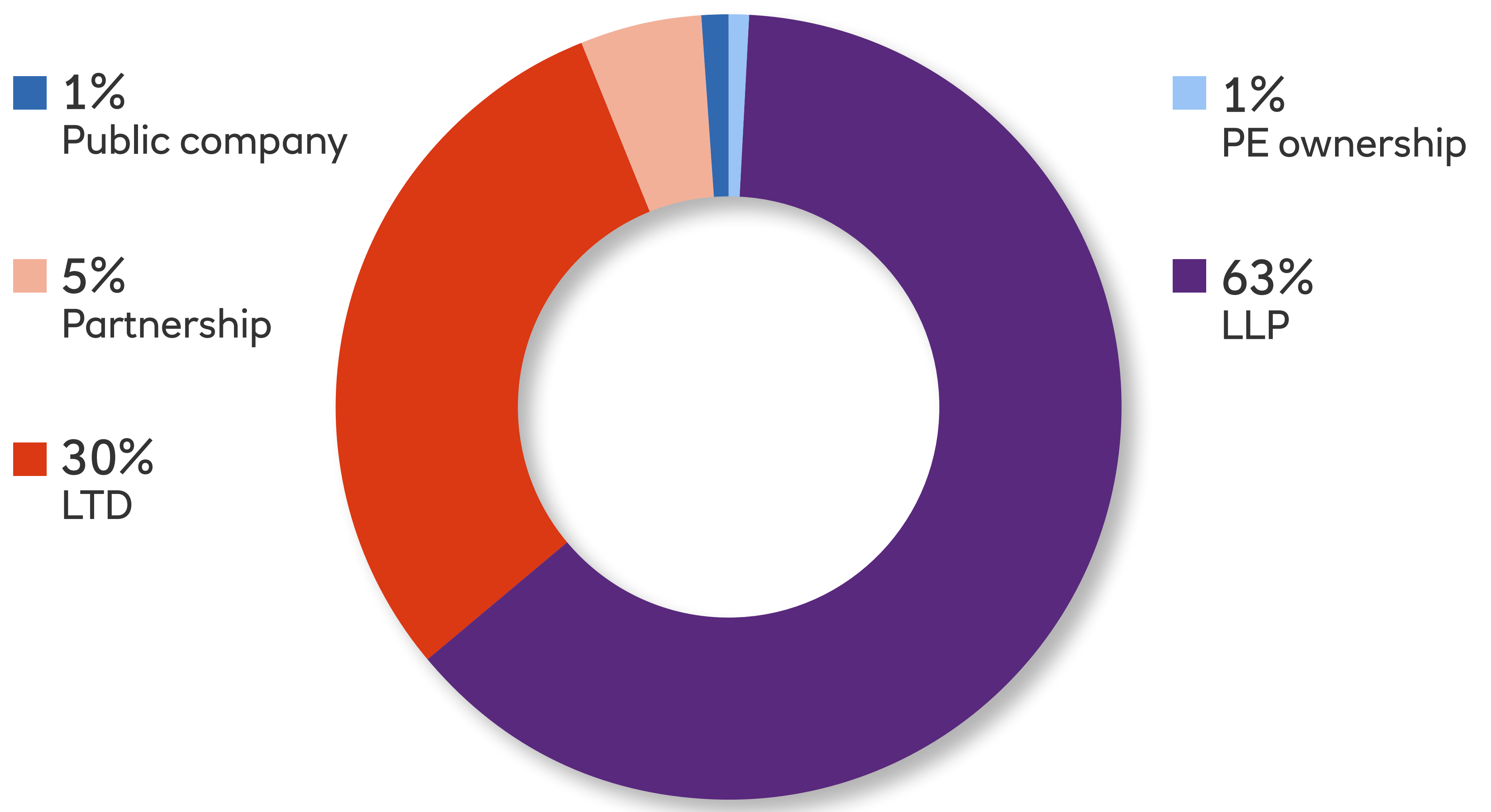
We asked survey participants for their views on what they felt was the most appropriate constitution for law firms and overwhelmingly at 63% their view was the LLP remains the most appropriate vehicle, with a limited company structure following at 30%.

Discussing structure and ownership of law firms in more detail with respondent firms, Sarb Gosal, Finance Partner of Spire Solicitors, noted: "We operate as an LLP. We are traditional in our ownership arrangements and, whilst like many firms we focus on succession, we believe that the LLP structure is most appropriate for our business, and we have no intention to consider alternatives at this point."

Alison Lobb, Managing Partner at Morecrofts Solicitors, explained: "We believe that ownership arrangements in law firms will continue to change in the future. The next generation often does not want to take on the risk of funding a business, nor the responsibility and commitment which comes with this. The next generation are not career-long people and like to move around much more than has been that case in the past. This presents a big challenge for the legal sector of the future."

James Maxey, Managing Partner of Express Solicitors, commented: "In the future, the legal sector is likely to consist of less partnership and individual ownership models, with more solicitors being employees rather than owners, probably in part as a result of increased larger corporate ownership and external investment in the sector."

What do you see as the most appropriate trading structure for professional service firms?



"The next generation are not career-long people and like to move around much more."

Contents

Section 3:
Fee income

Section 3: Fee income

3.1 Overview

- Median fee growth in 2022 was 8%.
- Anticipated fee growth in 2023 financial year-ends recently concluded was in the range of 7% to 12%.
- 71% of firms expect 2024 growth in fee income of less than 10%.
- 31% of firms expect 2024 growth in fee income of less than 5%.
- Firms predict people costs will rise in many firms by 10% to 12% in 2023, placing pressure on margins in firms.
- In 2023, the best performing areas in firms are residential property and private client. The worst performing areas are employment and family.

Questions to consider now

- Do your fee earners offer pricing choices to your clients?
- Do your terms of engagement and time recording processes enable fee earners to apply value billing?
- What are you doing to identify potential new matter types for the firm to deliver in the future?

3.2 Fee growth – 2022

In our experience, the level of fee growth in 2021 was unusually diverse in the legal sector. We saw firms report a range of results, from declines of 40% to growth of up to 10%. However, the largest volume of firms reported results ranging from a decline of 5% to growth of 5%.

Turning to 2022, the range of results we experienced in the legal sector was more narrowly concentrated on the 5% to 10% growth level year on year – so for that year, broadly just above inflation.

We can see in the table below that results from the NatWest survey this year present a similar picture, with the median fee growth reported by participants being 8% year on year. This was 7% for large firms and slightly higher at 10% for small firms, with small firms probably benefiting more from continued high activity levels in the property market.

Fees as a percentage of previous year

	Lower quartile	Median	Upper quartile
Small firms	101%	110%	122%
Large firms	100%	107%	115%
All firms	100%	108%	117%

Contents

Section 3: Fee income

3.3 Fee growth – 2023/24 forecast

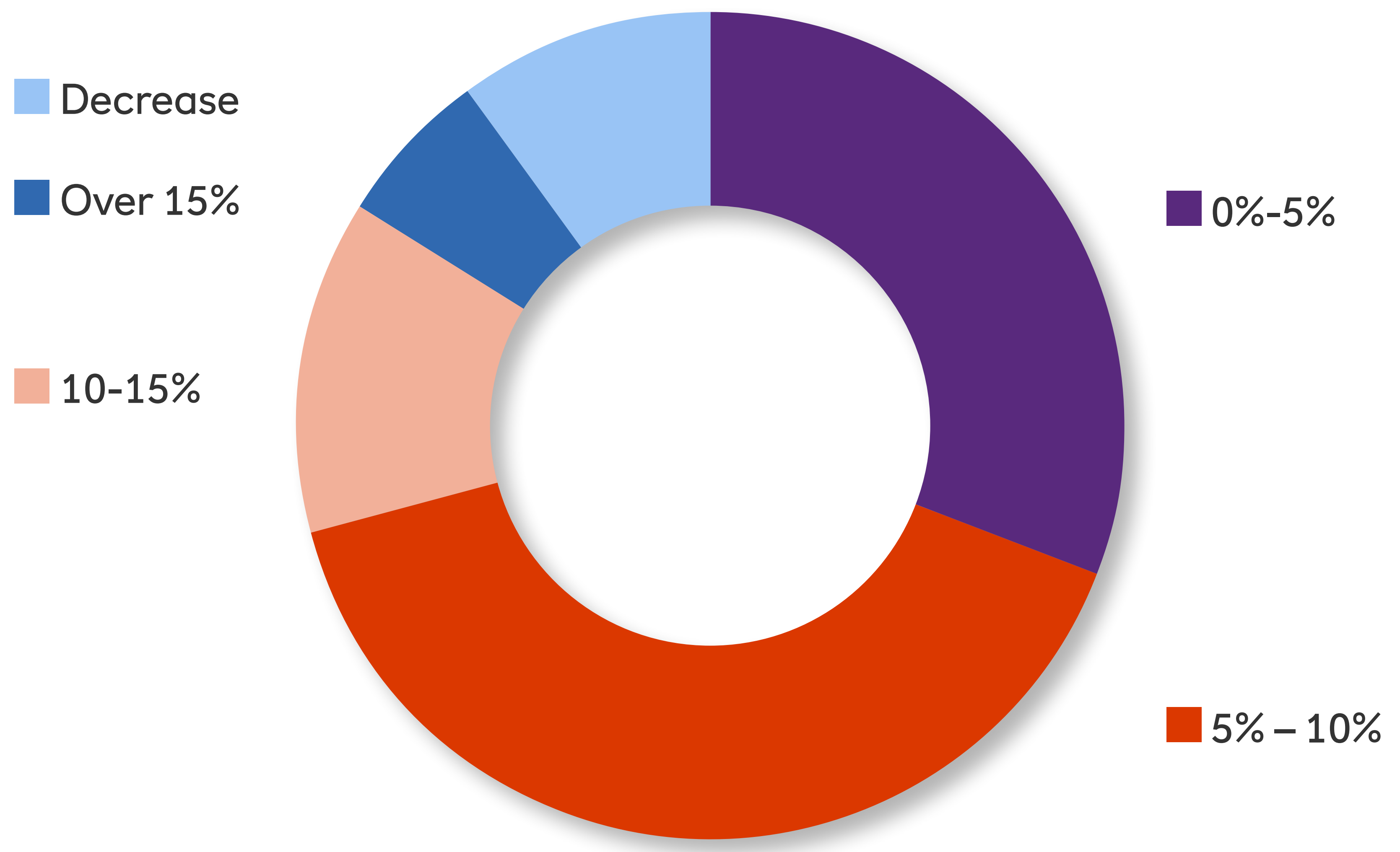
For many law firms, their 2023 financial year recently ended in March and April 2023. While not part of this survey data, our experience of management accounts and early financial data from law firms suggests growth in the range of 7% to 12% will be commonly reported from that financial year.

But what did our survey participants think about the future and what are they budgeting in terms of growth in income in 2023/24?

The data below shows 90% of firms expect fee income to increase. The most common projected growth level (40% of participants) is 5% to 10%. Considering recent inflation, this suggests firms expect to struggle to achieve growth that covers rising people costs and overheads during the next year.

When we include those in the 0% to 5% fee income growth category, we find in total 71% of the survey responses predict growth in income of 10% or less during 2023/24.

How much do you expect fee income/turnover to increase in the next 12 months?



Growth	0%-5%	5%-10%	10%-15%	Over 15%	Decrease
No. of firms	21	27	9	4	7
% of survey	31%	40%	13%	6%	10%

In conjunction with this information, it is interesting to also consider participants' expected inflationary increase in salary costs for 2023/24 in the table below.

Growth	0%-5%	5%-10%	10%-15%
No. of firms	36	31	1
% of survey	53%	46%	1%

Contents

Section 3: Fee income

The costs here are pure salary increases. Most firms find that once pensions and Employers' National Insurance are also considered, along with increments and promotions, this tends to add a further 20% to the increase.

Once pension and National Insurance costs of employment are accounted for as well, it seems probable many firms will be looking at total employee costs rising in the region of 10% to 12% in 2023/24.

This is also consistent with our own experience of the budgeting process for many law firms in 2023/24, where we've seen a considerable number of firms projecting increases of up to 12% in people costs.

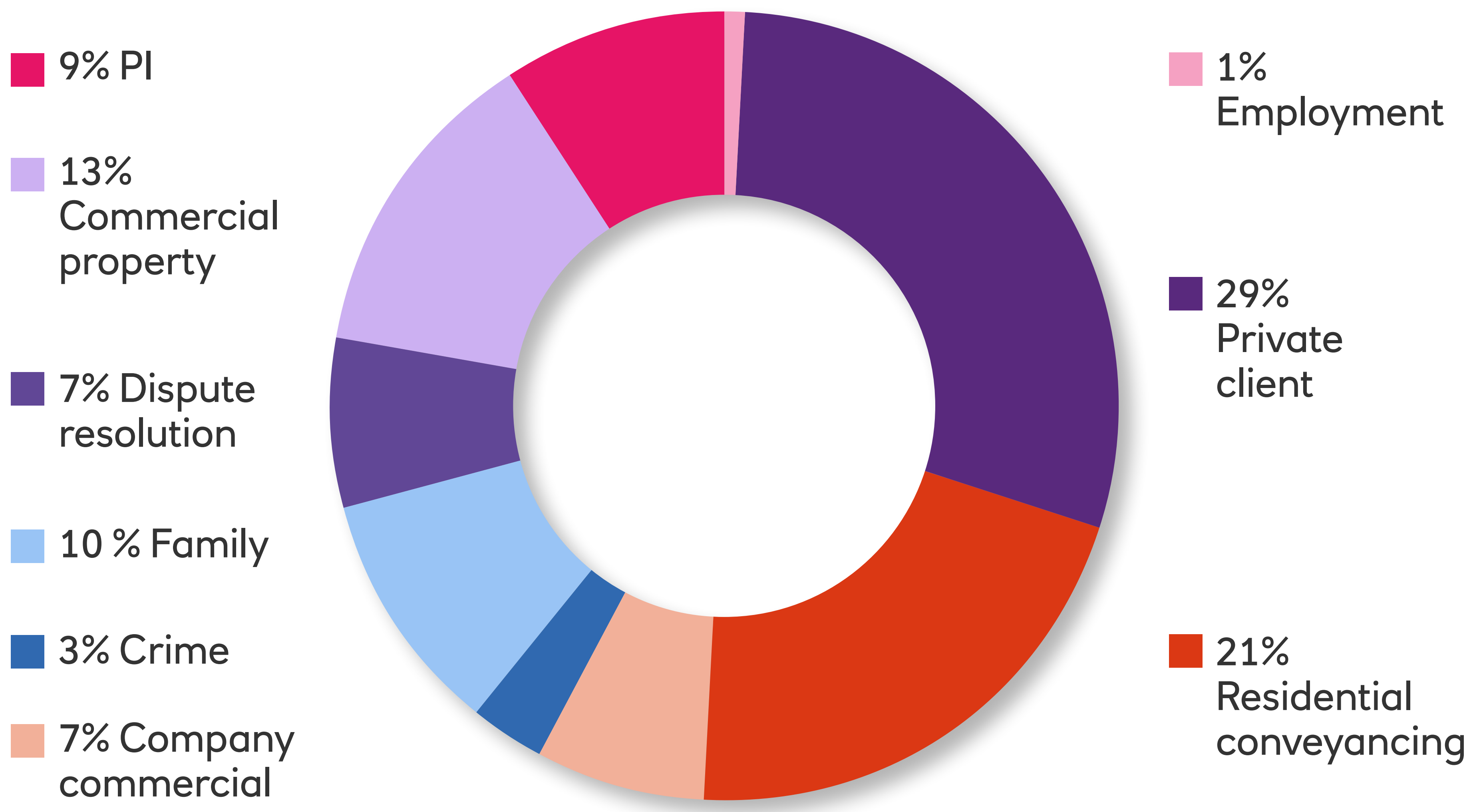
All these factors indicate a growing squeeze on margins for law firms during this period, and most probably the same pressures on PEP.

3.4 Fee performance by team

Looking at growth in income for law firms provides an overview of the sector, but of course growth levels are affected in a firm by the mix of work they undertake.

We asked participants for their views on the best and least performing teams in the current environment in quarter one of 2023.

What practice area is performing best at the moment?



With a clear result, private client (29%) and residential conveyancing (21%) were reported as the most buoyant areas at this time in 2023.

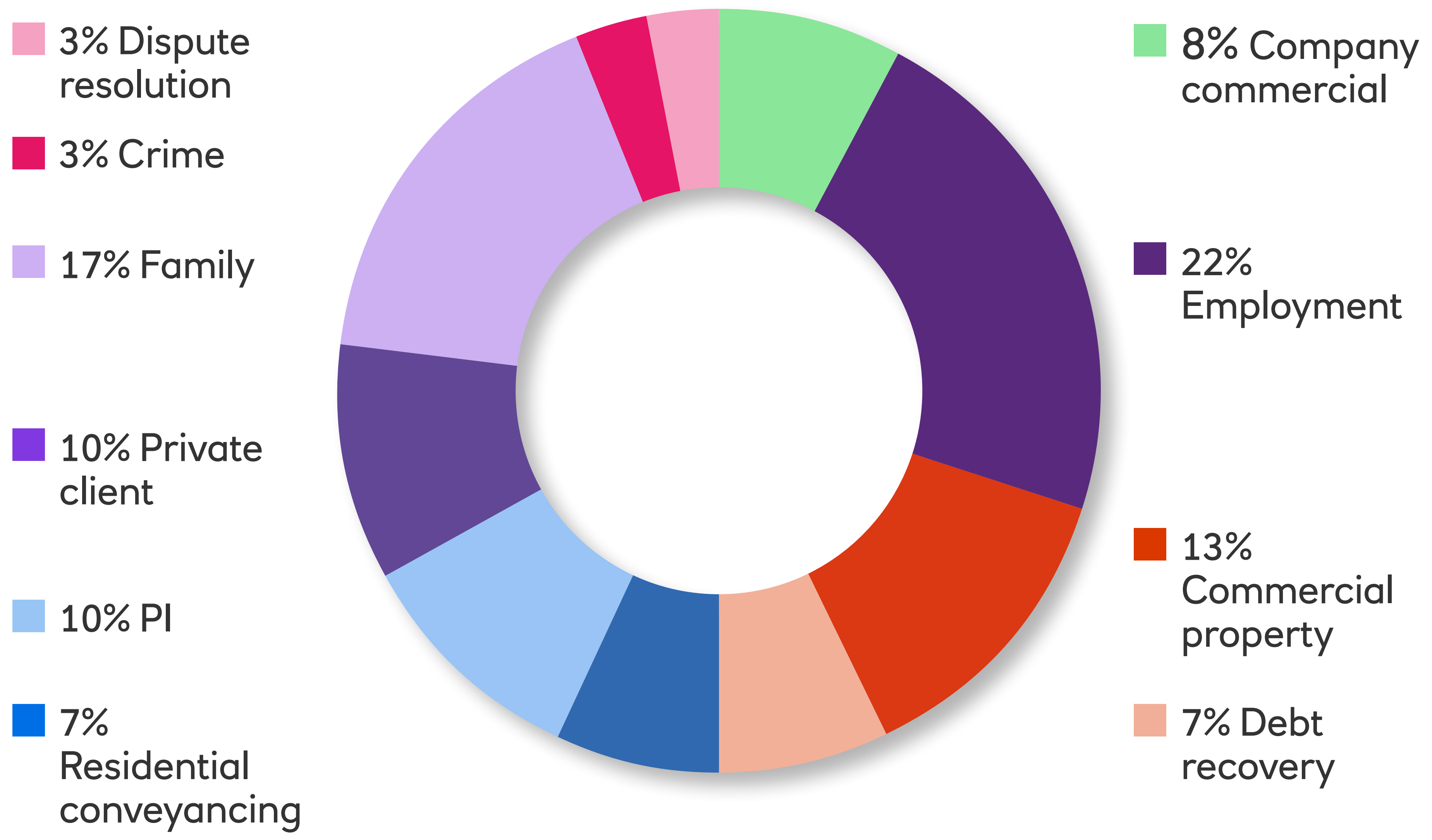
From our own experience, this is consistent with management accounts we have seen in the legal sector for the 2022/23 financial year. It's also consistent with actual results for the legal sector in 2021/22, where fee growth levels for private client teams were most frequently in the region of 10% and residential teams saw growth of 15% or more in many cases.

Contents

Section 3: Fee income

The challenges, in contrast, appear more evenly spread among the sector: although the top reported challenge areas were employment, cited by 22% of participants, and family, reported by 17% of participants.

What practice area is performing worst at the moment?



Employment team challenges are certainly consistent with our experience of results in 2022/23. Many teams have struggled in this area since the (short-lived) high-demand days during the pandemic. In many teams, for example, we saw 10% to 15% growth in reported income in 2020/21, which was then lost during 2021/22 with similar declines.

It's more surprising to see family and commercial property being reported as problem areas. Family teams, in our experience, remain extremely busy and often unable to meet client demands for service, particularly in firms that specialise in this area and those involved in children and care work. A continued high demand post-pandemic and a shortage of experienced and trained solicitors in this work in recent years both appear to be contributing to this challenge.

Commercial property continues to be extremely strong in many parts of the UK given our own experience of management accounts in 2022/23, although there are some parts of the sector (particularly in firms that operate smaller commercial property teams) where results have sometimes been more volatile.

"Commercial property continues to be extremely strong in many parts of the UK."

Contents

Section 3: Fee income

3.5 Fees per Equity Partner

The results for the 2022 survey are reflected in the table below. Overall, firms reported a median of just over £1m of fees per Equity Partner, although there was a significant difference reported between the small and large firms – where small firms reported a median closer to £700,000 compared with a median of £1.1m for larger firms.

Fees per equity partners (£’000)

	Lower quartile	Median	Upper quartile
Small firms	431	678	1,079
Large firms	916	1,120	2,167
All firms	704	1,004	1,586

The results here are consistent with our own experience of the legal sector in 2022, where in volume terms the most common levels of fees per Equity Partner we saw were in the region of £600,000 to £900,000 – and these were firms outside the top 100 UK law firms. Once we consider the top 100 firms, we would commonly be experiencing results in the region of £1.3m to £1.8m.

In broad terms, given the range of participants in this survey, the results here appear to be in keeping with the sector in 2022.

3.6 Fees per Fee Earner

This performance indicator provides one of the most reliable methods of comparing productivity between law firms because it focuses on the productivity on average of all fee earners in the business, irrespective of whether they are self-employed partners or employed fee earners.

Fees per fee earner (£’000)

	Lower quartile	Median	Upper quartile
Small firms	96	118	170
Large firms	131	153	187
All firms	116	141	183

The median here for all survey firm participants was £141,000, although there was a considerable difference between the small and large firm results, which were £118,000 and £153,000 respectively. The upper quartiles for small and larger firms were closer together and commence at £170,000 and £187,000 respectively.

Our experience is many law firms report results here between £120,000 and £150,000, which broadly falls in line with the data in this survey.

Top 100 firms would be reporting results of over £200,000, so the upper quartile of the large firm’s category will include some of those firms and some small boutique firms that typically have a less common ownership and fee earner structure compared with typical law firms.

Contents

Section 4: People costs and expenses

Section 4: People costs and expenses

4.1 Overview

- The median result for employee costs as a percentage of fees was 42%, and the median year-on-year growth in employee costs was 7%.
- The median result for people costs as a percentage of fees was 61%.
- Over 50% of firms are expecting to increase their charge-out rates by less than 10% in 2023, while most firms are anticipating a greater than 10% increase in people costs.
- 54% of firms reported employees work two days per week at home.
- 40% of firms reported growth in PII costs of more than 10% (noting median fee income growth was 8%).

Questions to consider now

- Do you monitor people costs by team and benchmark these results?
- What are you doing in your firm today to make it easier to manage your succession in the future?
- Are you investigating how factors such as ESG and diversity and equality policies can impact recruitment and retention?

4.2 Employee costs

Staff costs as a percentage of fees are a helpful indicator of the core profitability (profit margins) of a law firm.

We can see from the table below the median result for the survey was 42%. The upper quartile result was 49%.

In the legal sector more widely, we most frequently saw law firms report a result here of 45% to 55%. The results for this survey therefore compare favourably with these expectations.

Staff costs as percentage of fees

	Lower quartile	Median	Upper quartile
Small firms	33%	42%	54%
Large firms	37%	42%	46%
All firms	34%	42%	49%

It's also interesting to consider how the cost structure here changed in 2022 compared with 2021 for participants. The table below shows over 50% of firms saw an increase in employee costs of 7% or more in 2022 and 25% of participants saw growth of 19% or more in employee costs.

Contents

Section 4: People costs and expenses

Staff costs as percentage of previous year

	Lower quartile	Median	Upper quartile
Small firms	100%	109%	119%
Large firms	101%	107%	118%
All firms	100%	107%	119%

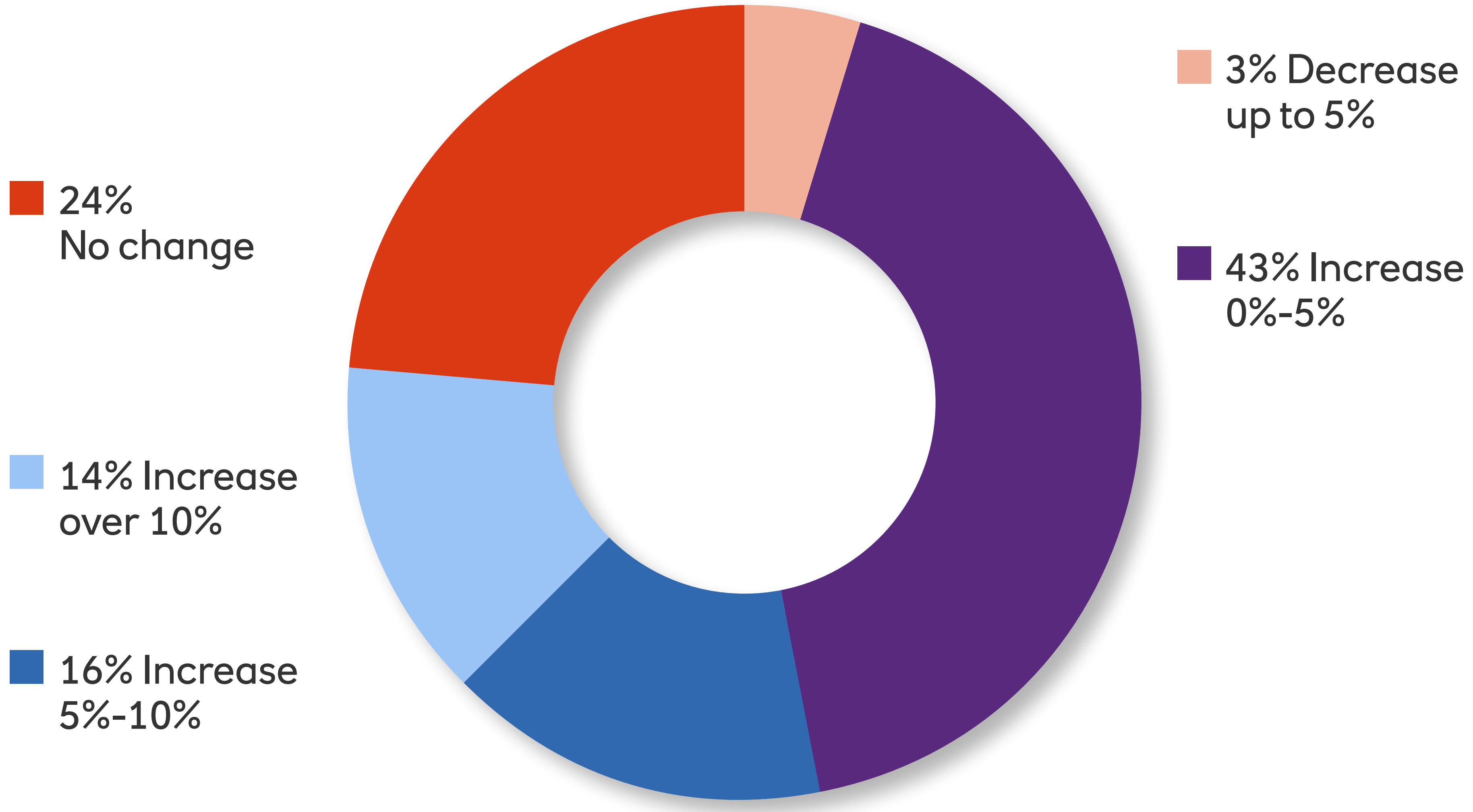
This high inflationary activity in employee costs is of course consistent with much of the legal headlines over the last year, reflecting the tight labour market in the legal sector and the high demand for services from clients.

We asked survey participants what level of inflationary increase they anticipated in their payroll costs in 2023. 53% of firms expected an increase of up to 5% and 46% anticipated costs rising by between 5% and 10%. Only 1% anticipated a rise in costs of more than 10%.

Considering background inflation and the costs of pension and National Insurance, along with other payroll costs, this seems an optimistic view. Certainly, we see many law firms budgeting for a total of 10% to 12% total payroll cost increases during 2023.

There's some evidence (more significantly in London) that recruitment challenges are easing slightly, but the cost base of many law firms, in terms of their employees, is at a high level – even before inflationary rises in 2022 are applied.

How do you expect headcount to change in your firm in 2023?



If we look at the recruitment market outlook, it's interesting to consider participants' plans for increasing headcount over the next 12 months. This is reflected in the chart above.

Of participants, 27% are anticipating a static or declining position, with 59% expecting headcount to increase by up to 10% in 2023.

This outlook suggests pressure on attracting and retaining talent in 2023 is likely to continue, and also implies employee salary pressures will remain prevalent in the sector into 2024.

Contents

Section 4: People costs and expenses

We asked participants how they anticipated their ability to attract and retain staff might change in 2023. 57% anticipated no significant change to the already difficult circumstances, while 27% anticipated it would become even more difficult.

It will be interesting to see how the employee market for the legal sector evolves during 2023. The increasing number of redundancies in international firms in London is certainly having an impact on the availability of fee earners, but a significant number of disciplines in the legal sector continue to have demands for services outstripping supply of talent.

4.3 People costs

Employee costs in isolation can provide a misleading picture because they don't consider the costs of self-employed individuals in the business, who also add to the productive capacity of a firm. So, a firm that is more predisposed to appointing self-employed partners is more likely to report a more favourable (lower) employee cost result.

To adjust for this, we included notional salaries for equity partners, and we also included the fixed-profit shares allocated for fixed-share partners and include these to arrive at total people costs (calculated as a percentage of fees as set out in the table on the next page).

In calculating this result, we've used actual fixed shares provided by participants. For equity partners in small firms, we've used a notional salary of £100,000, and in large firms £175,000*.

*There's some subjectivity in selecting this notional salary and, while this has been aligned to an extent with other legal sector national surveys, this is more complicated with our dataset for the large firm group due to the range of firms taking part. However, in context, for every £25,000 movement in the notional salary for large firms the impact is a 2% movement in the people costs % result reported, which provides an indication of the sensitivity impact of selecting the notional salary.

People costs

	Lower quartile	Median	Upper quartile
Small firms	56%	61%	71%
Large firms	56%	61%	69%
All firms	56%	61%	70%

The survey reports the median result for people costs as a percentage of fees was 61% and, interestingly, this was the same for both the small and large firms.

Our experience is most firms report a result here of between 55% and 65% most financial years, and results from this survey are broadly consistent with this.

The results for law firms in this area have fluctuated in recent years. During 2021 (the pandemic year), productivity in law firms improved significantly and many firms reported a reduction in people costs by up to 4% in a single year. Results of 57% to 60% were commonly reported.

However, around half of this improvement was then eroded for many firms in 2022 as fee earners returned to the office and inflationary pressures grew. It's anticipated, as results flow through for 2023, that the residual element of the 2021 improvement will have also been eroded from factors like competition for talent and rising costs of employee salaries in the sector.

Given this pressure on margins in the sector, we asked firms what plans they have in respect of their charge-out rates in 2023.

Contents

Section 4: People costs and expenses

Charge-out rate increase expected (%)	0-5%	5-10%	10-15%	15-20%
% of firms	52%	38%	7%	3%

Over half of firms are therefore expecting to increase rates by less than 5%, and only 10% of firms anticipate increasing their rates by over 10%.

Considering the projected employee cost increases in 2023, which we discussed earlier in the report, along with substantial background inflation in overheads, this further points to significant pressures on margins for firms in 2023 and 2024.

Given the cost of living challenges in the economy that are affecting employees in law firms, we asked whether firms are considering any one-off payments to help their employees manage rising costs.

We found 39% of firms were positive about such action, with 24% already offering such payments to their employees. However, most firms (61%) were either undecided or negative on the subject.

With these continued challenges on attracting, retaining and rewarding talent in law firms, we asked several law firm leaders for their views on what's important to their employees in 2023.

Alison Lobb, Managing Partner at Morecrofts Solicitors, explained: "In the past, work-life balance and feeling looked after were really the priority for our employees. With the cost of living crisis, salary and pay rises are now the dominant factor for them. For firms undertaking private work, there is a reasonable expectation of being able to recover inflationary rises to some extent. But firms that undertake significant public-funded work are faced with fixed income and rates, and the margins are plummeting in the face of employee rate rises."

Colin Rodrigues, Finance Partner of Hawkins Hatton, commented: "A high number of our people focus on their work experience and the type of clients and legal work we can offer them through our strong client base. So the experience and the training element on that work is often a driving factor for them."

Sarb Gosal, Finance Partner of Spire Solicitors, reported: "Sharing financial information is important for our people – they want to feel involved with the business. We promote an environment where everybody is a shareholder, and we apply this through a bonus system and quarterly rewards. So, feeling part of the team is important to our people. Work-life balance and mental health matters are also important and valued issues in our firm."

"Work-life balance and mental health matters are important and valued issues."

Contents

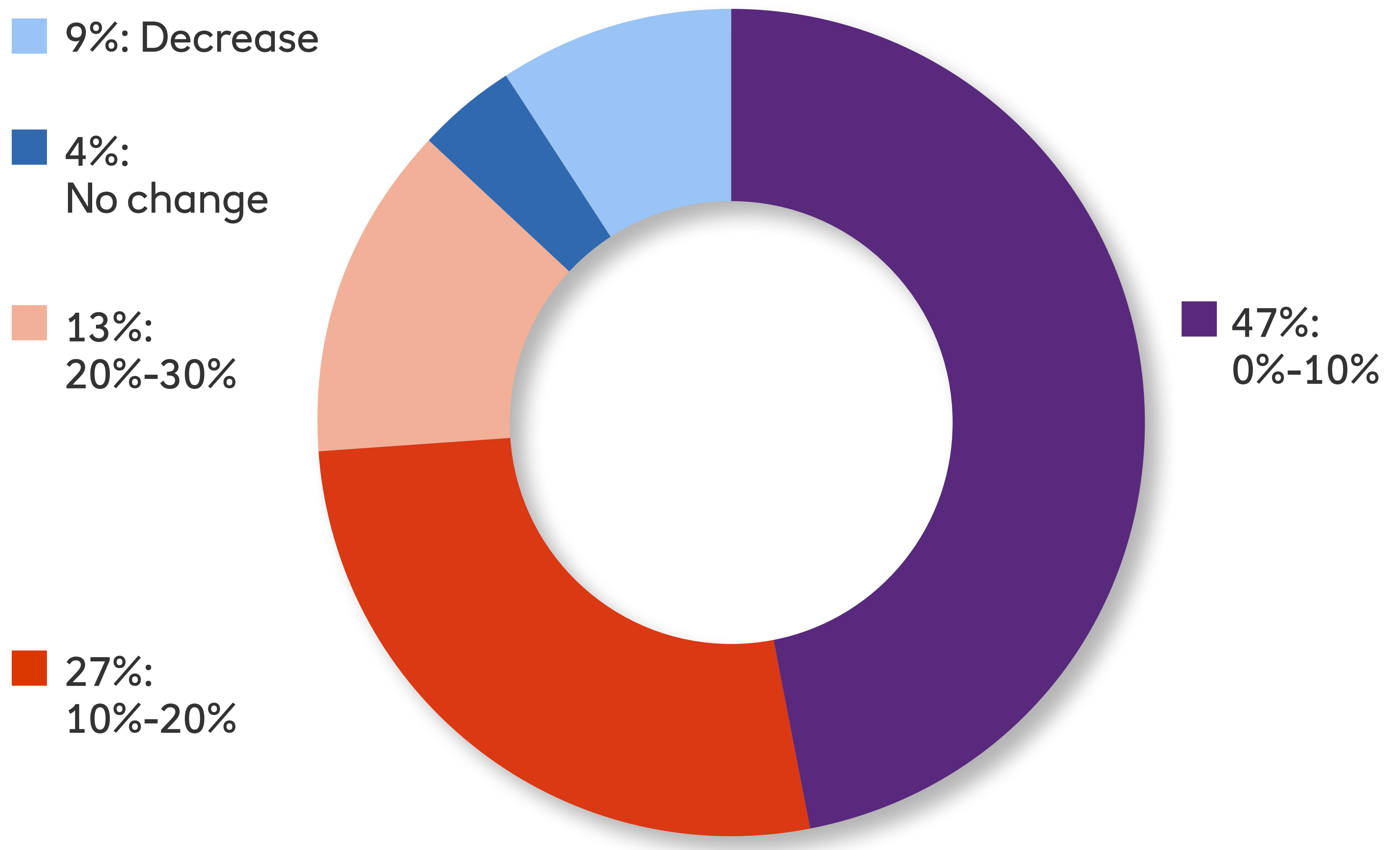
Section 4: People costs and expenses

4.4 Professional indemnity insurance

After several successive years of rises, 2022 again saw increasing premiums for most law firms, with 91% of participants reporting a rise in costs compared with 2021.

This is illustrated below.

What was the change to your PII premium for the year's renewal?



"For the legal sector at least, PII rate pressures may be easing."

Remember of course, premiums rise in part based on fee income growth, so it's not surprising that most firms reported growth of some kind in PII costs.

If we keep in mind that in 2021 many firms saw fee income growth of at most 5% and in 2022 this rose to between 5% and 10% growth, then we could conclude that growth in PII costs of more than 10% would represent a rate rise rather than a volume rise.

In context, the above chart reflects 40% of participants reporting growth in their PII costs of more than 10%.

The outlook for the 2023 renewal from brokers appears slightly more optimistic, with new insurers entering the market and more general signs that, for the legal sector at least, PII rate pressures may be easing.

4.5 Property

Following employee costs, property costs are one of the highest areas of expenditure in the profit and loss account of most law firms. We often find firms spend between 6% and 10% of their fee income in this area.

For many law firms, the entire landscape of planning office facilities has totally changed in the last three years. But with many firms locked into leasehold arrangements, it's been challenging for firms to evolve to meet client and employee needs.

Contents

Section 4: People costs and expenses

Our participants reported the most common working arrangement for their employees is now a pattern of working two days each week from home, which was reported by 54% of survey respondents. Only 15% of firms reported their employees worked more than two days at home each week.

No. of days working at home/week	0	1	2	3	4	5
% of participants	13%	16%	56%	13%	1%	1%

We also asked participants what their plans were in respect of office footprint and capacity over the next five years. Surprisingly, only 12% reported a planned decrease. No anticipated change in footprint was reported by 57% of respondents, while 31% anticipated increasing their footprint during this time.

When discussing these matters with firms, what becomes clear is many are looking to simply reconfigure the space, moving towards meeting rather than working spaces and accepting they'll be working with more spare capacity than they have in the past.

Alison Lobb, Managing Partner of Morecrofts Solicitors, commented: "Hybrid working has been good for us. We have a very loose arrangement with staff, with an underlying requirement to be in the office at least one day per week. However, the focus of our policy is that individual choices must be client-focused. We have seen some challenges with support staff – whilst some are more productive at home, we have a need for some physical presence for them to perform their roles. Like most firms, we have also found training more challenging with hybrid working."

Sarb Gosal, Finance Partner from Spire Solicitors, noted: "We don't operate a specific hybrid policy. We ask people to work in the best way to help them manage clients, achieve their fee target and ensure firm-wide that there is a balance of people always working from home and in the office. In effect, we operate an autonomous system."

Colin Rodrigues at Hawkins Hatton commented: "All of our employees are working full-time in the office. We see this as crucial in developing our team. Being around other people helps to both provide them with practical training, and it makes management of the business more effective."

James Maxey, Managing Partner from Express Solicitors, explained: "Our team works on a 3:2 rotation – three days in the office one week and two days in the office the following week, but with an overarching view that not more than 50% of their time should be at home. We see this as important for our clients and crucial for training junior people who are the future of our business."

When considering property options, there's a notable focus on ESG specification for properties, with more firms planning to take advantage of break clauses to move to more efficient premises.

A challenge, however, in many parts of the UK is the physical availability of such buildings for firms to move to, resulting in many looking at property improvement schemes with existing property owners to improve their existing location.

Property fit outs and building enhancement projects are likely to feature significantly in law firm's capital spending plans over the next five years.

Contents

Section 5: Profitability and people structure

Section 5: Profitability and people structure

5.1 Overview

- Median PEP (Profits per Equity Partner) reported in the survey for 2022 came in at £246,000, broken down as £148,000 for small firms and £302,000 for large firms.
- The median decrease in PEP in 2022 results compared with 2021 was only 3% for both small and large firms in the survey.
- In context, we should keep in mind 2022 followed the most financially successful year in the sector in 2021 for the last 25 years.
- 25% of firms reported growth in PEP of 18% or more, and 25% reported declines in PEP of 20% or more.
- The median net profit margin in the survey was 29%.
- Gearing (fee earners per equity owner) was reported as a median result of seven, with the upper quartile commencing at 12.
- The median ratio of support staff per fee earner for the survey was 0.8, with the upper quartile commencing at 1.2 and the lower quartile ending at 0.6.

Questions to consider now

- Does your firm have a formal time recording policy and are all fee earners trained on time recording to ensure all matter-related time is captured?
- Do you have robust policies in place surrounding WIP write-off on billing or when actioning zero bill write-offs?
- Do you need to revisit the effectiveness of your hybrid working policy?

5.2 Profits per Equity Partner

A common measure for law firm profitability is Profits per Equity Partner (PEP). The table below shows the results for participant firms from their 2022 financial accounts. A further table then provides the growth rates in terms of PEP compared with the 2021 results for the same firms.

Profit per Equity Partner (£'000)

	Lower quartile	Median	Upper quartile
Small firms	87	148	230
Large firms	224	302	499
All firms	141	246	356

Contents

Section 5: Profitability and people structure

Profit per Equity Partner as a percentage of last year

	Lower quartile	Median	Upper quartile
Small firms	80%	97%	133%
Large firms	83%	97%	111%
All firms	80%	97%	118%

The median figure for all firms from their 2022 results was £246,000, but we can see a significant differential between the groups. Small firms reported a median of £148,000 and large firms reported a median of £302,000.

The median decline in PEP year on year among all the participant firms was 3%, which was consistent across both the large and small firm groups. It's also notable that 25% of small firms reported growth of 33% or more compared with large firms, where 25% reported growth of 11% or more.

In our experience, this performance is better than the legal sector overall, where it was common to see more significant declines in PEP in 2022 when compared with 2021 (which for many firms were the best results in over 25 years because of high productivity, grants and reduced operating costs during the pandemic).

5.3 Net profit margins (profit as a percentage of fees)

Law firms often monitor net profit margins as a measure of profitability. It can be a useful benchmark, but it should always be kept in mind that a firm with a less common ratio of equity partners to employees is likely to produce a more unusual result – which may not then accurately reflect the firm's comparative profitability with the sector.

This is simply because of the impact of employee costs being in the profit and loss account compared with equity partners who have no salary in most LLPs, or a director-shareholder in a company where the level of any remuneration might be affected by tax planning activity.

Profit as a percentage of fees

	Lower quartile	Median	Upper quartile
Small firms	14%	22%	36%
Large firms	24%	30%	36%
All firms	20%	29%	36%

The median for all firms in the survey was 29%. When looking at small firms, the median fell to 22% compared with 30% for large firms.

From our experience, these results appear in line with the legal sector, where most firms we see report net profit margins of between 20% and 30%.

Firms reporting 35% to 50% in our experience would represent most of the upper quartile of firms.

5.4 Gearing

Gearing considers the number of equity owners (equity partners in an LLP or shareholders in a limited company) in the business compared with the number of employed fee earners. The rationale then being that the higher the number of fee earners in total per equity owner, the better the theoretical structure is in the business for generating profits for the equity owners.

Contents

Section 5: Profitability and people structure

The table below shows the gearing for the survey participants, and this reports a median of seven fee earners per equity partner, with large firms reporting a median of eight and small firms reporting a median of six.

Gearing (total fee earners/equity partners)

	Lower quartile	Median	Upper quartile
Small firms	3	6	11
Large firms	6	8	13
All firms	4	7	12

The differentials reported here between the small and large firms are what we would expect to see.

We often find in the legal sector that the difference (financially) between a small firm and a large firm is not in their core profitability (so not in the people costs percentage or net profit margin) but in the gearing.

Specifically, as law firms grow, their gross profit margins may improve a little – but the main thing that helps them increase their PEP is the fact their growth in equity partners is usually at a slower pace than the growth in fee income and net profits.

“The larger the law firm, the lower the number of support staff per fee earner.”

5.5 Support staff

The table below considers the mix of fee earning staff in law firms compared with support staff. For these purposes, support staff are deemed to be anyone on the payroll who aren’t fee earners and don’t have a fee earning target. Support staff therefore by default include central support functions but also support people working in teams alongside fee earners, e.g., secretaries.

Support staff per fee earner

	Lower quartile	Median	Upper quartile
Small firms	0.6	0.9	1.4
Large firms	0.5	0.7	1.1
All firms	0.6	0.8	1.2

The survey reports a median result of 0.8 support staff per fee earner, with small firms reporting a median of 0.9 and large firms reporting a median of 0.7.

These results are consistent with what we see in the legal sector, with common results reported in the range of 0.8 to 0.9 – and a general correlation that the larger the law firm, the lower the number of support staff per fee earner.

There’s no ‘correct’ answer to this statistic. One law firm may, for example, have a high number of support staff who are well utilised and free up fee earner time to undertake profitable work. Another firm may have the same ratio but may not have the same effective use of those support staff, and the structure therefore becomes detrimental to profits in that firm.

Contents

Section 6: Lock-up

Section 6: Lock-up

6.1 Overview

- Median WIP days in the survey were 90 days compared with 88 days for the same firms in the prior year.
- Median debtor days in the survey were 34 days compared with 33 days for the same firms in the prior year.
- Median lock-up days in the survey were 136 days compared with 134 days for the same firms in the prior year.

Questions to consider now

- Can your practice management system be used more to help fee earners and support staff reduce lock-up?
- Have you considered centralised or partial centralised billing to free up free-earner time and accelerate cash collection?
- Do you benchmark your lock-up by team to consider how they compare with similar teams in other firms?

6.2 About lock-up

For most law firms, the medium-term financial objective might be to improve margins and profitability. The short-term financial objective for most firms is generating cash to keep the business running.

A key factor for law firms is therefore the ability to convert chargeable time into cash received. Time that's been recorded by fee earners but not billed to clients is known as Work in Progress, or WIP. Time that's been billed but the fee remains uncollected is known as a debtor.

WIP and debtors combined are known as lock-up. This represents the total amount of investment a law firm has in work undertaken and waiting to be converted to cash.

Firms usually report levels of WIP and debtors by describing them as the number of days of fee income/turnover that they represent for the firm. For example, a firm with £12m of fee income in a year with WIP and debtors combined of £4m at the year-end is said to have 120 days of lock-up.

6.3 WIP days

	Lower quartile	Median	Upper quartile
Small firms	134	66	40
Large firms	153	123	53
All firms	152	90	47

Survey firms reported a median of 90 days of turnover (fees) invested in WIP, reflecting a modest increase from 88 days for the same firms in the prior year.

The median result for small firms of 66 days compares with 68 for those firms in the prior year. But for large firms, the shift is a little more significant, with an increase from 113 days in the prior year to 123 days in the 2023 survey.

Contents

Section 6: Lock-up

Looking back to the NatWest survey in 2021, we can see median WIP days were 86. So the 2023 survey result here of 90 days represents a slightly worsened position.

6.4 Debtors

	Lower quartile	Median	Upper quartile
Small firms	48	26	18
Large firms	61	41	23
All firms	54	34	21

In relation to debtors, survey firms reported a median of 34 days of turnover (fees) invested, reflecting a minor increase from 33 days for the same firms in the prior year.

The median result for small firms of 26 days compares with 29 for those firms in the prior year. For large firms, there was also a decrease to 41 in the 2023 survey compared with 42 in the prior year.

Looking back to the NatWest survey in 2021, we can see median debtor days were 46. So the 2023 result here of 34 days represents a notable change in this area.

6.5 Lock-up

	Lower quartile	Median	Upper quartile
Small firms	166	110	74
Large firms	222	157	116
All firms	199	136	85

Firms reported a median of 136 days of turnover (fees) invested in lock-up, reflecting a small increase from 134 days for the same firms in the prior year.

The median result for small firms of 110 days compares with 115 for those firms in the prior year. For large firms, the position was the same in both recent financial years at 157 days.

Looking back to the NatWest survey in 2021, we can see median lock-up days were 172. So the 2023 survey result at 136 days here represents a notable change in this area.

Median days of fees: 34 invested in debtors, 136 invested in lock-up.

Contents

Section 7: Finance, IT and management

Section 7: Finance, IT and management

Questions to consider now

- Do you have a methodology for setting partner capital funding in your business?
- Is it time to make a more substantial commitment to future investment in IT and potentially AI?
- Do you need to look at alternative financial incentives for your employees? Is a form of employee ownership a potential option?

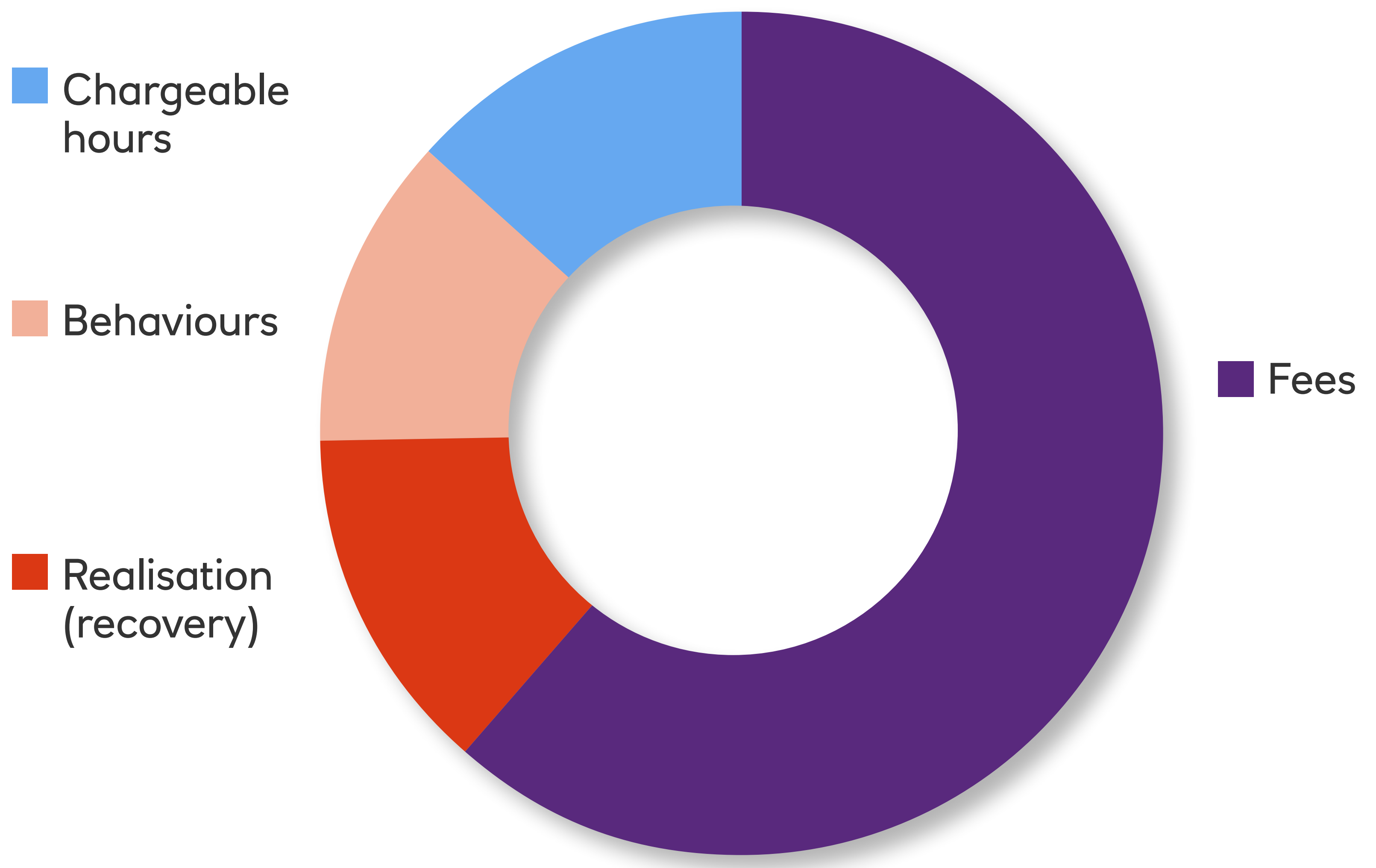
7.1 Productivity

With people and overhead costs rising sharply in law firms – along with the challenges of recovering this inflation from client rate rises – many law firms are starting to focus on the efficiency of the services they deliver.

For most firms, this will involve focusing on areas like time capture, pricing and matter management. However, in this process firms need some mechanisms to assess fee earner performance.

We asked participant firms what mechanisms they used to assess fee earner performance.

What is your primary way to access fee earner performance?



Mechanism	Fees	Realisation (recovery)	Behaviours	Chargeable hours
% of firms	61%	14%	12%	13%

Most firms (61%) noted that fees issued was the favoured mechanism, with a broadly even split between chargeable hours, recovery rate and behaviours picking up the remaining approaches.

Contents

Section 7: Finance, IT and management

A challenge, of course – with firms focusing on fees issued – is it has the risk of encouraging poor behaviours. For example, it can encourage fee earners to retain matters even if they're not the most appropriate person to deliver the service to the client. It also inhibits cross-matter working – fee earners will focus on getting their fees completed and not assisting others where their skills may be better used.

Similar comments could apply for chargeable hours, where there's less incentive for fee earners to focus on appropriate delegation or recovery of time recorded.

In our experience, firms often find a blend of fees, realisation and chargeable hours can provide the most effective and balanced way of monitoring fee earner productivity.

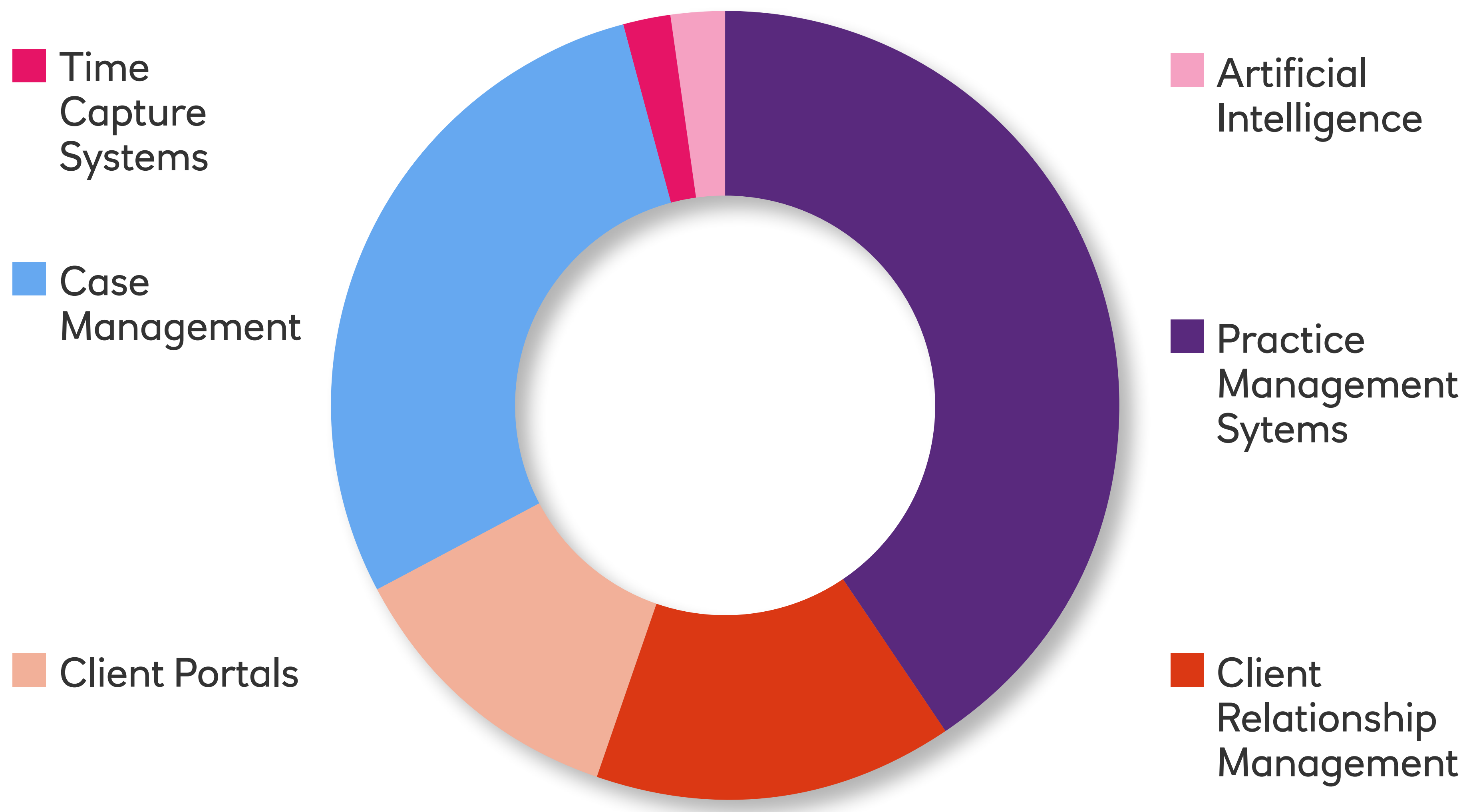
7.2 IT Management

Along with planned property investment, mentioned earlier in this report, many firms have five-year planning cycles for IT investment.

Over the last 25 years of maintaining data, we've noted a rising proportion of law firms' income is often invested in IT and, more importantly, we've noticed a positive correlation between those firms investing above average levels in IT and those experiencing higher growth in PEP over the medium term.

We asked firms to comment on their biggest priority in terms of IT investment.

What is your biggest priority for legal technology investment in your firm?



Investment Area	Practive management Systems	Client Relationship Management	Client Portals	Case Management
% of firms	41%	15%	12%	29%

Time Capture Systems	Artificial Intelligence
2%	2%

In terms of daily management of IT infrastructure, we also asked firms about the frequency of cyberattack challenges they've faced in the last 12 months.

Contents

Section 7: Finance, IT and management

No. attacks in last 12 months	0 or 1	2	3	4	More than 4
% of firms responding	54%	16%	7%	2%	21%

Of the firms reporting any attacks, we can see 54% experienced a single incident, 46% experienced more than one event and 21% experienced over four attacks in the last year.

We asked several firms to talk to us about their current areas of focus in technology.

Sarb Gosal, Finance Partner of Spire Solicitors, commented: "IT investment for us is all about our Practice Management and case management system to drive efficiencies in the way we deliver our service to clients. As a practice which is the product of mergers, we are looking to amalgamate systems which is a big project for us. As part of this project, specifically we are looking at ways to minimise the time dealing with emails, and we see IT developments as being key to helping us. We are also looking at digital dictation options where we find that software solutions in this area do not provide a good solution, and seeking external support on dictation is expensive."

James Maxey, Managing Partner of Express Solicitors, commented: "AI is something that we see as relevant to our area of work and more generally to models where there are significant non-repeat client services with a similar structure. Computers can already read medical reports and make suggested offers for settlement in some PI and medical negligence work. There could be interesting developments in this area over the next few years, which will change the way a range of legal services are delivered."

7.3 Debt and Equity

We've commented on the investment plans some law firms have, both in property and IT, already in this report. We've also discussed recent performance of law firms in respect of lock-up management. These issues combined summarise the majority of balance sheet funding law firms need, and therefore drive the funding they need to seek from either working capital credit, their partners or third-party debt.

The amount of funding a law firm requires is driven by lock-up and fixed asset investment in their balance sheets. The extent to which this is funded by partners (Equity), or third parties (debt) is then a combination of choice and availability of finance.

For participating firms, the table below expresses actual debt taken as a percentage of net assets.

If we think about an LLP for example, net assets represent the same figure as Members' Funds (so partner capital accounts, current accounts, and tax reserves). In a company, net assets reflect the profit and loss reserve (which is akin to current account and tax reserves in an LLP).

In effect, the table therefore tells us how much external debt firms are taking on per £1 of Members' Funds.

Contents

Section 7: Finance, IT and management

Borrowing as percentage of net assets

	Lower quartile	Median	Upper quartile
Small firms	6%	32%	79%
Large firms	0%	22%	43%
All firms	1%	24%	54%

The median result for all firms is they borrow 24p for every £1 of Members' Funds, although we note borrowing levels in smaller firms at 32p is slightly higher than in large firms at 22p.

In broad terms, we can also see most firms in the survey borrow less than 50p per £1 of Members' Funds. And we can also see some firms are debt averse, with around 25% of firms having no borrowing.

These results are very much in line with our experience of debt in the sector. Around 20% of the firms we see hold no debt and those that do tend to borrow between 20p and 50p for every £1 of Members' Funds.

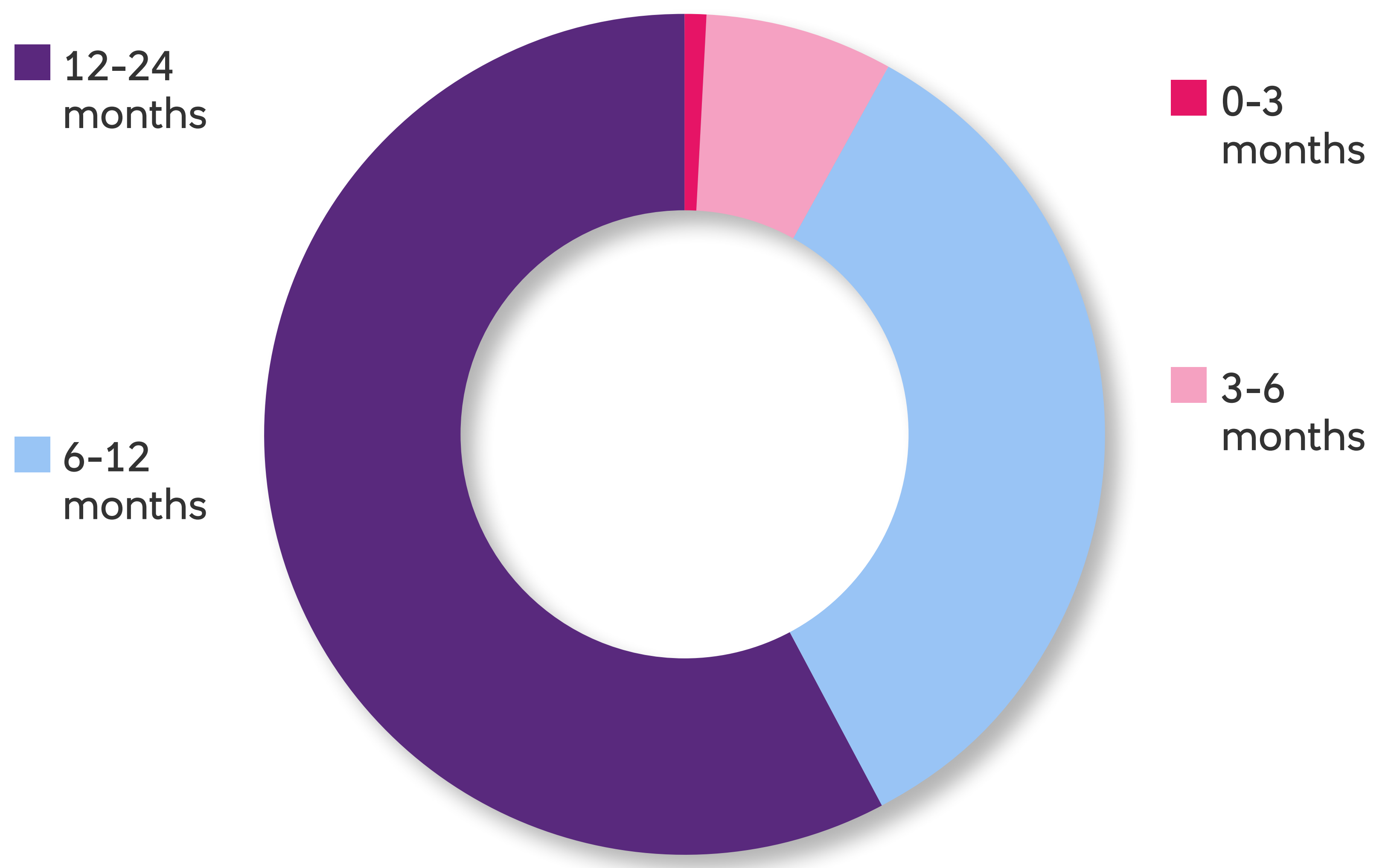
In practice, we often find debt levels available to firms are much higher than they seek. For example, many law firms could borrow up to £1 for every £1 of Members' Funds.

In our experience, the 'right' debt level for a firm is very personal to that firm and is affected by many factors, including the personal views and financial positions of owners, the nature of the work the firm undertakes, future succession planning and partner and fee earner behaviour in the business.

7.4 Business planning

We asked participant firms to comment on how far ahead they plan for their business (whether financially or strategically).

How far ahead are you now business planning?



No. of months planning	0-3 months	3-6 months	6-12 months	12-14 months
% of firms	1%	7%	35%	57%

Encouragingly, we report most firms (57%) are looking over 12 months ahead and so aren't simply looking at plans and budgets for their current financial reporting period.

Contents

Section 8: Sector outlook and topical issues

Section 8: Sector outlook and topical issues

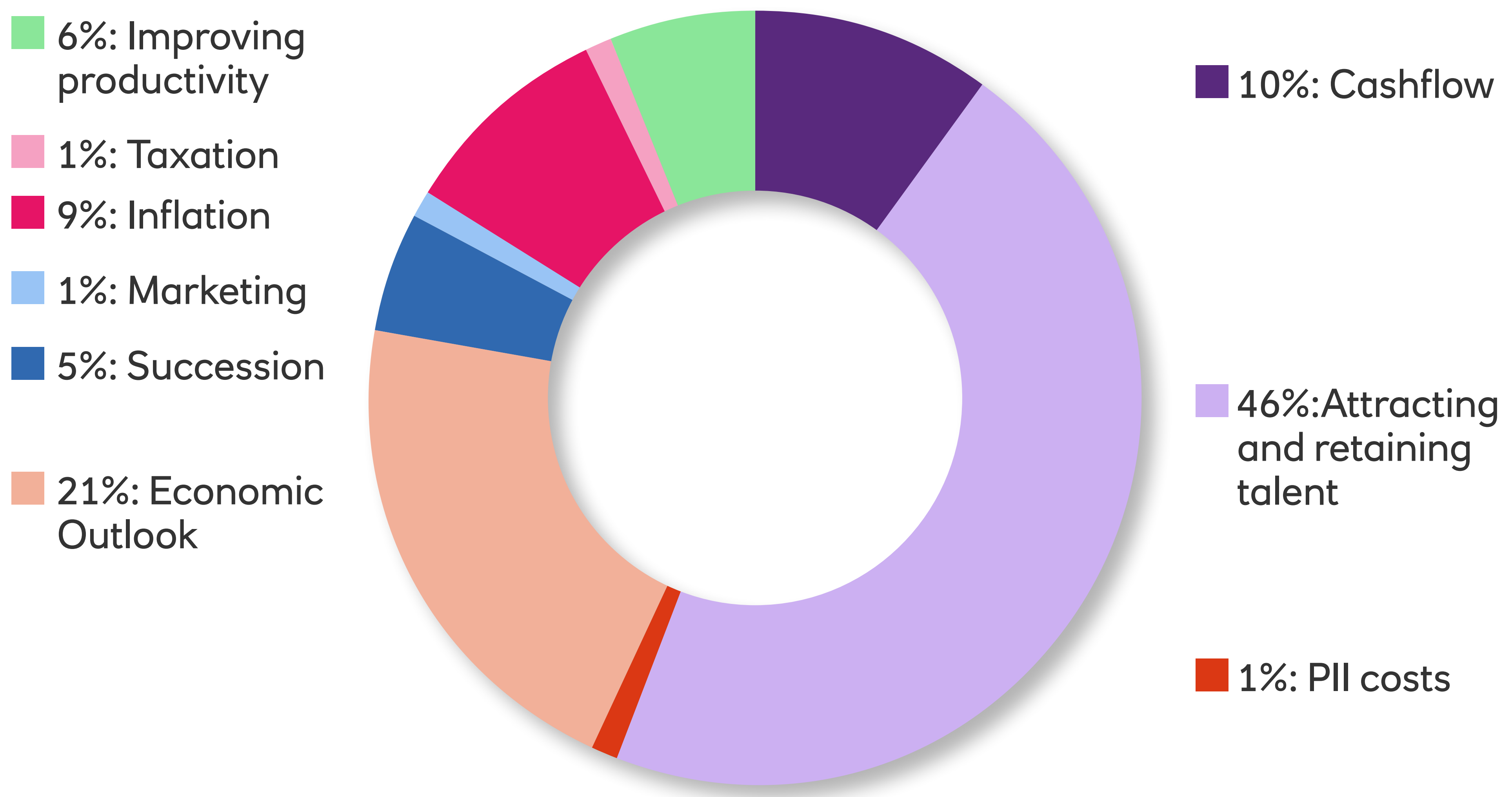
8.1 Challenges

When looking to the future, an interesting place to start with law firms is to identify what they perceive as their greatest challenges.

Respondents reported on a range of issues here, and we can see from the charts below that by far (46%) firms deemed attracting and retaining talent to be the biggest challenge in the future.

Some considerable distance behind this, economic outlook was cited by 21% as the most concerning feature of the future, followed by cashflow (10%) and inflation (9%).

What do you think will be your most significant challenge for your firm in 2023?



The labour market in the legal sector remains a crucially concerning issue for many firms. The differential between demand and supply makes it difficult for law firms to grow and develop their business. At the same time, the above inflationary cost of people in law firms is making it difficult for law firms to pass on those costs to clients, resulting in profit margin pressures in many firms.

Considering the relative challenges, we asked firms about their level of optimism for the future. Reassuringly, despite the range of issues the legal sector faces, 87% of survey participants were either optimistic or very optimistic about the future.

Interestingly, in our discussions with law firms, a further key issue emerged about regulation and government intervention.

James Maxey, Managing Partner of Express Solicitors, commented: "One of the key issues affecting the legal sector is regulatory change. PI lawyers have suffered significant reforms, with the balance of influence now sitting with insurers. General regulatory reform, cost reforms and intervention by regulators and government is challenging for the legal sector."

This was a view also shared by Sarb Gosal, Finance Partner of Spire Solicitors, who commented: "One of the challenges law firms encounter is remaining agile and not becoming too dependent on any one source of income. This challenge is exacerbated by the degree of government intervention in the sector, which often results in a diminishing role and reputation for lawyers along with a general 'dumbing down' of the law. Law firms need to be increasingly agile and able to show the true value of lawyers in what they do."

Contents

Section 8: Sector outlook and topical issues

Colin Rodriguez, Finance Partner of Hawkins Hatton, explained: “We see consolidation as a key challenge of the legal sector. Firms are left with few strategic options – which broadly are get big, get niche or get out. But behind this firms must accept that there is no point in growing if this does not lead to net profit margins improving – what is the point of more risk for no more margin?”

Colin also explained: “We see a significant risk in the profession being devalued, with the emphasis moving towards procedural administration rather than being advisers. There is a serious lack of experienced people in the sector and the larger firms seem to have lost their way, along with the skill sets they used to carry.”

Finally, Alison Lobb, Managing Partner of Morecrofts Solicitors, commented:

“Naturally recruitment and retention is a key issue, along with the challenge of creating loyalty as a guard against poaching by larger firms. In addition to this, we see cashflow and lock-up growth is a big challenge for law firms, combined with fatigue amongst fee earners following a period of exceedingly high demand for services. Ironically, cashflow during the pandemic was extremely strong, but subsequently this has declined in many firms. For example, we have seen WIP levels double since the pandemic period and, of course, many firms have faced high tax payments and now have the challenge of facing the basis period reforms for income tax payments.”

8.2 Transactions in law firms

The structure of the legal sector in the UK remains fluid, and the volume of new-start law firms – as well as mergers and team moves – is high.

We asked respondents whether their firms anticipate a merger or a team acquisition over the next year.

68% of respondents reported such activity as unlikely, while 22% and 10% reported it was likely or very likely respectively that such a transaction would take place in their firms within the next year.

Consolidators have played a significant part in the evolution of the legal sector over the past few years. Despite their relative successes at times, they still play an active part in the many law firm transactions we see reported.

Our survey participants reported that almost a quarter (22%) of them had been approached by consolidators in the last year.

So, combining this investor appetite with the fact almost a third of the sector is looking to grow through consolidation in some form, it will be interesting to see what impact this has on the overall shape of the legal market in the UK over the next few years.

Contents

Section 8: Sector outlook and topical issues

8.3 Diversity and inclusion

Reflecting on the importance of attracting and retaining employees the issue of diversity and inclusion is a strong focus for many law firms.

Many firms have statutory reporting requirements in this area. It can have a significant impact on factors – not just attracting and retaining clients and employees, but also the overall brand and image of a firm in the legal sector.

We asked several of our participant firms for their views on the relative importance they placed on diversity and inclusion. The table below shows most firms (52%) reported it was of "medium" importance to them (giving a score of three out of five), while only 19% of firms citied this as a high priority (giving a score of five out of five).

Notably, only 11% of firms reported this as "relatively unimportant to them" by reporting a ranking of one or two.

Priority ranking	1 (lowest priority)	2	3	4	5 (highest priority)
% of firms	3%	8%	52%	18%	19%

Turning to gender mix, we asked participating firms about the percentage of females undertaking the roles of fee earners and equity partners in their firms.

% of female fee earners	30%-40%	40%-50%	50%-60%	Over 60%
% of firms	5%	7%	26%	62%

% of Equity Partners female	0%-10%	10-20%	30-40%	40%-50%	50%-60%	Over 60%
% of firms	15%	22%	20%	13%	6%	24%

At a fee earner level, 88% of respondent firms reported females account for over 50% of their fee earners, while 62% of firms reported females account for over 60% of their fee earners.

The position at equity partner level is different. Here, only 30% of respondent firms reported females account for over 50% of their equity partners, with 24% of firms reporting females account for over 60% of their equity partners.

"The issue of diversity and inclusion is a strong focus for many law firms."

Contents

Section 8: Sector outlook and topical issues

8.4 Environmental, social and governance (ESG)
8.4.1Focus on ESG

Like diversity and inclusion, ESG is a prominent issue that's affected many of the core decisions law firms make.

We asked our participant firms their opinion on the relative importance they placed on ESG.

The table below shows most firms (51%) reported it was of "medium" importance to them (giving a score of three out of five), while only 10% of firms citied this as a high priority (giving a score of five out of five).

Priority ranking	1 (lowest priority)	2	3	4	5 (highest priority)
% of firms	9%	10%	51%	20%	10%

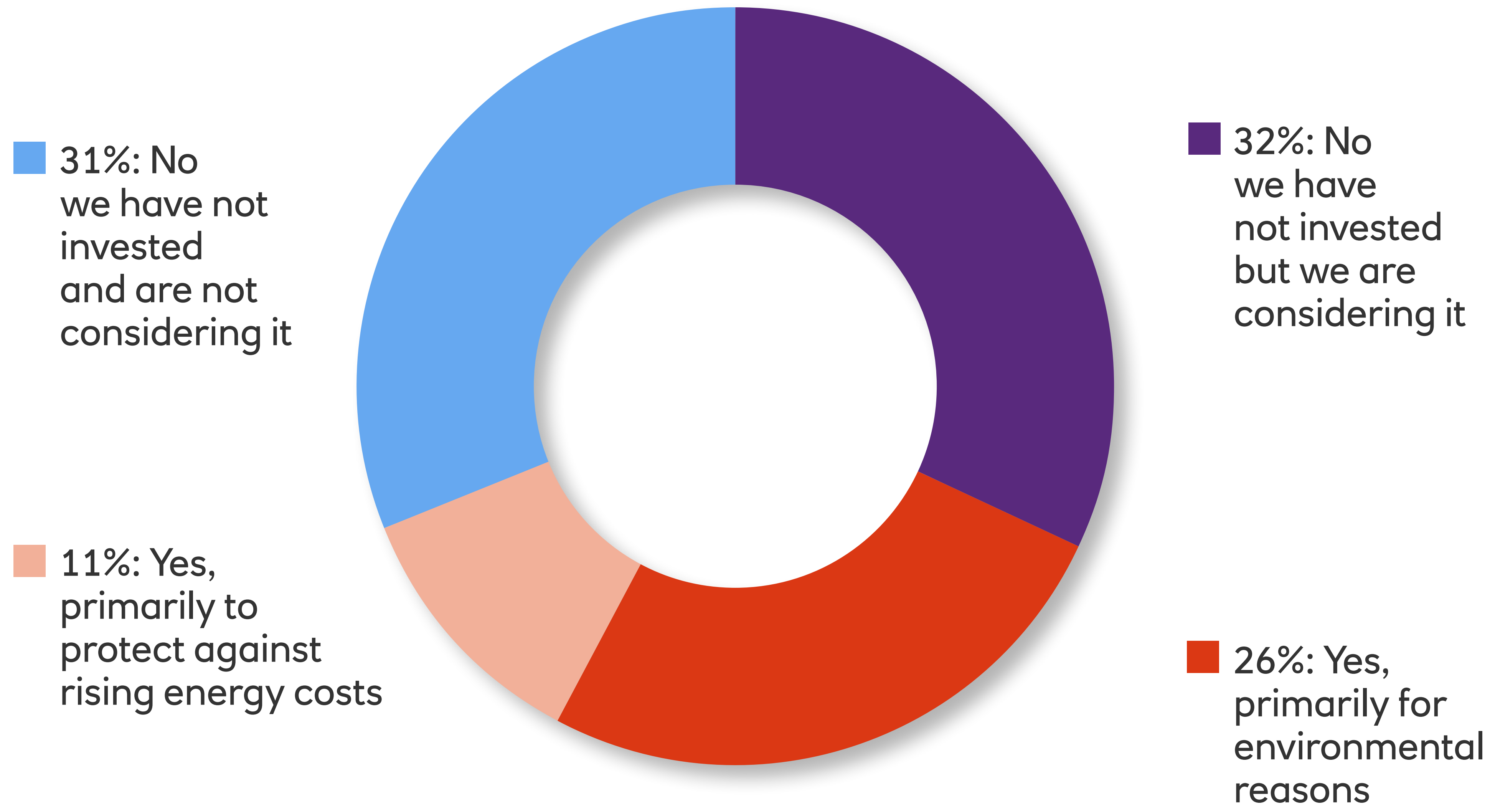
It's noticeable that the relative importance to firms of ESG appears lower to firms than diversity and inclusion above.

For example, 19% of firms put low importance (scoring one or two) on ESG (compared with 11% in the case of diversity and inclusion) and similarly only 10% of firms place the highest priority on ESG (compared with 19% for diversity and inclusion).

8.4.2 Energy cost management

We enquired with firms about the extent to which they've considered green energy solutions.

Have you, or are you considering, investing in green energy solutions?



We found that 37% of respondents had invested in renewable energy solutions to safeguard against rising costs or for environmental reasons. Of the remaining 63% of respondents, they were evenly split between those who were considering renewable energy and those who weren't considering it at this time.

Contents

Section 8: Sector outlook and topical issues

Top five tips for business success and growth

1. Attracting and retaining talent

There are signs the availability of fee earners is easing in parts of the legal market. But the ability to attract and retain future talent remains a crucial issue for law firms.

Not only is this the lifeblood of delivering legal services today, but it could be the potential solution for succession in the future.

Firms increasingly need to consider what's important to their people in everything they do.

Many fee earners in their early career, for example, are interested in the values of their firm and its attitude towards issues like ESG and diversity and equality.

Making sure law firms are in tune with the opinions and needs of their employees is likely to be a key differentiator for law firms in the future.

2. Managing matters

Margins are under pressure. Salary costs and overhead inflation remain significant, and a firm's confidence in its ability to pass those costs on to clients is less robust.

Firms, more so than ever, need to ensure their matters are being run by fee earners in an effective way.

Focusing on scoping the work at the outset, care on communication with clients on fee options and terms of business are crucial aspects to matter management, which often aren't given sufficient time by fee earners.

Considering these areas in conjunction with good client care and regular billing could make a significant different to margins in law firms.

Firms should focus on the training they give their fee earners in these areas and on the systems the firm itself has in place to ensure good practice.

Contents

Section 8: Sector outlook and topical issues

3. Have a clear funding policy for your firm

Now more than ever, cashflow in law firms is under pressure.

Inflation in salaries and overheads has naturally pushed up the level of cash invested in working capital (lock-up) and the general pressure of inflation in the economy is having the effect of making cash collection from clients harder.

Factor in other pressures, such as the change of basis periods for the taxation of the self-employed, along with succession challenges of retiring partners, and we can see future challenges ahead.

Firms should be clear about how their business is funded – how much from working capital, how much from structured debt and how much from partners.

Regular review of this position, the preparation of robust financial forecasts and good dialogues with your bank on funding matters will become increasingly important for firms over the next few years.

4. Know where you make a profit

When setting your charge-out rates, consider not copying your competitors, or pricing your work by guessing the market.

Remember, time recording isn't about billing, it's about costing. Time recording gives you information to understand what it costs you to undertake and deliver legal advice.

Firms should focus on ensuring fee earners capture all matter-related time and that this information is then used to inform firms how to set charge rates and how to cost future work, before pricing options are provided to clients.

Contents

Section 8: Sector outlook and topical issues

5. Be open to change

The legal sector remains a very dynamic and exciting place to work in at present. Just consider a small range of things we regularly hear about.

- Consolidator/Private Equity investment
- AI/IT investment
- Employee ownership
- Mergers/Acquisitions and sales
- Financial failures

"The legal sector remains a very dynamic and exciting place to work in at present."

While each law firm will have different views about issues, such as those above, they still need to take an active interest in these and similar issues to ensure they aren't missing out on crucial opportunities to take their business forward (or safeguard its future).

Of course, every opportunity that comes along will not necessarily be right for all firms. But without some openness to change and an interest in considering the options, firms run the risk of falling behind the legal sector's fast pace of change.

Looking at improving how your firm considers and makes strategic decisions may be a useful starting point to make sure you're agile enough to consider and make decisions when you need to.

Contents

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Contents

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