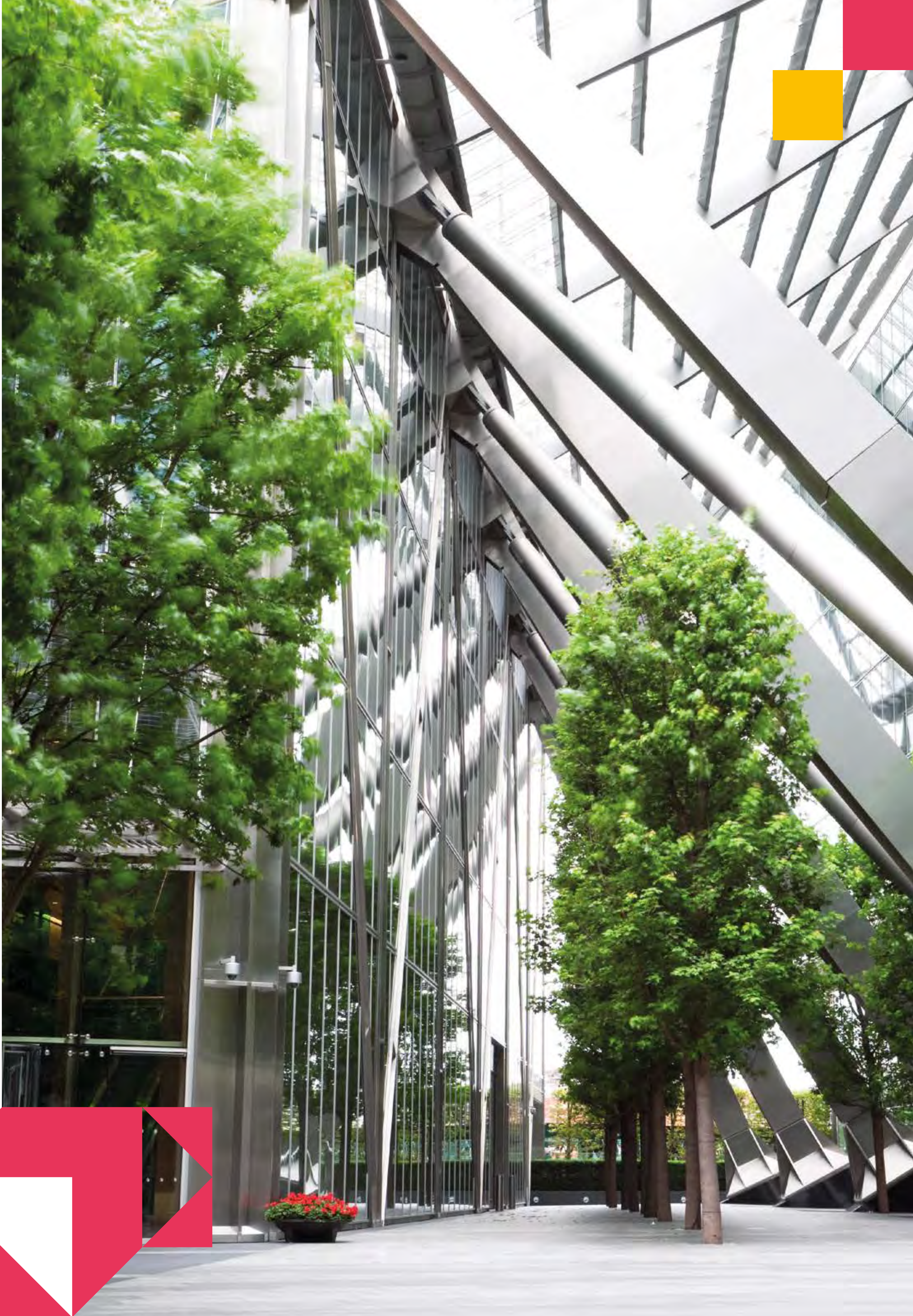
Industry in Focus

Bold steps to sustainable transformation

PwC Law Firms' Survey 2023

#PwCLawSurvey



This is the 32nd PwC Law Firms' Survey

The editorial team for 2023 consists of:

Kate Wolstenholme
Kate leads our Law Firms' Advisory Group ("LFAG") and works with national and international law firms on audit, accounting and strategy issues. Past roles include chairing PwC's Risk Committee and serving on PwC's Supervisory Board and Audit Committee.

David Baxendale
David is a Partner in our Deals business who has worked both with law firms and other financial stakeholders in relation to sources of funding, appropriate funding structures and in relation to firms facing financial stress.

Leon Hutchinson
Leon is an Assurance Director who works with a number of national and international law firm clients, advising them on accounting issues and SRA Accounts Rules compliance.

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Greg is a Director in our Consulting practice. He has spent more than 10 years advising law firms on strategy and business transformation both in-house and at PwC.

Tony Hodgson
Tony is a Partner in our Consulting practice. He leads assignments with law firms supporting them with transformation in areas such as pricing, matter management, business support services and IT.

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Alexa is a Partner in our People and Organisation practice. She has spent more than 15 years advising law firms on managing and communicating change and ensuring they are fit for the future.

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Nina is a Cloud & Data Transformation Director who works specifically in the legal sector to deliver business transformations that are underpinned by technology – from strategy and case for change development through to vendor selection and implementation.

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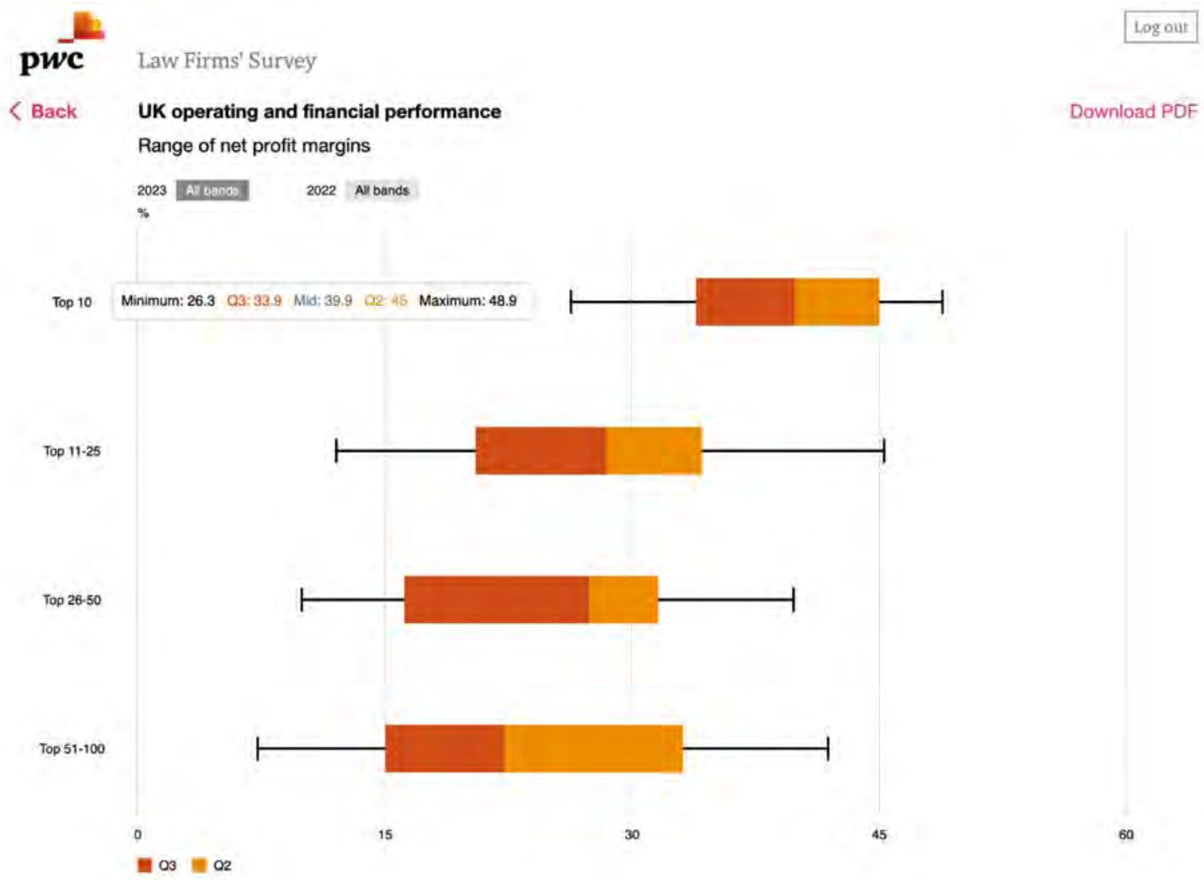
Liz leads our US law firm tax practice and is the main advisor in the UK to the AMLaw100. Liz also focuses on UK headquartered law firms and other professional practice firms leading advice on M&A, IPO listing and international structuring.

We would like to thank all other members of the LFAG who helped with this year's survey, particularly Tiarnan Branson, Rachel Kelly, Niamh Wood, Sanah Faridi, Somya Chawla, John Carter, Katie Neish, Dan Holmes, Craig Shaw, James Rashleigh, Mark Anderson, Nehal Khongbantabam and Rukhsar Khalid who contributed significantly to the production of this report.

Our Law Firms' Advisory Group harnesses the expertise of specialists nationally and internationally to provide assistance with:

- Audit
- Direct and indirect taxation
- Strategic consultancy
- IT strategy, selection and implementation (Finance / PMS, HR and CRM)
- Cost reduction and outsourcing
- Mergers and acquisitions
- Capital Markets advisory
- Compliance with SRA Accounts Rules and associated regulatory requirements
- Working capital management and financing
- Limited Liability Partnerships and other structuring advice
- Partner reward
- Employee and employer issues (reward structures and taxation)
- Internal audit and other risk management services
- Cyber security services

In addition to the information presented in this report, all participating firms have access to an interactive online benchmarking tool that holds a vast amount of data from our survey. This tool also benchmarks the individual firms' results against their associated peer group banding.



The survey results are presented by size of firm using the bandings Top 10, Top 11-25, Top 26-50 and Top 51-100, except where otherwise stated. The classification is by annual global fee income.

Our report is based on survey responses from firms at consistent response rates to prior years. This summary document focuses on the key findings from our survey.

Our thanks are due, as always, to the firms which participated in this survey. We appreciate that the questionnaire takes considerable time to complete. All of the responses are processed in full and we have a significant amount of data that isn't fully reproduced here. If you'd like further information on the responses to any of the questions, please contact one of our editorial team.

Key definitions

Global Top 10 – Top 10 (by global revenue) UK headquartered firms where international revenue exceeds 20% of total revenue.

Global Top 11-25 – Top 11-25 (by global revenue) UK headquartered firms where international revenue exceeds 20% of total revenue.

UK – Operations of all UK offices only.

International – Operations of all international offices only.

Contents

Overview and key themes

Introduction

Despite economic uncertainty at the beginning of the survey year, law firms were buoyant following two very successful years during the COVID-19 pandemic. Law firms, and other professional service firms alike, benefited from rising fees and a reduced cost base during those years.

Law firms entered FY23 with an air of optimism, but by May 2022 inflation was rising, with a UK peak in October 2022 of 11.1%. Sharp increases in interest rates (from 0.75% at May 2022 to 4.25% at 30 April 2023) also contributed to a shift in market conditions and reduced deals activity, which has had a ripple effect on the financial performance of law firms.

On the face of it, law firms have achieved impressive fee income growth in a tougher market. Across the Top 100 bandings, average UK fee income growth was between 8.0% and 9.7%. However, with average inflation across the year approximating 10%, **in real terms fee income has fallen, albeit slightly.**

A comparison of average inflation to net profit provides a more stark contrast. Top 10 firms achieved average UK profit growth of 7.7%, but the range across the remaining bandings is from a reduction of 0.4% (Top 26-50) to an increase of 3.9% (Top 51-100). These averages do hide a range of results with **44% of Top 100 firms reporting falling profits.**

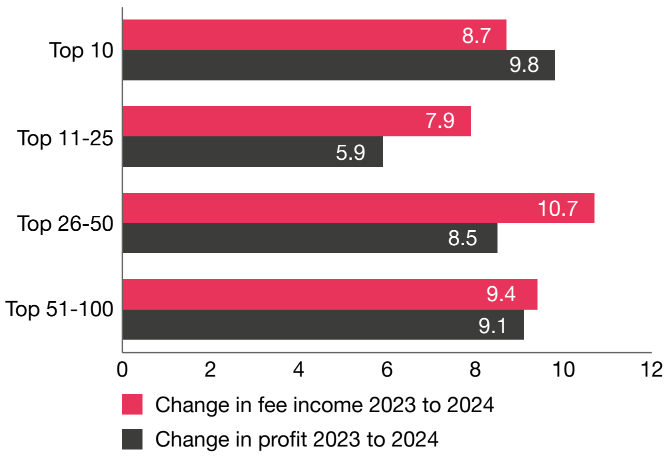
Rising costs stand out in this year's survey, with both **staff and support costs rising at a faster pace than fee income.** COVID-19 masked the shape of firms' cost bases through a period of unusual spend, and now is the time to establish a revised target cost base with consideration of the appropriate return on areas such as IT, marketing, and HR.

We included a number of new strategy and transformation questions in this year's survey, recognising the imperative for firms to be updating strategic choices to keep pace with the transformation happening across the business world.

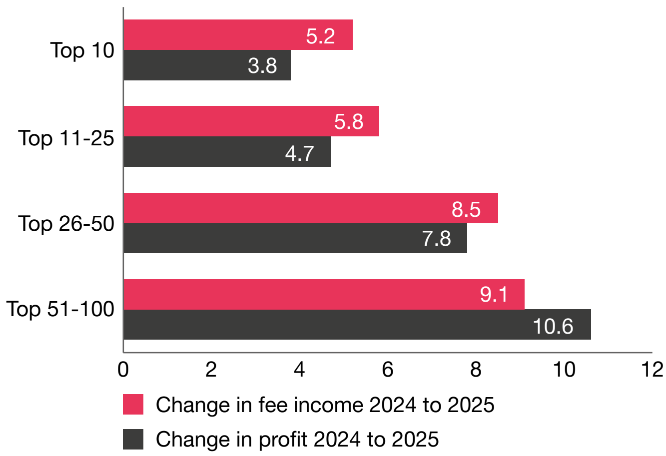
The **most significant concern to future growth identified in our survey is 'macroeconomic volatility'.** Despite the current unsettled economic environment, law firms remain optimistic about future growth. All Top 100 firms expect to grow fee income in each of the next two years, and all firms expect profit to increase in FY24 and FY25 with the exception of a very small minority.

Predicted movements in fee income and profits: 2023 to 2024 and 2024 to 2025 (%)

2023 to 2024



2024 to 2025



Organic strategies to achieve growth are focussed on commercial fundamentals, while inorganic growth is expected to be limited to tactical small scale acquisitions rather than large, transformational merger and acquisition activity.

Firms anticipate pricing to be difficult over the next year or so, as clients seek to apply their own cost control measures. Indeed, **the 'inability to recover cost inflation through pricing' is one of the four key concern areas identified by law firms.** Providing support to partners and staff responsible for pricing is key. This includes ongoing training on price negotiation, backed up by the right data to assess the required level of return needed on each engagement.

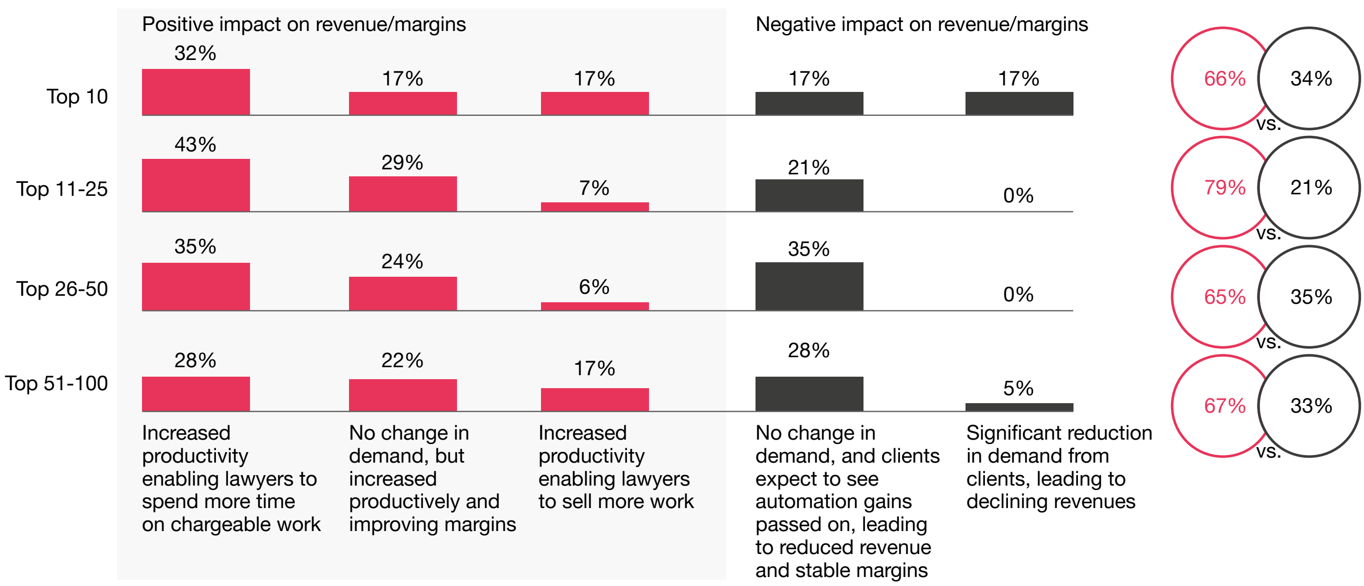
Despite uncertain market conditions and cost pressures, **investment in a robust and future-proofed technology and data strategy remains essential.** Part of that strategy should include upskilling the Board and other key leaders in the business to ensure they have sufficient understanding of technology, cloud and data to drive the technology strategy and its implementation.

There are challenges to getting the right infrastructure in place to support new technology at the pace required. For example, without a unified data platform, firms will not be able to properly leverage the AI opportunities that will be so key to remaining competitive.

Yet many have data stored across multiple systems with no means to draw on the totality of their data set.

One of the emerging technologies that has arisen over the last year or so is Generative Artificial Intelligence ("GenAI"). **The majority of law firms believe that GenAI will have a positive impact on revenue and margins. However, only a minority of law firms are yet doing anything meaningful when it comes to GenAI.** While it is 'early days' in terms of this technology, it presents a significant opportunity.

Impacts of GenAI on the legal sector if adopted more widely



GenAI opens up the possibility of increased efficiency in service delivery, with a positive profit impact. Law firms need to evaluate how their adoption of GenAI will impact their operating model and delivery of services.

GenAI will also affect staffing considerations, as it has the potential to transform how law firms carry out activities such as reviewing documents, conducting research, and analysing legal texts. Headcount has continued to creep upwards this year, while chargeable hours have remained flat at best. With, perhaps, a prolonged period of economic difficulty, along with the transformational possibilities that new technology brings, firms should take the opportunity now to free up capacity and increase efficiency across their workforce.

Cloud modernisation and migration is a top IT strategic priority across all bandings in the next one to two years, with significant moves of key applications into cloud Practice Management Systems, Document Management Systems and People Systems. However, there still remain significant legacy Data Centre migrations that many firms need to undertake to fully move to the Cloud.

This combination of cloud work is critical to creating a fully unified data platform so that GenAI can be fully leveraged to its maximum potential – across time recording data, CRM data, financial performance data and legal precedents/documents.

To take advantage of GenAI and other emerging technology, investment will be needed. Competing with this in the near future will be accelerated partner tax payments due to basis period reform. It follows then that **the number one priority for business support functions this year is to 'improve working capital performance'.** A number of law firms are acutely aware that there is a significant opportunity when it comes to their firms' lock up.

Realistically though, historical trends suggest that most firms will not create sufficient additional liquidity through lockup improvement, and other options including partner capital calls and external funding are likely to be needed.

Overall, many firms appear to be taking a "wait and see" approach to transformation, whether that be structural, scale or operational technology. Being slow to act will hinder firms' ability to capitalise on innovative technologies such as GenAI and cloud, manage rising costs and weather the macroeconomic volatility ahead. Instead, firms need to act decisively and take bold steps to transform into a sustainable 'law firm of the future'.

Global financial performance

The challenging economic environment does not appear to have negatively impacted fee income for global law firms headquartered in the UK, although growth in profits is not as strong as the last two years.

All Top 10 and 11-25 firms increased global fee income. In contrast, only half of Top 10 and 70% of Top 11-25 firms reported growth in profit.

Top 10 average fee income was £1,281m, representing growth of 7.8% (2022: 8.5%). Profit performance was weaker and it is clear firms have struggled to pass on the full extent of a significant rise in staff and supplier costs to clients. Average profit before full and fixed equity partner remuneration (as this allows a better comparison across a range of partnership models in UK and international offices), was £512m, which was 2.7% (2022: 9.2%) higher than prior year.

Top 11-25 firms have outperformed the growth of their larger competitors; however, the variation in fee and profit performance still exists. Fee income and profit growth were 12.3% (2022: 5.8%) and 5.8% (2022: 3.0%) respectively, to £446m and £149m.

In Top 10 and 11-25 firms, UK and international offices have contributed relatively evenly to fee income growth (prior to the impact of foreign exchange rates).

At the profit level, it is predominantly the UK office performance that has aided the increase. In Top 10 firms, the UK contributed £12.7m to global profit growth, while international profit fell by £9.8m before a positive £3.6m impact from foreign currency exchange rates. In Top 11-25 firms, £5.3m of global profit growth is attributable to the UK, with international offices providing £2.1m (before a positive foreign exchange impact of £0.8m).

International profit has fallen by 1.7% in the Top 10, while increasing in Top 11-25 firms by 5.0%, although this hides a significant range in both bandings: (i) Top 10 from -8.5% to +13.8%; and (ii) Top 11-25 from -9.5% to +17.9%.

Top 10 firms have reversed, somewhat, the last two years of net profit margin growth (before full and fixed equity partner remuneration). The increase in average net profit margin from 2020 to 2022 was 35.2% to 40.4%, and in the current year this has fallen to 38.2%.

Global – Average percentage profit and loss account

	Top 10		Top 11-25	
	2023	2022	2023	2022
	%	%	%	%
Fee income	**100.0**	**100.0**	**100.0**	**100.0**
Staff costs – fee earners	28.4	27.0	27.1	28.2
Staff costs – non-fee earners	12.3	11.0	15.0	14.8
Property costs	7.2	7.0	7.0	7.7
IT revenue costs	3.1	2.7	3.2	2.8
Marketing & BD costs	1.0	0.8	1.4	1.0
Finance function costs	0.9	1.3	0.6	0.6
Depreciation	1.5	1.7	1.3	1.8
Insurance costs	1.4	1.2	1.8	1.6
Bad debts and disbursements	1.0	0.8	1.3	1.2
Foreign exchange differences	0.3	-0.4	-0.2	-0.2
All other costs	4.7	6.5	6.1	6.4
Profit before fixed share equity remuneration	**38.2**	**40.4**	**35.4**	**34.1**
Fixed share equity partners' remuneration	2.9	3.9	9.2	8.5
Net profit margin	**35.3**	**36.5**	**26.2**	**25.6**

The data for Top 11-25 firms suggests net profit margin growth from 34.1% to 35.4%. However, this is influenced by two firms who have increased fixed share equity partner remuneration from a zero cost base. These costs were likely included in prior year profit (as part of fee earner costs). Excluding these two firms from the current and prior year averages, the actual movement in the net profit margin is a 2.5 percentage point fall.

Top 10 firms' global staff cost ratio has increased by 2.7 percentage points, which suggests that an average Top 10 firm has been unable to pass on staff cost increases of some £36m to clients.

Top 11-25 firms' average staff cost ratio for fee earners has decreased by 1.1 percentage points, and for non-fee earners it has increased by 0.2 percentage points. Both of these are impacted by outliers and when these are removed the movements are an increase of 0.9 and 0.8 percentage points respectively.

We also note that above-inflation cost increases are impacting IT, marketing and insurance costs. For Top 10 firms, the average cost and percentage increase across these three areas is £14.5m and 26% respectively. For Top 11-25 firms it is £7.3m and 34%. For some, this may simply be a return to pre-pandemic cost levels, especially for marketing. However, this may also highlight a need for a cost control exercise. We note that fewer than 20% of Top 25 global firms identified "reduce cost" as a top three priority for business support over the next twelve months. However, we believe that law firms of the future will need to consider cost control in the context of more radical changes to their future operating model, bringing innovative thinking to how and where services are delivered.

UK Financial Performance

At this time last year, UK law firms were optimistic about the future. All Top 100 firms predicted either an increase in or consistent fee income, with the average increase expected at 8.2%. Firms were also confident in converting this into profits, with 93% expecting increased or consistent net profits.

Since those predictions, there has been turbulence in the UK economy with the cost of living crisis and the ongoing war in Ukraine working together to bring inflation to an all time high of 11.1% (CPI) in October 2022.

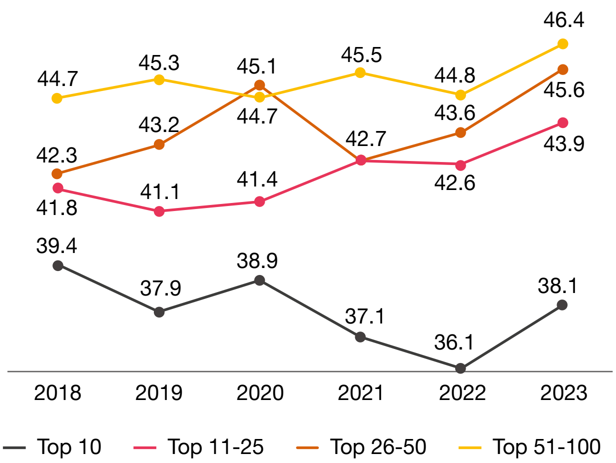
These factors did not dampen the outturn on UK fee income, which slightly exceeded expectations across Top 100 firms, at 8.6% growth. All bandings apart from the Top 26-50 (who appeared aggressive against other firms' predictions in the prior year) exceeded their predicted fee income growth, as follows: (i) Top 10: 8.3% (prediction: 7.7%); (ii) Top 11-25: 9.7% (prediction: 7.5%); (iii) Top 26-50: 8.6% (prediction: 11.0%); (iv) Top 51-100: 8.0% (prediction of 7.7%).

The ability to convert expected profit increases did not materialise. Of the Top 100 firms, 56% achieved net profit growth (prediction: 92%). This hides a mix of performance against expectations by banding, with Top 11-25 (2.9% growth vs 2.0% prediction) and 51-100 (3.9% actual vs 3.6% prediction) firms exceeding assumptions. However, Top 10 (7.7% actual vs 8.2% prediction) and 26-50 firms (-0.4% actual vs 1.4% prediction) fell short of their targets.

Firms have struggled to remain profitable this year as they have not been able to pass staff and other cost increases on to clients. We also know from wider market conditions that the number of deals/ transactions has reduced over the course of the last year and while chargeable hours are generally flat, the time spent may well have been on less profitable work.

Staff cost ratio has increased across all bandings and is at record levels for Top 11-25, 26-50 and 51-100 firms. In absolute terms, staff costs have increased by between 12% and 14% across the bandings. With only modest increases in headcount (between 1.8% and 3.3% across the bandings), the bulk of this increase can be attributed to staff remuneration.

Movement in UK staff cost ratio: 2018 to 2023 (%)



Focussing on the Top 10, we also note that property (an increase of 11%), IT (16%) and marketing (44%) costs all exceeded fee income growth and inflation (although we note the increase in marketing spend is doubtless still reflective of a return in activity post COVID-19). For Top 11-25 firms, it was IT (27%), marketing (24%), finance (101% – we suspect this is due to rising interest costs on a function with a small cost base) and bad debts (20%).

A number of firms have had a measure of success in increasing fee income and rates. However, this has not been enough against the backdrop of the significant cost increases noted to deliver net profit margin increases.

Top 10 firms have been most successful at limiting the impact of rising costs, with net profit margin falling by only 0.3 percentage points to 38.9%. This compares to the Top 11-25 and 26-50, where the fall was 1.4 (to 27.9%) and 1.8 (to 25.2%) percentage points. Top 51-100 recorded a net profit margin of 23.7%, which is down 0.6 percentage points on prior year.

The margin performance by banding is not reflected in PEP, with Top 10 and 51-100 firms increasing this KPI by 0.9% to £1,417k and by 3.2% to £479k respectively. Top 10 firms have achieved this while increasing full equity partner numbers (by 4.6%). Top 51-100 firms have only achieved increased PEP due to a slight reduction in full equity partner headcount.

Average PEP in Top 11-25 and 26-50 firms has deteriorated, by 7.0% to £807k and by 10.8% to £580k respectively. This follows a rise in full equity partners of 4.3% in Top 11-25 firms and 1.8% in Top 26-50 firms. This level of performance deterioration will doubtless be a catalyst for cost-cutting action, and indeed we are already seeing announcements of redundancies in some areas of the market.

UK – Average percentage profit and loss account

	Top 10		Top 11-25		Top 26-50		Top 51-100	
	2023	**2022**	**2023**	**2022**	**2023**	**2022**	**2023**	**2022**
	%	%	%	%	%	%	%	%
Fee income	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Staff costs – fee earners	27.0	26.1	28.5	28.1	30.4	29.5	31.3	30.9
Staff costs – non-fee earners	11.1	10.0	15.4	14.5	15.2	14.1	15.1	13.9
Property costs	7.0	6.8	6.8	7.1	6.4	6.6	6.9	7.6
IT revenue costs	3.3	3.1	3.6	3.1	3.6	3.3	4.2	4.1
Marketing & BD costs	1.1	0.8	1.2	1.1	1.6	1.3	1.9	1.7
Finance function costs	0.9	1.4	0.5	0.3	0.3	0.6	-0.2	0.7
Depreciation	1.6	1.9	1.3	1.5	1.8	1.7	1.7	1.8
Insurance costs	1.3	1.3	1.7	1.9	2.1	2.2	3.2	2.7
Bad debts and disbursements	0.9	1.0	1.1	1.0	0.9	0.8	1.0	0.7
Foreign exchange differences	0.3	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0
All other costs	4.0	5.1	5.6	5.1	4.2	4.2	3.2	4.5
Profit before fixed share equity remuneration	**41.5**	**42.7**	**34.4**	**36.3**	**33.5**	**35.7**	**31.7**	**31.4**
Fixed share equity partners' remuneration	2.6	3.5	6.5	7.0	8.3	8.7	8.0	7.1
Net profit margin	**38.9**	**39.2**	**27.9**	**29.3**	**25.2**	**27.0**	**23.7**	**24.3**
Staff cost ratio (all staff costs)	38.1	36.1	43.9	42.6	45.6	43.6	46.4	44.8
Staff cost ratio (all staff costs, inc. FSEP costs)	40.7	39.6	50.4	49.6	53.9	52.3	54.4	51.9

Strategy and Transformation

Organic and inorganic growth
Despite the current economic uncertainties, firms are positive about their growth predictions for the next 2 years, with 100% and 93% of Top 100 firms expecting to increase revenue and profits respectively in the next year. Average growth across the Top 100 firms is predicted at 9.3% for revenue and 8.2% for profits. Predictions for FY25 are similar, with all Top 100 firms expecting to increase both revenue and profits and this is by an average of 7.8% and 7.6% respectively.

This should be taken in the context of the current high inflation levels and future forecasts. The Bank of England expects inflation to fall to around 5% by December 2023 and to reach the target of 2% by early 2025. This would indicate that firms expect to outperform inflation, which will be ambitious for some in the current environment.

Law firms are considering or actively pursuing a range of avenues to organic growth, with the most popular strategies being those that are least disruptive, albeit also lowest impact. Commercial training for Partners scored highest (73% of Top 100 actively pursuing), with innovative legal service solutions (69%), improvements in account management planning (65%) and hiring new rainmakers (64%) close behind.

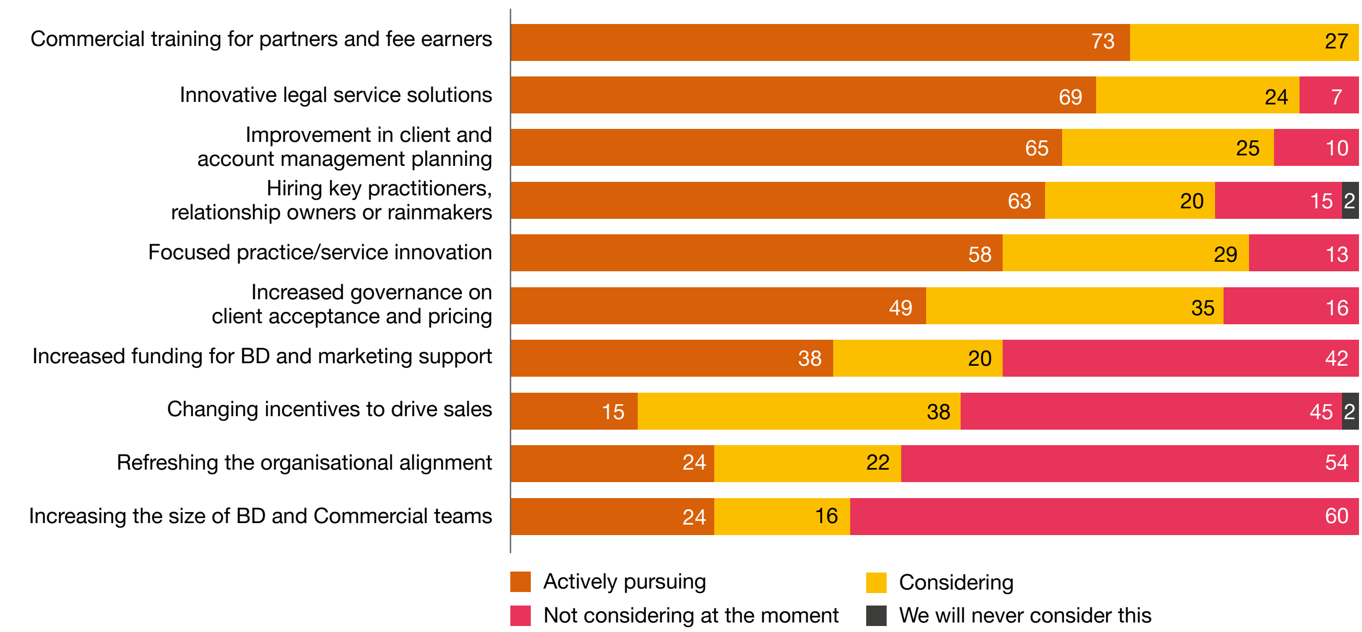
The focus on innovative legal service solutions, being the second most popular strategy, highlights a desire to take advantage of advancements in AI and automation. As law firms look to build proprietary technology solutions, in partnership with technology firms/open AI models, those most proactively pursuing innovation will put themselves in a foremost position in the market.

The approach to inorganic growth appears similarly conservative. Non-transformational options such as lateral hires (98% of Top 100 firms are considering or actively pursuing) are being widely considered; however, a smaller number of firms are looking at a tactical acquisition to enter into new practice areas and/or geographies (62% and 55% respectively).

The approach to inorganic growth partly reflects the benefits of smaller scale activity, i.e. actions that are quicker to execute and have lower risks of failure.

There is no appetite to pursue funding through public capital markets (no Top 100 firm surveyed is actively pursuing or considering this) which is unsurprising given the current sentiment in public markets.

Strategies to drive organic growth or profit margin improvement (Top 100 firms)



Appetite for private investment among firms also remains subdued with no firms considering a full buyout and only 9% of the Top 100 considering a minority investment from private capital investors. Among the Top 51-100, 18% are considering forming or joining a holding company of legal brands. This suggests they are looking for ways to build scale without compromising culture. However, it remains to be seen whether this would deliver the benefits of scale that they perhaps are looking for from such a venture.

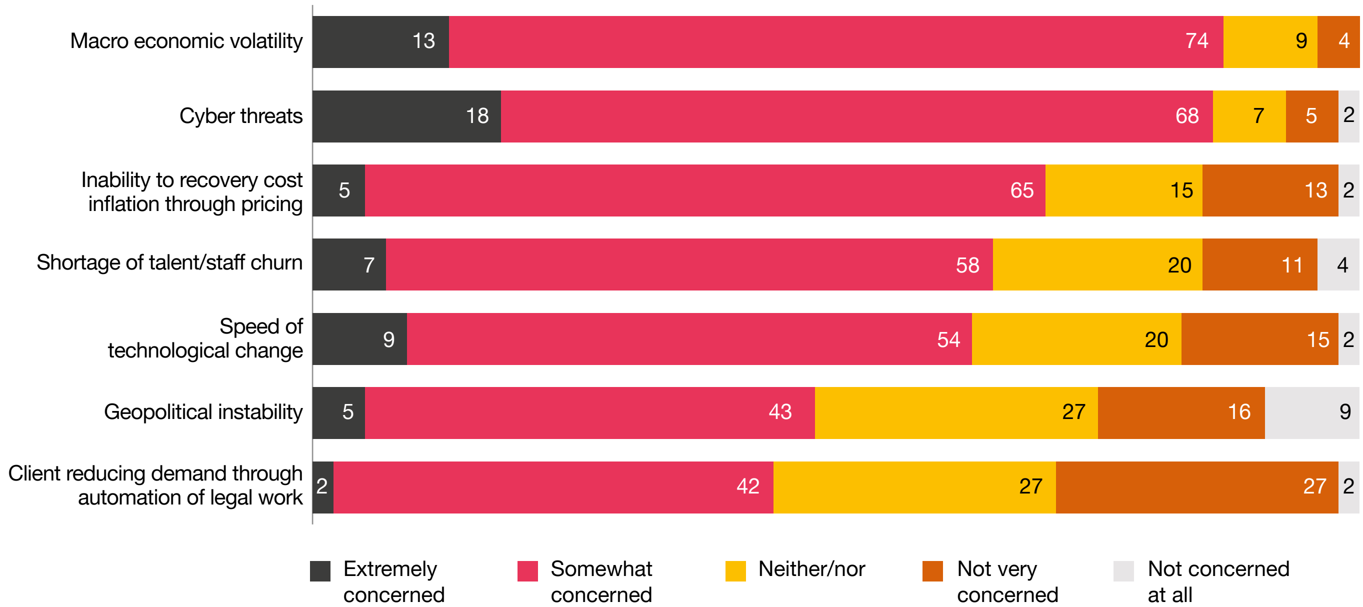
Concerns regarding future growth
While the UK economy has, to date, narrowly avoided a recession with GDP growth of 0.1% and 0.2% in calendar quarters one and two of 2023 respectively, significant macroeconomic challenges persist. The war in Ukraine continues to influence energy and other commodity prices. The follow-on impact of inflation has resulted in further tightening in credit markets. As a result, the deals market remains subdued with valuation gaps between sellers and buyers persisting.

With the above in mind, Top 100 law firms have cited macroeconomic volatility as the top concern, with 87% either extremely or somewhat concerned that this will impact future growth ambitions over the next two years.

This is followed by:

- Cyber threats (85%) – continuing concern around cyber risk is expected, as the volume of connected devices continues to grow, hybrid working habits remain embedded, and hackers become more sophisticated.
- Inability to recover cost inflation through pricing (71%) – inflation is adding further pressure to high salary and other costs in the legal sector and in the current year a significant number of firms have struggled to pass higher costs onto their clients. It appears firms expect this challenge to continue, at least for the short term.
- Shortage of talent (65%) – this was the number one concern in 2022. In the current volatile economic environment, the challenge has lessened somewhat though we do not expect the issue to fully abate. The percentage of firms concerned by talent shortages increases through the bandings (Top 10: 33%; Top 11-25: 57%; Top 26-50: 71%; and Top 51-100: 78%). This reflects trends seen more broadly among people-led services businesses where the war for talent has seen smaller businesses struggle to match the financial packages and career opportunities offered by larger organisations.

Key threats to firms meeting or exceeding their ambitions over the next two years (Top 100 firms)



Emerging technology

AI is presenting both a risk and an opportunity. Most firms see a chance to benefit from the disruption, though few to date have taken meaningful steps to capitalise on the opportunity.

The launch of ChatGPT at the end of 2022 brought to life the capabilities of GenAI for many. Its intuitive, language-based interface helped it achieve user uptake faster than any technology before it. Several new tools specific to legal services that leverage the capabilities of GenAI have already emerged. These include Harvey (a tool for contract analysis, due diligence, litigation, and regulatory compliance built on GPT-4) and ContractPodAI LeAh (contract drafting and reviewing tool).

GenAI presents both a material opportunity and significant threat of disruption to the legal industry.

Against this backdrop, the speed of technological change was recognised as a risk to growth by 71% of Top 100 firms in the medium term (FY25 to FY28), up by 37 percentage points from 2022. On the other hand, there is an opportunity for first movers to adopt new technologies to improve existing services, boost margins and develop new client solutions.

Of the Top 100, 69% believe GenAI will have a positive impact on revenues or margins. This view is largely consistent across each banding (Top 10: 66%; Top 11-25: 79%; Top 26-50: 65%; and Top 51-100: 67%).

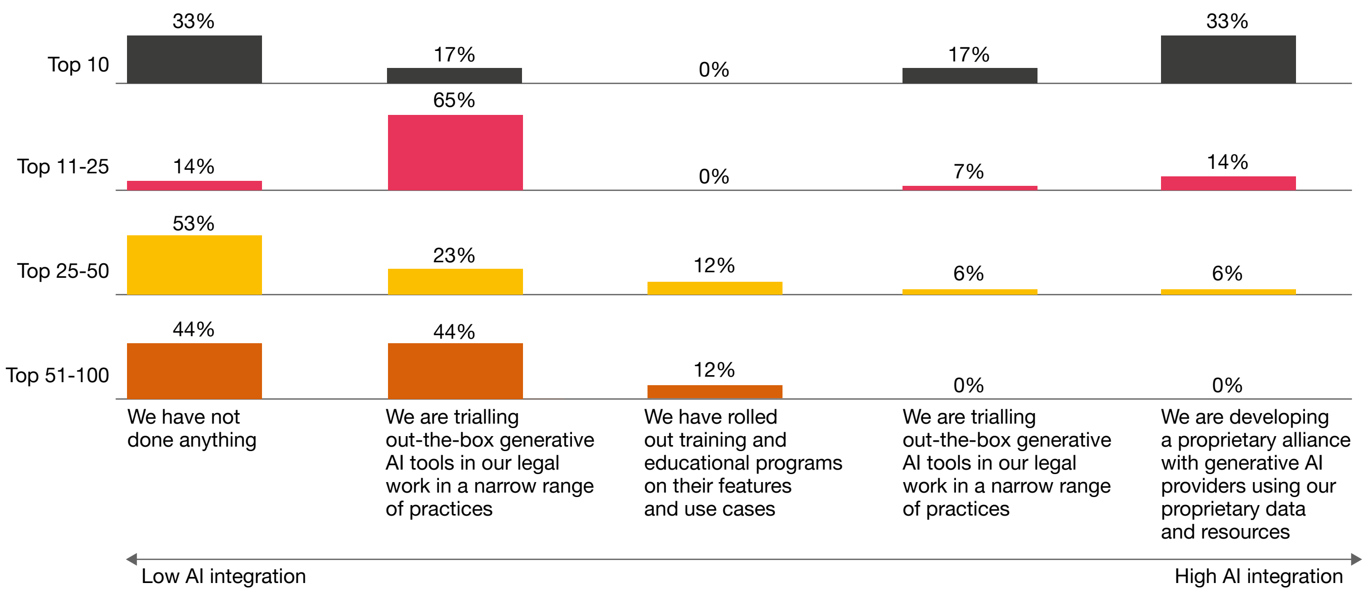
The risks and opportunities are seen across practice areas, with high-volume work seen as most susceptible. Larger firms see slightly more opportunity for automation across practice areas than smaller firms, perhaps reflecting their closer understanding of the tools given that these firms have likely already tested some of what is available.

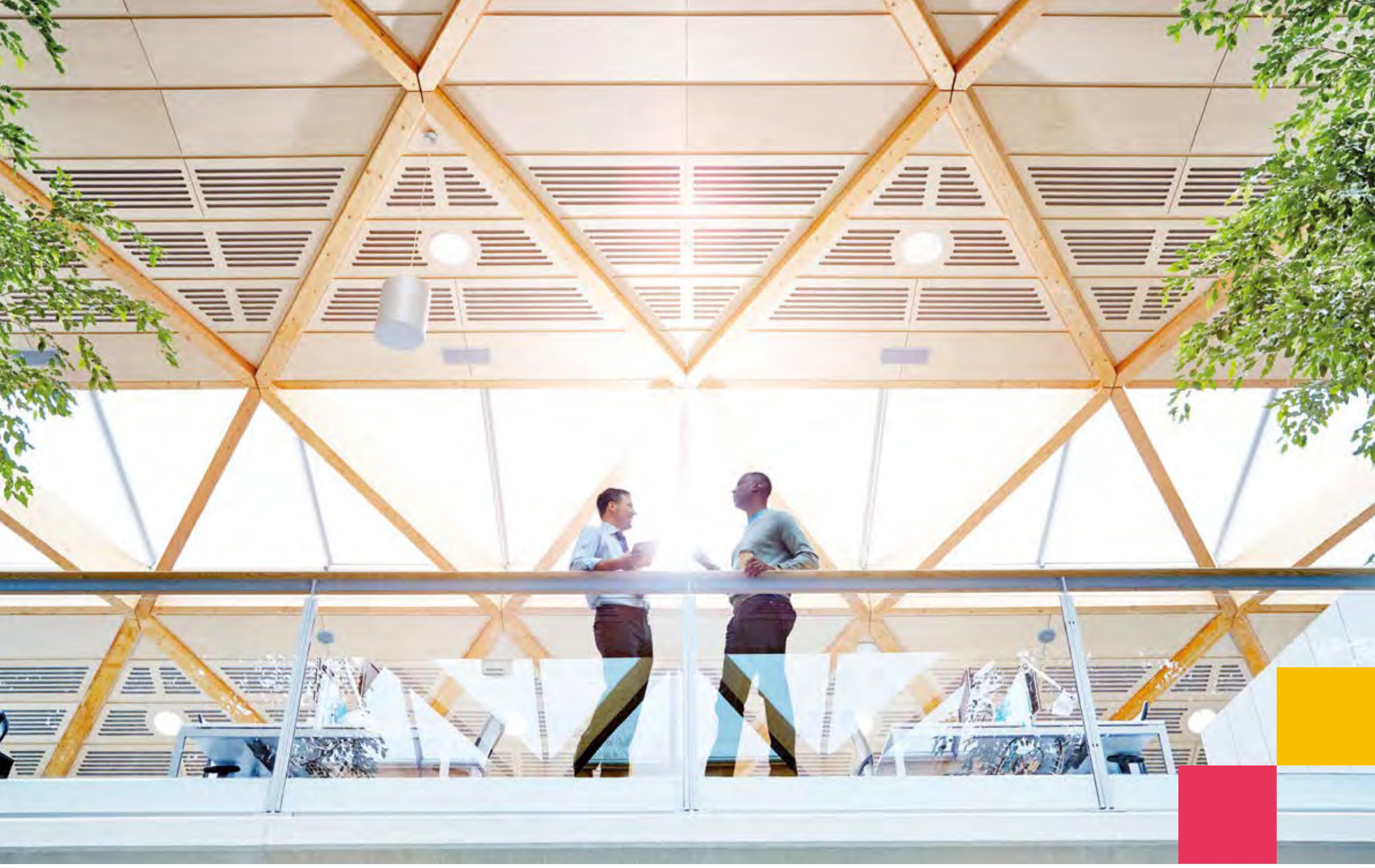
GenAI certainly presents an opportunity, but also poses a number of questions and secondary challenges for law firms to address, such as:

- What tools should they choose to use and for which use cases?
- How should law firms think about pricing where GenAI is used to significantly reduce the time required to complete work?
- Is the use of GenAI denying trainee lawyers opportunities to train and develop?
- How are the risks of relying on these new technologies managed, particularly where access to confidential information is required to deliver work?
- How will in-house legal teams respond to the opportunities presented by GenAI tools and how, if at all, will they adopt them themselves?

Despite wide acknowledgement of the risks and opportunities of GenAI, 38% of Top 100 firms have not done anything with respect to this new technology. Further, only 9% of Top 100 firms are actively developing technology alongside GenAI providers. The majority of these more innovative law firms are among the Top 25.

Extent of usage of AI tools (such as ChatGPT/Harvey)





Environmental, Social and Governance (ESG)
ESG remains at the centre of law firm strategies. This is driven by increasing client and staff interest and the spotlight that regulatory reporting demands (including Streamlined Energy and Carbon Reporting and Task Force on Climate-Related Financial disclosures) have shone on firms' performance. Further, in the near future the EU adopted Corporate Sustainability Reporting Directive will impact global law firms with significant operations in the EU.

Law firms are at various stages of progress in integrating ESG policies into their operations. Top 10 firms are most progressed with 50% having successfully formulated and integrated such a policy, and the remaining 50% having a policy formulated but not yet enacted. In the Top 11-25, while 64% have formulated but not implemented a policy, only 7% have their policy embedded. This falls short of the Top 26-50 (47%).

In terms of the influence of ESG on existing business models, most Top 100 firms expect the key impacts to be similar to last year with a heightened focus on internal policies, such as selection of suppliers, travel policies, recruitment of employees and the firms' organisation strategy.

The most prevalent ESG targets set by the Top 100 law firms are gender representation rates (70%), greenhouse gas emission targets (64%) and race and ethnicity representation targets (55%). All Top 10 law firms have gender representation targets, while 83% have targets for greenhouse gas emissions and race and ethnicity targets. Among the Top 11-50 firms, 65%+ have specific targets in these three categories; however, only 30-40% of the Top 51-100 firms have targets across these areas.

ESG is not only an important topic in terms of internal governance, but also gaining traction as a growth segment for legal and advisory firms. Of the Top 100 firms, 62% are considering, actively pursuing or have already established an ESG consulting service offering. ESG consulting could become one of the most important growth areas for law firms, driven by a confluence of factors from heightened client demand for sustainability strategies to evolving regulatory landscapes. ESG consulting will allow law firms to differentiate themselves as well as attract a broader client base.

People

Despite a turbulent economic climate and challenging market conditions for certain practice areas, law firms have continued to grow total headcount over the past year with increases noted as follows: (i) Top 10, by 1.8% (2022: 1.3%); (ii) Top 11-25, by 3.3% (2022: 3.6%); (iii) Top 26-50, by 2.4% (2022: 3.3%); and (iv) Top 51-100, by 2.9% (2022: 3.5%).

Narrowing this down to the fee earner population (including partners), headcount has risen across all bandings, as follows: (i) Top 10, by 2.2% (2022: 0.8%); (ii) Top 11-25, by 2.4% (2022: 0.9%); (iii) Top 26-50, by 0.5% (2022: 4.7%); (iv) and Top 51-100, by 2.7% (2022: 2.3%). Law firms have also continued to invest in business support staff over the past year.

On the face of it, the movements indicate that the sector is weathering the volatile operating environment well. However, chargeable hours are broadly flat across the fee earner grades (excluding partners) for all bandings, with no movement greater than 4.5% across all grades in the Top 10 and 11-25. The only exception to this is +9 years PQE in the Top 10, which increased by 14% to 1,406 hours (although, with the exception of one outlier the increase is limited to 4.4%).

There has been a marked fall in chargeable hours across the partner population (including a reduction of between 5% and 9% across all Top 100 bandings for full equity partners).

UK headcount

	Top 10			Top 11-25			Top 26-50			Top 51-100		
	Avg 2023	Avg 2022	% mvt 2022 - 2023	Avg 2023	Avg 2022	% mvt 2022 - 2023	Avg 2023	Avg 2022	% mvt 2022 - 2023	Avg 2023	Avg 2022	% mvt 2022 - 2023
Full equity partners	160	153	4.6%	72	69	4.3%	57	56	1.8%	29	30	-3.3%
Fixed share equity partners	48	52	-7.7%	63	57	10.5%	62	60	3.3%	27	22	22.7%
Non-equity partners	1	2	-50.0%	1	7	-85.7%	7	6	16.7%	10	11	-9.1%
Total Partners	**209**	**207**	**1.0%**	**136**	**133**	**2.3%**	**126**	**122**	**3.3%**	**66**	**63**	**4.8%**
9+ years PQE	146	132	10.6%	110	110	0.0%	98	96	2.1%	43	43	0.0%
6-8 years PQE	160	179	-10.6%	56	53	5.7%	54	54	0.0%	23	23	0.0%
3-5 years PQE	154	141	9.2%	73	71	2.8%	61	65	-6.2%	30	31	-3.2%
1-2 years PQE	139	135	3.0%	56	48	16.7%	44	40	10.0%	22	21	4.8%
Newly qualified	40	44	-9.1%	32	33	-3.0%	22	21	4.8%	9	8	12.5%
Paralegals and legal executives	142	131	8.4%	68	68	0.0%	107	114	-6.1%	54	51	5.9%
Trainees	151	147	2.7%	62	63	-1.6%	44	41	7.3%	22	22	0.0%
Total fee-earners (including partners)	**1,141**	**1,116**	**2.2%**	**593**	**579**	**2.4%**	**556**	**553**	**0.5%**	**269**	**262**	**2.7%**
Business support staff	968	956	1.3%	451	432	4.4%	344	326	5.5%	157	152	3.3%
Total	**2,109**	**2,072**	**1.8%**	**1,044**	**1,011**	**3.3%**	**900**	**879**	**2.4%**	**426**	**414**	**2.9%**

When a weighted average chargeable hours per fee earner (excluding partners) is used, it would indicate fee earners are less busy. This is minimal in the larger firms and becomes more pronounced as you move down the bandings: (i) Top 10, down by 1.7% to 1,300 hours; (ii) Top 11-25, down by 2.9% to 1,182 hours; (iii) Top 26-50, down by 4.9% to 1,056 hours and (iv) Top 51-100, down by 7.2% to 881 hours.

With small increases in headcount and flat (or falling) chargeable hours, we do see spare capacity increasing for all bandings outside the Top 10, at a time when firms are focussing on improving their utilisation levels. Firms will need to be mindful of their workforce as they prepare for potentially significant transformation over the short to medium term.

Strategic workforce planning will be a critical activity for firms in the coming years as they embrace the rapidly changing operating context around them. Evaluating skills gaps in areas such as change, leadership, and technology, and identifying the talent pools to source these requisite skills will enable firms to respond with agility as the sector changes.

UK chargeable hours

	Top 10			Top 11-25			Top 26-50			Top 51-100		
	Avg 2023	Avg 2022	% mvt 2022 - 2023	Avg 2023	Avg 2022	% mvt 2022 - 2023	Avg 2023	Avg 2022	% mvt 2022 - 2023	Avg 2023	Avg 2022	% mvt 2022 - 2023
Full equity partners	1,059	1,155	-8.3%	976	1,046	-6.7%	851	938	-9.3%	818	862	–5.1%
Fixed share equity partners	1,048	1,300	-19.4%	957	1,055	-9.3%	904	966	-6.4%	858	899	-4.6%
9+ years PQE	1,406	1,234	13.9%	1,252	1,221	2.5%	1,103	1,082	1.9%	970	994	-2.4%
6-8 years PQE	1,381	1,386	-0.4%	1,287	1,297	-0.8%	1,153	1,182	-2.5%	1,052	1,073	-2.0%
3-5 years PQE	1,471	1,431	2.8%	1,276	1,283	-0.5%	1,155	1,200	-3.8%	1,026	1,084	-5.4%
1-2 years PQE	1,418	1,441	-1.6%	1,307	1,286	1.6%	1,181	1,204	-1.9%	1,046	1,048	-0.2%
Newly qualified	1,265	1,246	1.5%	1,184	1,190	-0.5%	1,046	1,066	-1.9%	968	900	7.6%
Paralegal and legal executives	881	901	-2.2%	1,009	1,048	-3.7%	879	888	-1.0%	810	835	-3.0%
Trainees	1,070	1,074	-0.4%	940	984	-4.5%	793	840	-5.6%	745	735	1.4%

UK Staff turnover

	Top 10			Top 11-25			Top 26-50			Top 51-100		
	2023	2022	Change	2023	2022	Change	2023	2022	Change	2023	2022	Change
	%	%	PPM	%	%	PPM	%	%	PPM	%	%	PPM
Full equity partners	4.5%	4.3%	0.2	4.1%	4.9%	-0.8	2.4%	2.0%	0.4	4.3%	2.0%	2.3
Fixed share equity partners	10.0%	1.0%	9.0	6.4%	6.7%	-0.3	7.2%	5.0%	2.2	6.6%	3.0%	3.6
Non-equity partners	-	-	-	9.5%	15.0%	-5.5	12.7%	12.0%	0.7	4.9%	5.0%	-0.1
9+ years PQE	21.3%	13.3%	8.0	11.4%	17.0%	-5.6	19.0%	13.9%	5.1	17.0%	16.8%	0.2
6-8 years PQE	17.0%	14.5%	2.5	18.6%	17.8%	0.8	14.0%	15.1%	-1.1	13.4%	14.0%	-0.6
3-5 years PQE	19.8%	18.5%	1.3	16.6%	25.8%	-9.2	16.3%	22.3%	-6.0	21.6%	18.0%	3.6
1-2 years PQE	19.0%	17.0%	2.0	17.5%	24.1%	-6.6	20.8%	27.6%	-6.8	18.1%	20.0%	-1.9
Newly qualified	4.5%	7.0%	-2.5	9.9%	14.0%	-4.1	10.9%	12.0%	-1.1	7.4%	12.0%	-4.6
Paralegal and legal executives	42.8%	29.8%	13.0	32.6%	25.0%	7.6	27.3%	27.0%	0.3	25.4%	23.0%	2.4
Trainees	13.5%	7.3%	6.2	9.4%	10.0%	-0.6	9.3%	8.0%	1.3	12.3%	12.0%	0.3
Business Support staff	17.5%	18.8%	-1.3	19.0%	19.6%	-0.6	16.5%	16.5%	0.0	19.4%	17.9%	1.5

PPM = Percentage Point Movement

Following the significantly increased levels of staff turnover last year due to the 'Great Resignation', many may have expected staff turnover to fall across all (or most) grades and bandings. However, that has not been the case with a number of grades across all bandings seeing staff turnover increase. Top 11-25 firms do buck this trend, with staff turnover falling at all grades except 6-8 years PQE and paralegals. This continued movement in staff could be attributed to the ongoing push of US law firms in the UK legal market and the associated ripple effect.

Notwithstanding the above, there has been a general softening of labour markets and we expect this to flow through to the legal sector over the course of 2023/24.

In the current environment, we expect law firms to adopt less aggressive hiring tactics as they assess the impacts of reduced market demand on certain practice areas, as well as the longer-term impacts of post-COVID working models and the potential for GenAI to free up capacity and drive efficiency across the workforce.

Female representation at full equity partner level has trended upwards across all bandings. The Top 26-50 and 51-100 firms have made the largest strides this year, reporting increases of 2.3 and 1.3 percentage points respectively to 23.9% and 28.6%. The increases in the Top 10 and 11-25 firms were both 0.8 percentage points to 25.0% and 21.4% respectively. While these figures are encouraging, some firms will need to push harder to increase the pace of change and meet diversity and representation targets within published timelines.

The above contrasts with 60%-65% female representation in the trainee grades across the Top 100 bandings. While increasing the proportion of women in the profession should result in better representation at partner level, firms should be mindful of gender balance to best reflect the diversity of society and clients.

An additional consideration is the potential for AI to disrupt diversity initiatives by impacting the volume of roles at junior grades. Ensuring a talent pipeline for under-represented groups is a key ingredient to enhance representation at more senior levels, including full equity partner.

Financing

Year end lock up levels remain stubbornly high across all bandings (between 119 and 132 days). In respect of average lock up, which is the real driver of a firm's working capital performance, we see an increasingly gloomy picture for at least the Top 50 bandings: (i) Top 10, up 5 days to 152; (ii) Top 11-25, up 6 days to 145; and (iii) Top 26-50, up 3 days to 142. Top 51-100 held their average lock up days at 140. While the year end lock up picture is not as bad, this is simply due to the usual year end 'dive to the line' approach to get bills out the door and cash collected.

The average to year end lock up gap has grown across all bandings of firms this year, with the exception of the Top 11-25 where the gap remains at 18 days. The gap in Top 10 firms has grown by 6 days to 22, and it has risen by 2 days in both the Top 26-50 and 51-100 to 23 and 8 respectively.

International offices saw an even greater deterioration in lock up performance. This was most marked in Top 10 firms where average lock up days was 166, being 9% higher than the UK. Top 11-25 firms performed better, with international average lock up standing at 148 days and only 2% higher than UK average lock up performance.

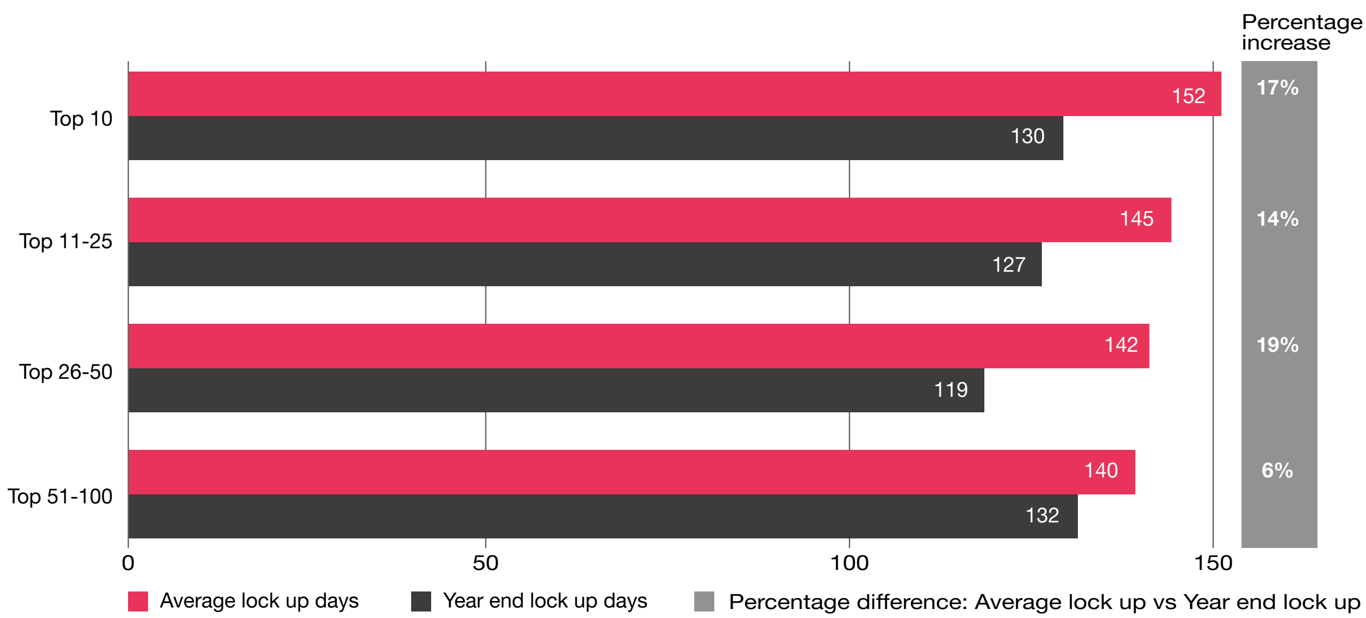
For both UK and international offices, rising debtor days is the main driver of the current year working capital results. Improving debtor days requires a sustained cultural change, especially in organisations where there has been limited focus or sustained pressure from leaders. Enhancements can typically be achieved by flexing levers in operating models, processes and technology, with suggestions as follows:

- **Finance operating model –** find an appropriate balance of dedicated focus between billing and collections and consider the role of managed services to balance efficiency with effectiveness and enable focus on core activities.

- **Process –** remove friction and bottlenecks, while adopting wider corporate best practices, including a more data driven approach to collections.

- **Technology –** consider augmenting practice management system capability with debt management solutions that can bring automation and workflow solutions.

Lock up days: Average vs year end



Given the historic lack of focus on working capital, it is likely that business support functions will struggle to deliver a step change in performance quickly. Investment in processes, technology and capabilities that underpin cash performance will take time to bed in.

Managed services are one way for firms to unlock cash fast. Being able to access skilled resources on a flexible basis can help augment typically stretched billing and collections teams and serve as a catalyst for accelerating cash performance.

Basis Period Reform is a significant tax change which will have a notable impact on financing requirements, with accelerated tax payments applying from January 2025 (with 2023/24 being the transitional year).

The majority of Top 100 firms are planning to take advantage of the HMRC allowance to spread the impact of basis period reform over five years, ranging from 85% in the Top 11-25 to 100% in the Top 10.

All bandings outside the Top 10 ranked improved working capital management as their planned primary source of funding for basis period reform, with almost two thirds of such firms selecting this as their primary source. In the Top 10, capital call from partners was ranked marginally higher (60% vs 40% improved working capital). Further, 42% of Top 100 firms identified external funding as either their primary or secondary source.

Given that basis period reform will impact cash flows significantly in the future, it is imperative that there is a sustained focus on improving working capital which is the cheapest form of generating cash. With currently high interest rates, meeting the needs of basis period reform through external financing would be costly. A step towards greater cash awareness amongst partners and practice teams is therefore needed, along with an investment in the process and technology that underpins the pitch to cash cycle.

For large global UK headquartered law firms, a 30 April year end has been imposed on international offices for a number of years. There is no appetite for a change of year end to ease the cash burden of basis period reform among these firms as it would inflict further complexity on international partners and a significant administrative change.

The approach is different in the UK domestic market where a number of mid-tier firms are planning to make the change in order to (i) allow an extra month to undertake the tax compliance process; and (ii) avoid the need to complicate partner taxation by apportioning profits between tax years. In the Top 11-100 bandings, 44% are planning to change their year end.

The movements in capital account balances per partner have moved only marginally in Top 10 (down 0.3% to £373k) and Top 11-25 (up 1.2% to £260k) firms. Top 26-50 firms increased capital balance per partner by 4.6% to £273k, whilst the rise in Top 51-100 firms was more marked at 15.1% to £213k.

Current account balances per full equity partner have fallen across the bandings outside of the Top 10. In Top 11-25 and 51-100 firms the fall is approximately 6% (to £668k and £371k respectively), with a 19.2% reduction (to £433k) noted in Top 26-50 firms. The move in Top 26-50 accompanies a shift of the in-year profit distributions, being an increase from 49% of total profits in the prior year to 57% in the current year.

Top 10 firms' current account balance per full equity partner has increased by 4.6% to £947k, reflecting strong prior year profits and a small decrease in the percentage of in-year profit payments (from 54% to 51%).

Business Support

For a number of years, 'Improving working capital performance' has barely featured as a business support priority. However, it now appears to be at the top of the agenda. Top 11-25 and 51-100 firms have the keenest focus in this area, 86% and 67% respectively citing it as a top three priority. This falls to 50% and 41% for the Top 10 and 26-50 firms.

'Standardising & Centralising Processes' and improving use of 'Data & Analytics' remain significant areas of focus, with approximately 55% of Top 100 firms noting these as top three priorities.

Overall, law firms are increasing their use of legal technology including innovative technology, such as the use of GenAI. All bandings in the Top 100 have increased their spend on legal technologies this year, from a 13% increase in the Top 11-25 to 66% in the Top 26-50.

Firms will want to ensure that their legal technology investment pays dividends. To achieve this, partners and fee earners need support, including effective training and appropriate tone at the top.

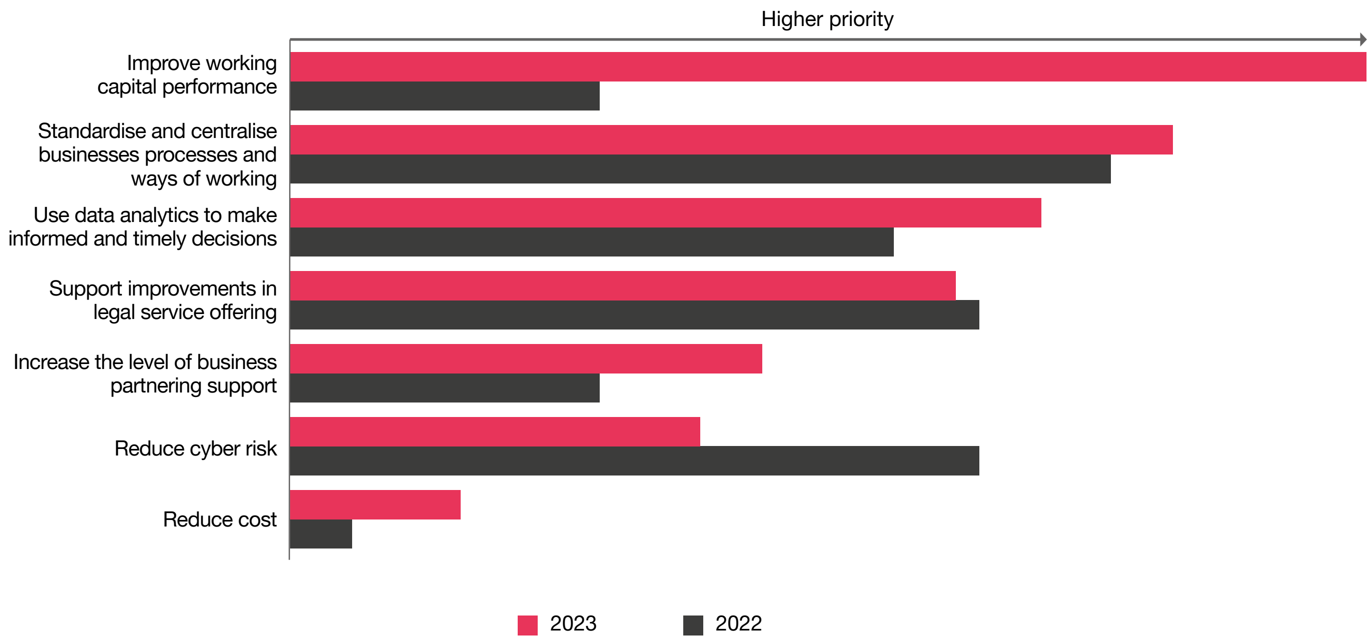
There are ongoing cost pressures that will challenge future investment in technology, but continued investment in the right technology will drive innovation, cost efficiency and competitive advantage. Firms want to ensure their people have the right tools, that their clients receive a seamless service and that they keep ahead, or at least keep pace, with the competition.

Cyber risk

Law firms deal with a lot of highly confidential information and are thus particularly vulnerable to ransomware attacks. This involves malware that either locks access to a computer or encrypts the data stored on it, sometimes even exfiltrating it. The emergence of 'Ransomware as a Service' models has enabled even technically unsophisticated criminals to commission attacks. While ransomware attacks often capture media headlines, it is crucial not to overlook other forms of malware, such as adware, viruses, worms, trojans, malicious bots, keyloggers, and spyware. It is extremely important that law firms continue to monitor the measures they put in place to protect their firms against cyber criminals and ensure that they are fit for purpose.

Law firms are responding to cyber risk in a number of different ways. Firstly, there has been an increase in the number of dedicated Cyber Security Chiefs/CISOs or equivalent who have responsibility for cyber security. There has also been a significant cyber security spend increase in Top 10 (up 21% to £6,141k), Top 26-50 (up 41% to £1,060k) and Top 51-100 (up 67% to £396k) firms. Top 11-25 firms have, on average, reduced their cyber spend by 16% to £1,083k.

Top priorities for business support over the next twelve months (Top 100 firms)



There are other areas where firms could do better, such as the regularity of business continuity plan testing. The number of firms performing this at least every twelve months has fallen from prior year for all bandings except the Top 11-25 (improvement from 79% to 86%). There also remains a large number of firms where management have not engaged in a crisis management exercise in the last twelve months: (i) Top 10: 17% (2022: 33%); (ii) Top 11-25: 21% (2022: 21%); (iii) Top 26-50: 37% (2022: 33%); and (iv) Top 51-100: 48% (2022: 55%).

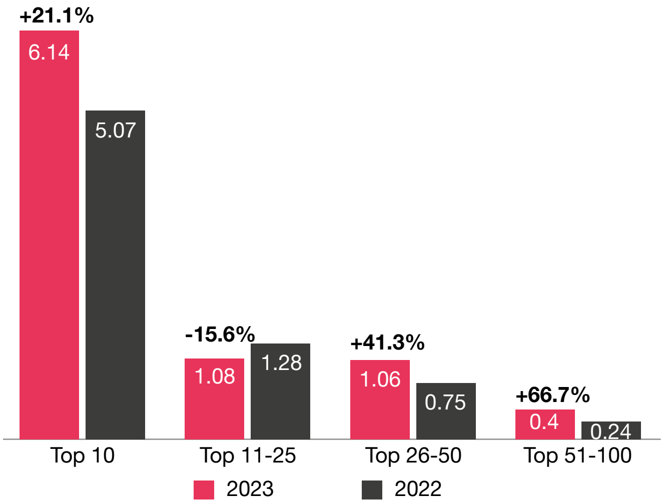
Cyber risk continues to be a key area of concern, with 85% (2022: 75%) of the Top 100 firms citing that they are extremely or somewhat concerned that cyber threats will stop them meeting and/or exceeding their firm's ambitions in the period from now until the end of financial year 2025.

Alongside the acknowledgement of the seriousness of cyber risk and the increased spend in this area, there is broad acceptance of a cyber skills shortage. It is a challenge for firms to attract and retain key staff with the right skills and experience to support the delivery of an effective cyber security strategy.

Cyber criminals continue to target people, essentially focusing on human vulnerability, exploiting poor security behaviours to gain access to organisations. Across the Top 100, 80% (2022; 75%) experienced incidents unintentionally caused by staff, 71% (2022; 78%) reported that they had been subject to phishing attacks and 69% (2022: 47%) experienced data loss or leakage of confidential information.

Phishing remains a dominant form of cyber attack that targets law firms, blending into the vast sea of harmless emails received daily by busy professionals. The minimal costs associated with sending millions of phishing emails make untargeted attacks, often originating from free email accounts, quite common. At times, criminals leverage publicly available information from law firm websites, social media, and business networking sites to craft more targeted attacks.

Average Cyber Security Spend (£'m)



Incorporating 'human cyber risk' into the cyber strategy of law firms is crucial, and this should encompass behaviour-driven approaches to cultivate a robust security culture. Ongoing, role-specific cyber security training and awareness are essential tools in mitigating the risk of employees, either intentionally or unintentionally, triggering a cyber incident. It is imperative for law firms to manage the human cyber risk effectively, including the risks posed by third parties across the entire organisation. This requires implementing comprehensive policies, processes, and controls that address human cyber risk throughout the entire employee and third-party relationship lifecycle, from initial recruitment screenings to role transitions and, ultimately, offboarding.

At a glance

1. Global financial performance

Global headcount

- There has been limited movement in Top 10 firms' global headcount: (i) partners down 2.0% (2022: up 2.2%); (ii) fee earners (excluding partners) down 1.2% (2022: up 3.0%); and (iii) business support staff up 1.7% (2022: up 0.9%).

- Top 11-25 firms have continued to invest in their global headcount: (i) partners and fee earners are both up 7.3 % (2022: 15.4% and 17.7% respectively); and (ii) business support staff up 11.8% (2022: 23.6%).

Global fees

- Average fee income growth across Top 25 firms was 10.6% (2022: 8.5%).

- The range of fee income growth in Top 10 firms was 6.6% to 10.0% (2022: 6.1% to 14.1%).

- Top 11-25 firms' average fee income growth ranged from 6.3% to 21.4% (2022: -4.6% to +15.4%).

- The source of fee income growth in Top 10 and 11-25 firms was: (i) Top 10: 44% from UK; 56% from international offices; and (ii) Top 11-25: 51% from UK; 49% from international.

Global profits

- Average profit (before full and fixed share equity partner remuneration) growth for Top 25 firms was 4.7% (2022: 5.2%).

- The range of movements in profit for Top 10 firms was -2.5% to +12.0% (2022: +1.8% to +14.9%).

- Top 11-25 firms' range of movements in profit was from -9.2% to +15.7% (2022: -31.1% to +20.9%).

- International profits in Top 10 firms declined by 2.3% (£6.2m) on average (after foreign exchange impact), with profit growth of 5.5% (£12.7m) from UK offices more than offsetting this decline (2022: international offices contributed 51% to Top 10 profit growth).

- International offices contributed 35% (2022: 87%) to profit growth for Top 11-25 firms.

- Top 10 and 11-25 firms' average global net profit margin (defined as profits before full equity and fixed share equity remuneration as a proportion of fee income) was 38.2% (2022: 40.4%) and 35.4% (2022: 34.1%) respectively.

- The range of global net profit margins in (i) Top 10 firms is 33.2% to 45.1% (2022: 32.9% to 49.0%); and (ii) Top 11-25 firms is 27.4% to 44.5% (2022: 22.0% to 51.1%).

International analysis

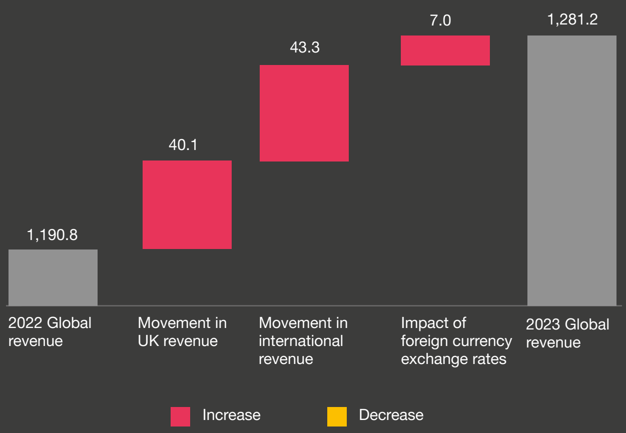
- There has been a mixed performance in respect of international net profit margins by region for both Top 10 and 11-25 firms, as presented opposite.

- The range of average Top 10 net profit margins in international regions was from 31% in China to 41% in Africa, although this excludes Central & Eastern Europe who reported an average -2% net profit margin.

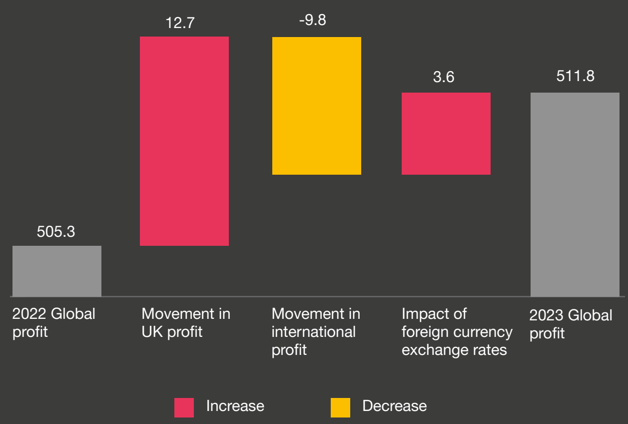
- In Top 11-25 firms, international net profit margins ranged from 6% in China to 27% in Western Europe, with only three of eight regions achieving an average net profit margin in excess of 20%

Global fee income and profits: Source of growth

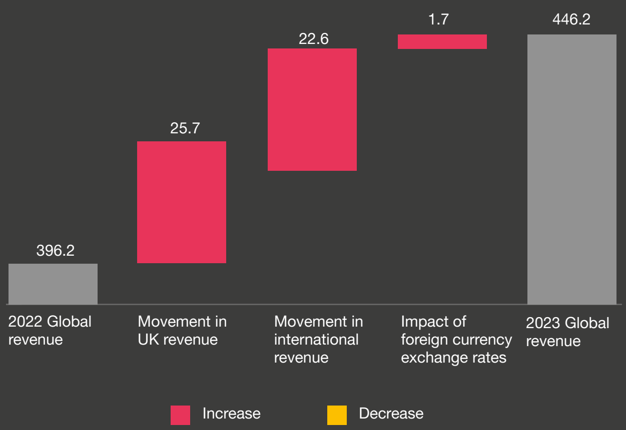
Top 10 Revenue



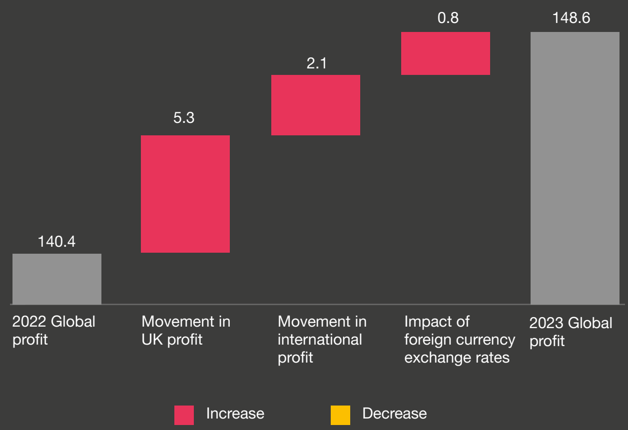
Top 10 Profit



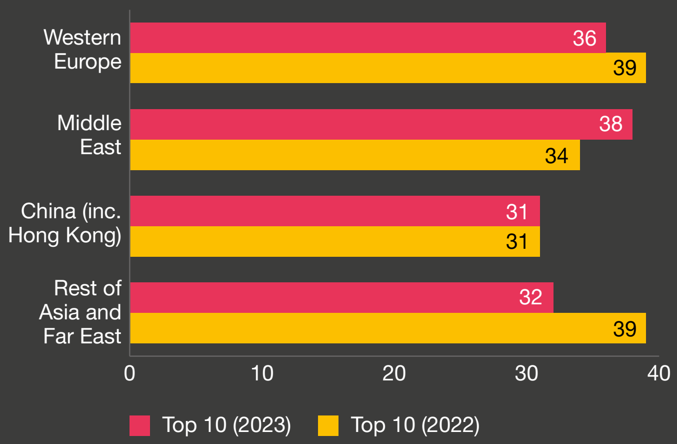
Top 11-25 Revenue

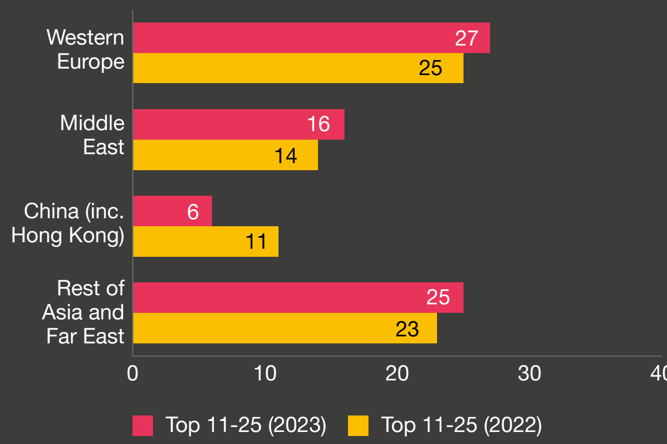


Top 11-25 Profit



International net profit margins for key locations





2. UK financial performance

UK Fees

- Average UK fee income growth across the Top 100 firms was 8.6%, compared to 9.1% in 2022 and 4.4% in 2021.
- All bandings experienced fee income growth, ranging from 8.0% to 9.7% (2022: 6.3% to 12.5%).
- In the Top 100, 95% (2022: 89%) of firms increased fee income.
- Fewer firms achieved double digit growth, 35% in 2023 vs 42% in 2022.
- Fees per fee earner have increased across all bandings, except the Top 11-25 firms, as follows: (i) Top 10, up 5.9% to £504k; (ii) Top 11-25, down 0.3% to £343k; (iii) Top 26-50, up 1.5% to £265k; and (iv) Top 51-100, up 4.1% to £204k.
- Top 10 firms achieved a substantial increase in fees per chargeable hour of 12.3% to £421. Top 26-50 (up 4.2% to £270k) and Top 51-100 (up 6.5% to £231) also reported a rise. Top 11-25 fees per chargeable hour remained consistent with prior year at £312.

UK fee income write offs

- The size of UK fee income write-offs in the Top 10 and 11-25 firms has reduced, with the number of firms reporting total write-offs of less than 5% of fee income increasing to 17% (from 0% in 2022) and 29% (from 14%) respectively.
- In the Top 26-50 firms, the size of fee income write offs are relatively similar to prior year.
- There has been worsening in the size of fee income write-offs in the Top 51-100 firms, with 39% (2022: 29%) of firms recording write-offs of between 15% and 20%.

UK costs

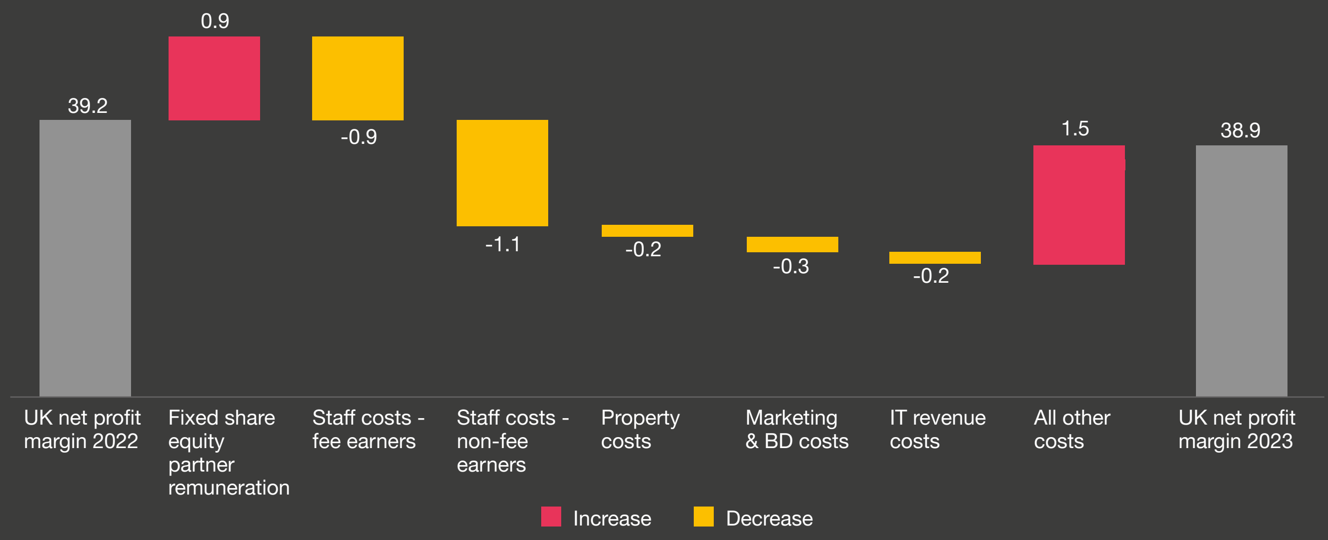
- The staff cost ratio (excluding fixed share equity partner remuneration), has increased across all Top 100 bandings: (i) Top 10, up 2.0 percentage points to 38.1%; (ii) Top 11-25, up 1.3 percentage points to 43.9%; (iii) Top 26-50, up 2.0 percentage points to 45.6%; and (iv) Top 51-100, up 1.6 percentage points to 46.4%.
- Fixed share equity partner remuneration, as a percentage of fee income, fell across the Top 50 bandings: (i) Top 10, down by 0.9 percentage points to 2.6%; (ii) Top 11-25, down by 0.5 percentage points to 6.5%; and (iii) Top 26-50, down by 0.4 percentage points to 8.3%. Contrary to this trend, the Top 51-100 firms increased this ratio by 0.9 percentage points to 8.0%.
- There has been limited movement in the property cost ratio across the Top 50 bandings at no more than 0.3 percentage points. In the Top 51-100, the property cost ratio fell by 0.7 percentage points to 6.9%.
- There has been an increase in certain other cost ratios; for example, IT (now between 3.3% and 4.2% across the bandings) and marketing & BD (between 1.1% and 1.9% across the bandings).

UK profits

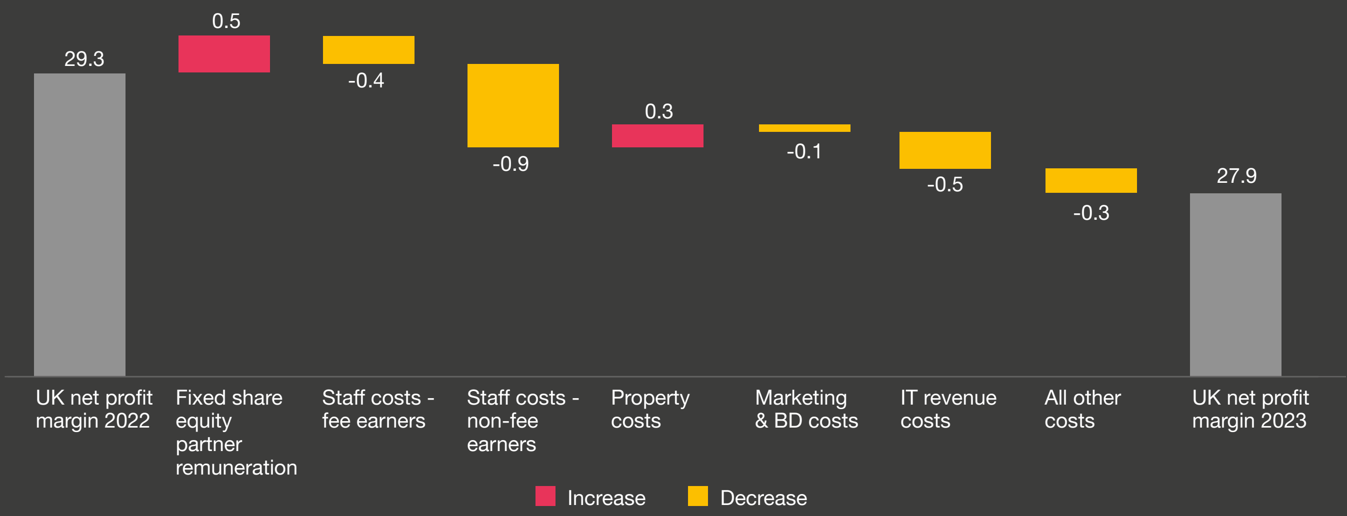
- There has been a reduction in the number of firms achieving profit growth across the Top 50 bandings: (i) Top 10: 67% (2022: 83%); (ii) Top 11-25: 50% (2022: 62%); (iii) Top 26-50: 52% (2022: 67%)
- The number of Top 51-100 firms reporting profit growth is similar to last year (2023: 61%; 2022: 60%).
- The above has impacted net profit margins, with all bandings seeing a fall in this KPI: (i) Top 10: 39.2% to 38.9%; (ii) Top 11-25: 29.3% to 27.9%; (iii) Top 26-50: 27.0% to 25.2%; and (iv) Top 51-100: 24.3% to 23.7%.
- The range of net profit margins continues to be significant: (i) Top 10: 26.3% to 48.9%; (ii) Top 11-25: 12.1% to 45.3%; (iii) Top 26-50: 10.0% to 39.8%; and (iv) Top 51-100: 7.3% to 41.9%.
- Despite the profitability struggles, Top 10 and 51-100 firms were able to increase profit per equity partner: (i) Top 10: up 0.9% to £1,417k; and (ii) Top 51-100: up 3.2% to £479k.
- The remaining bandings did see PEP fall: (i) Top 11-25: down 7.0% to £807k; and (ii) Top 26-50: down 10.8% to £580k.

Net profit margin bridge: 2022 to 2023

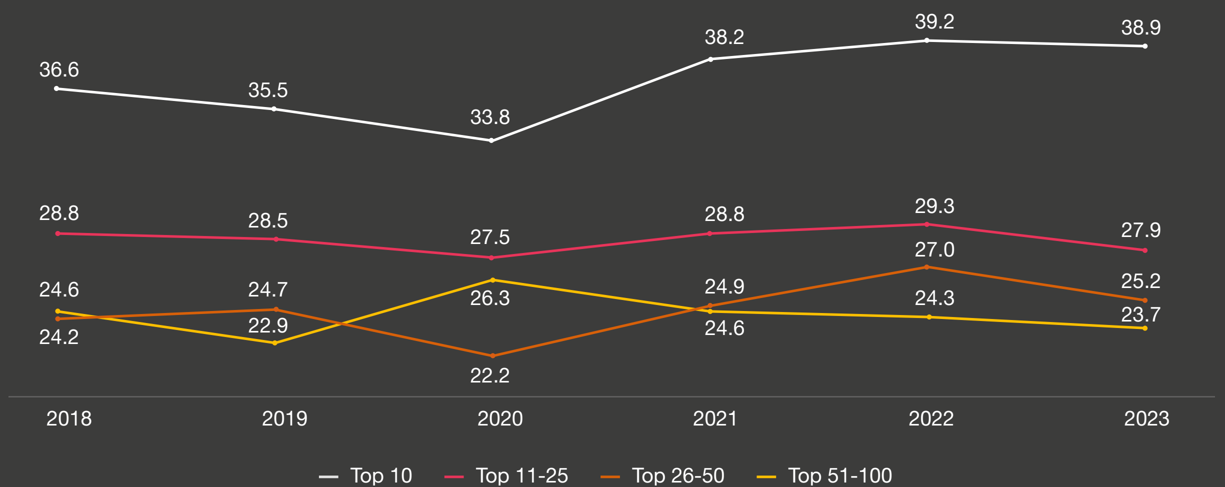
Top 10 average



Top 11-25 average



Movement in UK net profit margins: 2018 to 2023



3. Strategy and transformation

Key concerns and challenges for law firms

- The leading three concerns facing Top 10 law firms are cyber risk, macroeconomic volatility and speed of technological change, with 100%, 100% and 67% respectively being either extremely or somewhat concerned about these areas.
- Top 11-25 and 26-50 firms (86% to 94%) also had cyber risk and macroeconomic volatility as their top two concerns, but their third highest concern was the inability to recover cost inflation through pricing (78% and 82% respectively).
- In the Top 51-100, 78% noted shortage of talent, cyber risk and macroeconomic volatility, as being extremely or somewhat concerning.

Growth strategies

- The organic strategies most Top 10 firms are actively pursuing relate to 'Hiring key practitioners, relationship owners or rainmakers', 'Focused practice / service innovation' and 'Innovative legal service solutions' (all 83%).
- In Top 11-25 firms, 93% are actively pursuing 'Commercial training to partners and fee earners', with 'Innovative legal service solutions' (79%) and 'Improvements in client and account management planning' (71%) also scoring highly.
- In the Top 26-50 and 51-100, the key areas are 'Hiring key practitioners, relationship owners or rainmakers', 'Improvements in client and account management planning' and 'Innovative legal service solutions'.
- In terms of inorganic growth, 'Lateral hires/team grabs' is the only area being consistently pursued by most firms: (i) Top 10: 100%; (ii) Top 11-25: 57%; (iii) Top 26-50: 88%; and (iv) Top 51-100: 78%.

Alternative funding / ownership

- No firms in the Top 100 are actively pursuing alternative funding or ownership structures in the next 3-5 years.
- A small number are considering minority investment from Private Capital investors (Top 10: 17%; Top 11-25: 7%; Top 26-50: 6%; and Top 51-100: 11%).
- The only other area being considered is forming/joining a holding company of legal brands, by 17% of the Top 51-100.

Service Expansion

- 'Legal process outsourcing' (83%) and 'contract/flexible lawyers' (67%) are the most common areas of current service expansion beyond traditional legal services in the Top 10.
- 'Contract/flexible lawyers', 'legal operations consulting' and 'tax consulting and advice' (all at 36%) are most common in Top 11-25 firms.
- For Top 26-50 firms, it is 'tax consulting and advice' (47%), 'ESG consulting' (35%) and 'legal tech consulting' (35%).
- Only a minority of Top 51-100 firms have currently established service expansion beyond traditional legal services.

Competitive threats

- Top 10 firms identified US law firms as their greatest competitive threat and for bandings outside the Top 10, it is their direct peers in the UK.
- Legal functions retaining more work in house is also a recognised competitive threat across Top 100 firms.

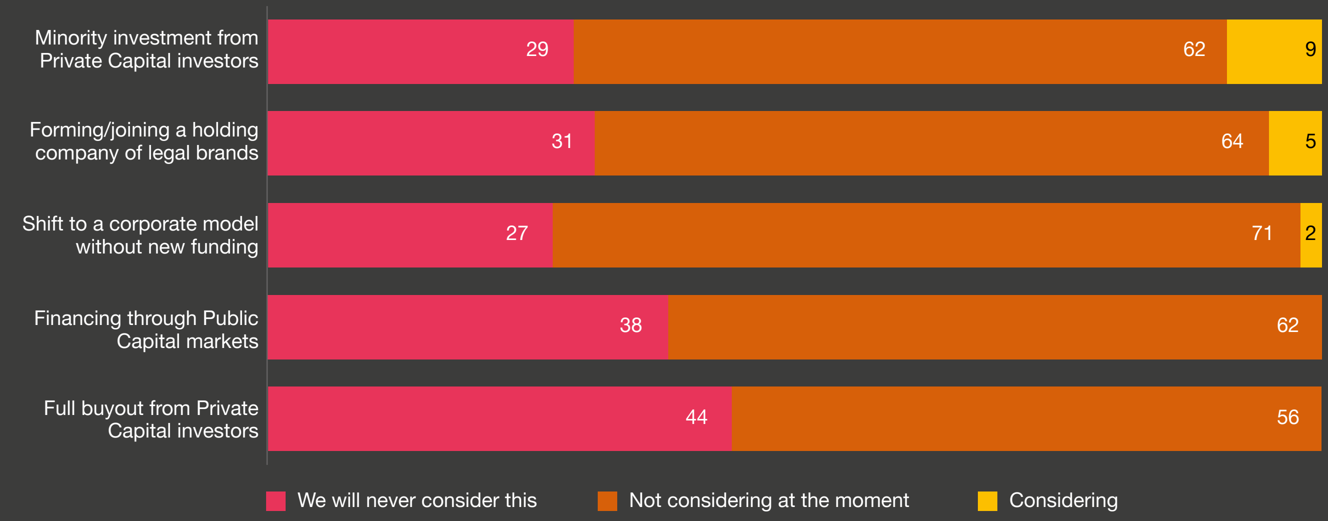
Generative Artificial Intelligence (GenAI)

- AI (100% of Top 25 firms and just over 80% of Top 26-100 firms) and Robotic Process Automation (85% of Top 25; 71% of Top 26-50 and 50% of Top 51-100) are seen as the emerging technologies that will add the most value.
- Approximately two thirds of Top 10, 26-50 and 51-100 firms believe GenAI will help improve revenue and profit margins and this grows to 79% in Top 11-25 firms.

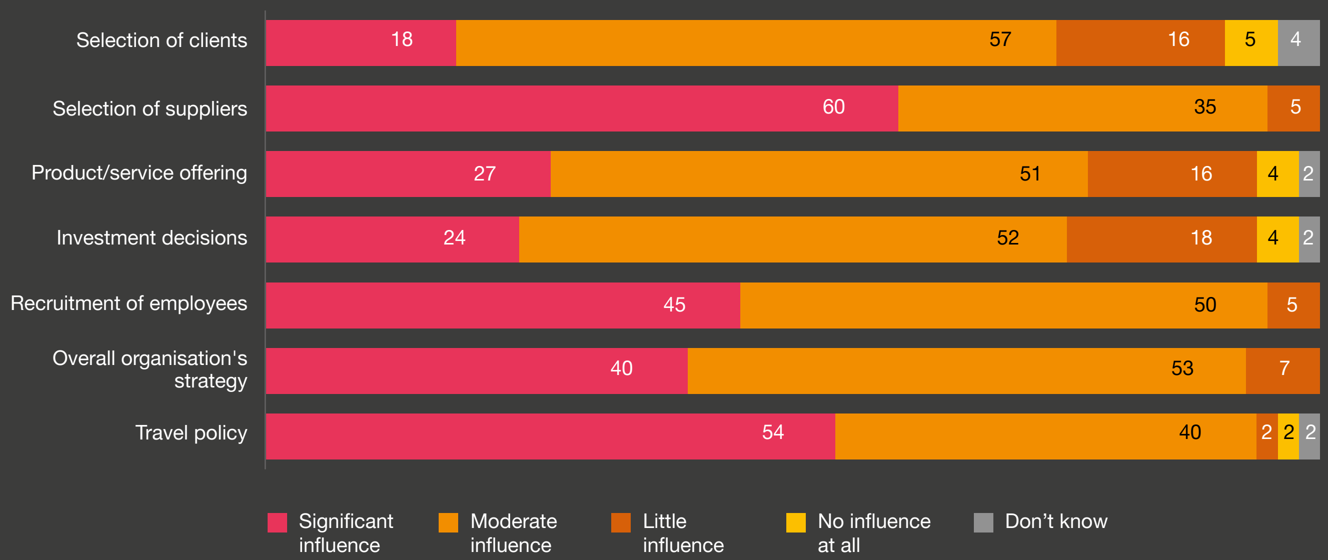
Environmental Social Governance (ESG)

- In the Top 10, 67% believe 'selection of suppliers' will be significantly influenced by ESG over the next five years, with 33% also identifying 'selection of clients' and 'travel policy' as impacted areas.
- In the Top 11-25, 64% indicate that 'selection of suppliers and 'travel policy' will be significantly influenced, with 50% selecting 'recruitment of employees'.
- Of the Top 26-50 firms, 53% identified 'selection of suppliers', 'recruitment of employees', 'overall organisation's strategy' and 'travel policy' as impacted areas.
- Gender representation rates is the most common ESG target (Top 10: 100%; Top 11-25: 93%; Top 26-50: 76%; and Top 51-100: 39%).
- Greenhouse gas emissions and race/ethnicity representation rates are also common in the Top 50 bandings (Top 10: 83% for both, Top 11-25: 64% for both; and Top 26-50: 88% and 71% respectively).
- All Top 10 firms have at least three ESG targets, whilst 7% of Top 11-25, 6% of Top 26-50 and 33% of Top 51-100 firms do not have any ESG targets.

Consideration of alternative funding structures (Top 100 firms)



Influence of ESG over the business model in the next 5 years (Top 100 firms)



4. People

Headcount

- Total UK partners increased across the bandings: (i) Top 10, by 1.0%; (ii) Top 11-25, by 2.3%; (iii) Top 26-50, by 3.3%; and (iv) Top 51-100, by 4.8%.
- Looking at full equity partners, all top 50 bandings saw increases: Top 10 (up 4.6%), Top 11-25 (up 4.3%) and Top 26-50 (up 1.8%), while Top 51-100 firms saw a fall of 3.3%.
- Total UK fee earner headcount (including partners) rose across all bandings: (i) Top 10, by 2.2%; (ii) Top 11-25, by 2.4%; (iii) Top 26-50, by 0.5%; and (iv) Top 51-100, by 2.7%.
- Business support staff headcount also increased: (i) Top 10, by 1.3%; (ii) Top 11-25, by 4.4%; (iii) Top 26-50, by 5.5%; and (iv) Top 51-100 by 3.3%.
- 9+ years PQE have increased in the Top 10 (by 10.6%) and Top 26-50 (by 2.1%), but remained static in the Top 11-25 and 51-100 firms.
- Significant headcount reductions include 6-8 years PQE (10.6%) and newly qualified (9.1%) in the Top 10.

Leverage

- The ratio of fee earners to non-fee earners has increased slightly in the Top 11-25 (1.38 to 1.41) and Top 51-100 (1.74 to 1.76), has fallen slightly in the Top 26-50 (1.72 to 1.63), and in the Top 10 this ratio remained constant with prior year at 1.16.
- The ratio of fee-earners to full equity partners has risen slightly in the Top 11-25 (7.39 to 8.20) and To 51-100 (9.46 to 10.07) and has seen a small fall in the Top 10 (7.07 to 6.76) and Top 26-50 (10.07 to 9.95).

Staff turnover

- Total UK fee-earner turnover (excluding partners) has increased in the Top 10 by 4.4 percentage points ("pp"), but has fallen in all other bandings: (i) Top 11-25, by 2.5pp; (ii) Top 26-50, by 1.2pp; and (iii) Top 51-100, by 0.1pp.
- Overall staff turnover in business support staff ranges from 16.5% in Top 26-50 firms, to 19.4% in the Top 51-100, with only the Top 51-100 reporting an increase in turnover year on year.

Chargeable Hours

- Chargeable hours for full equity partners fell across all bandings by between 5% and 9%.
- Amongst the fee earner population (excluding partners), average chargeable hours remained relatively flat year on year across most grades and bandings, although hours fell at all grades except 9+ years PQE in the Top 26-50.
- The most notable increases were 9+ years PQE in the Top 10 (up 14% to 1,406 hours; albeit, excluding an outlier this would be an increase of 4.4%); and newly qualified in Top 51-100 (up 8% to 968 hours)
- The most notable decreases were trainees in the Top 26-50 (down 6% to 793 hours); and 3-5 years PQE in Top 51-100 (down 5% to 1,026 hours).
- Weighted average chargeable hours per fee earner (excluding partners) has fallen across the Top 100 bandings: (i) Top 10, down by 1.7% to 1,300 hours; (ii) Top 11-25, down by 2.9% to 1,182 hours; (iii) Top 26-50, down by 4.9% to 1,056 hours and (iv) Top 51-100, down by 7.2% to 881 hours.

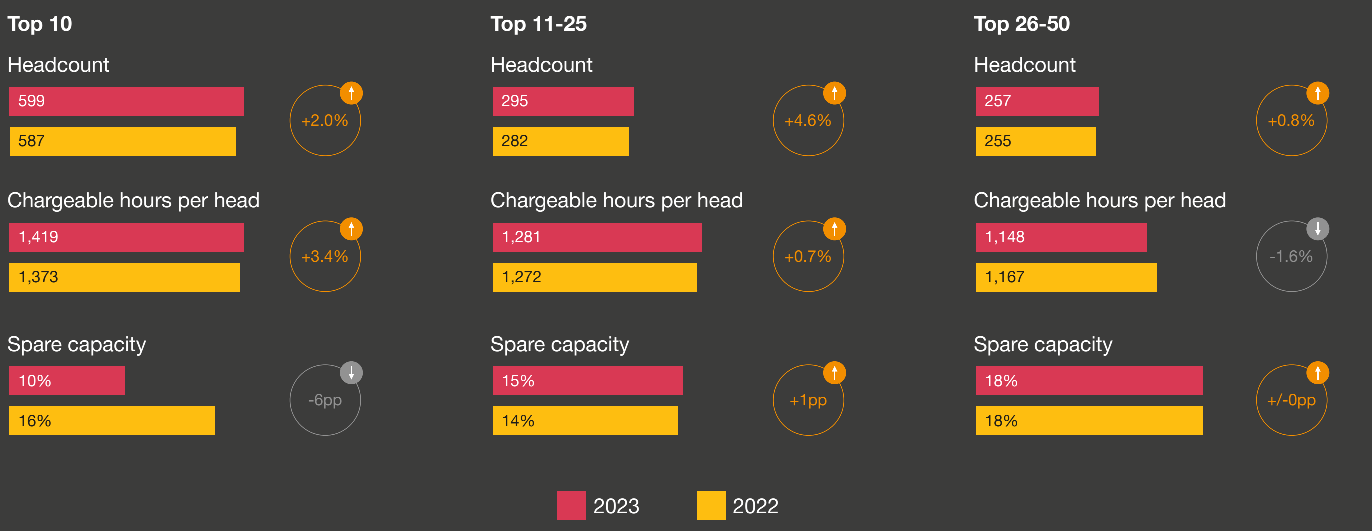
Spare Capacity

- Spare capacity has reduced significantly in the Top 10 for 1-+9 years PQE, from 16% to 10% and is driven by an outlier firm that has increased chargeable hours significantly over the last year; in the absence of this outlier the movement would be a fall of 1 percentage point only.
- Spare capacity has increase or stayed the same (1-+9 years PQE) across the bandings outside the Top 10.
- Spare capacity for all partner grades has increased in all the Top 100 bandings.

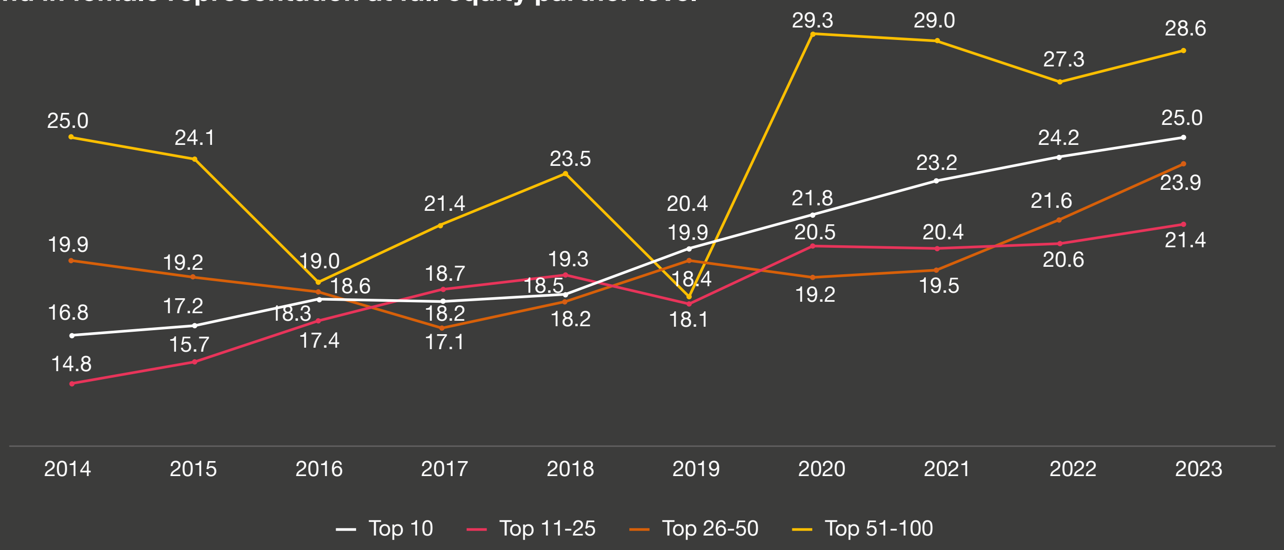
Diversity

- Female representation remains high in the trainee population and has increased in the Top 10 (59.7% to 61.2%) and Top 51-100 (62.6% to 64.6%), but has fallen slightly in the Top 11-25 (64.2% to 62.2%) and the Top 26-50 (63.9% to 63.2%).
- At full equity partner level, female representation has risen across all bandings: (i) Top 10: 24.2% to 25.0%; (ii) Top 11-25: 20.6% to 21.4%; (iii) Top 26-50: 21.6% to 23.9%; and (iv) Top 51-100: 27.3% to 28.6%.
- Minority ethnic representation at the trainee level has increased in the Top 10 (24.0% to 25.8%), Top 11-25 (20.2% to 21.6%), and Top 51-100 (8.3% to 11.4%), but has fallen in the Top 26-50 (16.9% to 15.5%).
- Movement in minority ethnic representation at the full equity partner level is mixed: (i) Top 10: up from 6.5% to 8.8%; (ii) Top 11-25: up from 5.4% to 6.4%; (iii) Top 26-50: down from 4.8% to 4.5%; and (iv) Top 51-100: up from 4.1% to 6.3%.

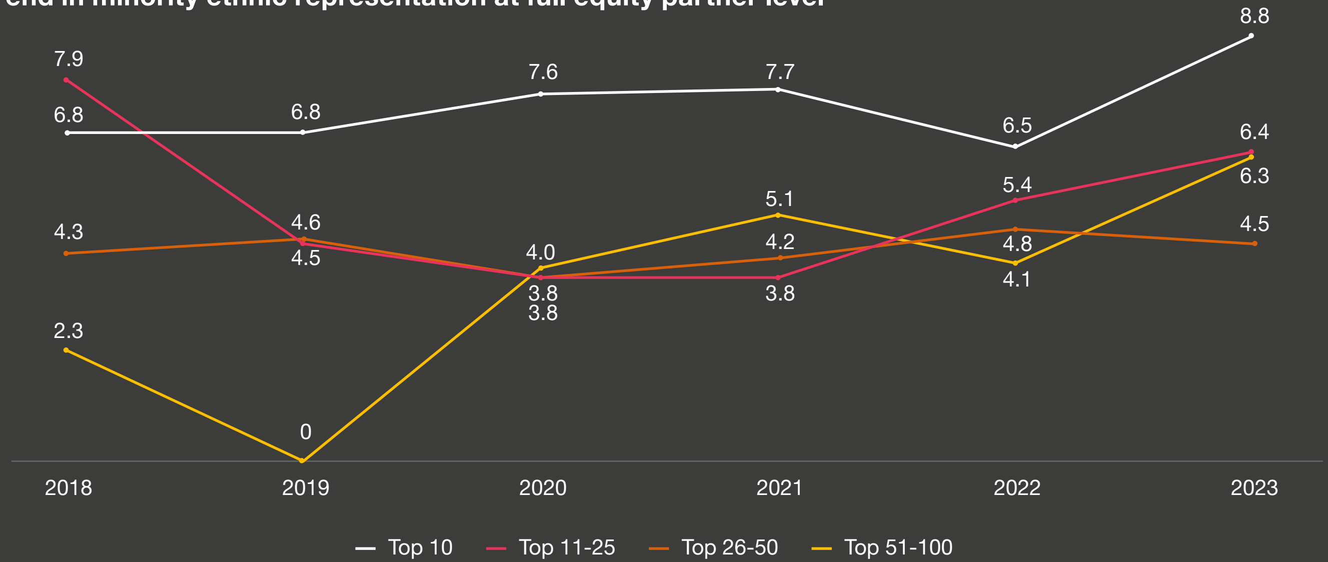
Movement in headcount, chargeable hours and spare capacity (1-+9 years PQE)



Trend in female representation at full equity partner level



Trend in minority ethnic representation at full equity partner level



5. Financing

Lock Up

- Year end lock up days have fallen slightly in Top 10 and 51-100 firms, by 1 day to 130 and by 2 days to 132 respectively; while Top 11-25 and 26-50 firms increased year end lock up by 6 days to 127 and by 1 day to 119 respectively.
- There has been a general improvement in year end WIP days: (i) Top 10, down 3 days to 58; (ii) Top 26-50, down 3 days to 49; and (iii) Top 51-100 down 8 days to 66. Top 11-25 firms held WIP days constant at 44 days.
- Year end debtors days, which were already high, have deteriorated across all bandings: (i) Top 10, up 2 days to 72; (ii) Top 11-25, up 6 days to 83; (iii) Top 26-50, up 4 days to 70; and (iv) Top 51-100, up 6 days to 66.
- Average lock up throughout the year has worsened in Top 10 (up 5 days to 152), Top 11-25 (up 6 days to 145) and Top 26-50 (up 3 days to 142), with Top 51-100 firms holding average lock up steady at 140 days.
- All bandings managed to improve average WIP days: (i) Top 10, down 1 day to 76; (ii) Top 11-25, down 5 days to 58; (iii) Top 26-50, down 3 days to 67; and (iv) Top 51-100, down 3 days to 73.
- Conversely, there has been a significant deterioration in average debtors day, especially in Top 11-25 firms, with movements as follows: (i) Top 10, up 6 days to 76; (ii) Top 11-25, up 11 days to 87; (iii) Top 26-50, up 6 days to 75; and (iv) Top 51-100, up 3 days to 67.
- International lock up has increased at the year end and as an average across the year in both Top 10 and 11-25 firms: (i) Top 10: Year end up 4 days to 149 and average up 7 days to 166; (ii) Top 11-25: Year end up 12 days to 137 and average up 6 days to 148.
- Top 10 and 11-25 firms did improve year end international WIP days, by 3 days to 57 and by 1 day to 49 respectively; however, the deterioration in debtor days was greater: (i) Top 10, up 6 days to 91; and (ii) Top 11-25, up 11 days to 97.
- Top 10 firms increased both international average WIP and debtor days, by 2 days to 76 and by 5 days to 90 respectively.
- Top 11-25 firms managed to reduce international average WIP days by 7 days to 50; however, international average debtors rose by 13 days to 98.

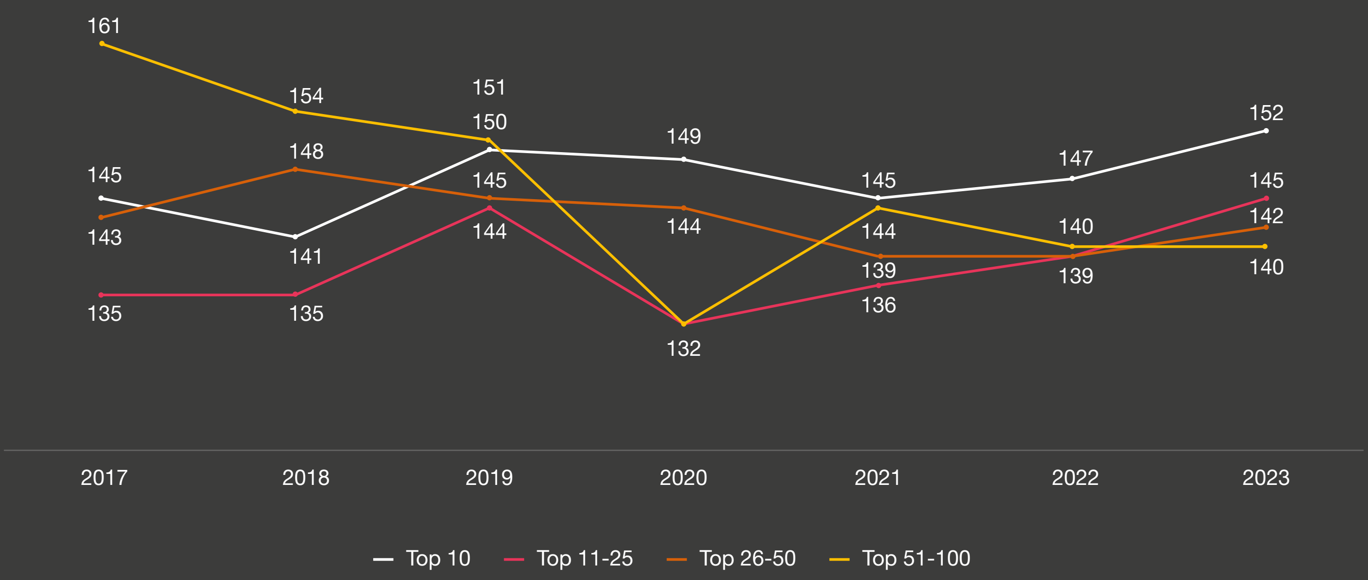
Financing

- There have been movements in the proportion of UK financing attributable to partner capital accounts, partner current accounts and external financing across all Top 100 bandings, but the movement in the Top 26-50 has been very limited (1 percentage point movement in partner capital and current accounts).
- In Top 10 firms, there has been an increase of 3 percentage points in partners' fixed capital accounts to 34%, while partners' current accounts have dropped by the same amount to 56% and direct external funding has remained consistent at 10%.
- Top 11-25 firms have reported a significant increase in the proportion of financing coming from external funding, from 8% last year to 22% this year; this is influenced by significant outliers and on a like for like basis the increase is only 7 percentage points.
- Top 51-100 firms have increased the proportion of financing from partners' current accounts by 5 percentage points to 52%, with partner capital accounts falling by 5 percentage points to 32%; external funding remained consistent at 16%
- Bandings outside the Top 10 increased capital account balances per full equity partner as follows: (i) Top 11-25, up 1.2% to £260k; (ii) Top 26-50, up 4.6% to £273k; and (iii) Top 51-100, up 15.1% to £213k.
- Top 10 firms' capital account balances per partner stayed relatively consistent with prior year at £373k (down 0.3%).
- Bandings outside the Top 10 reported a fall in current account balances per full equity partner: (i) Top 11-25, down 5.9% to £668k; (ii) Top 26-50, down 19.2% to £433k; and (iii) Top 51-100, down 5.8% to £371k.
- Top 10 firms' current account balances per full equity partner increased by 4.6% to £947k.

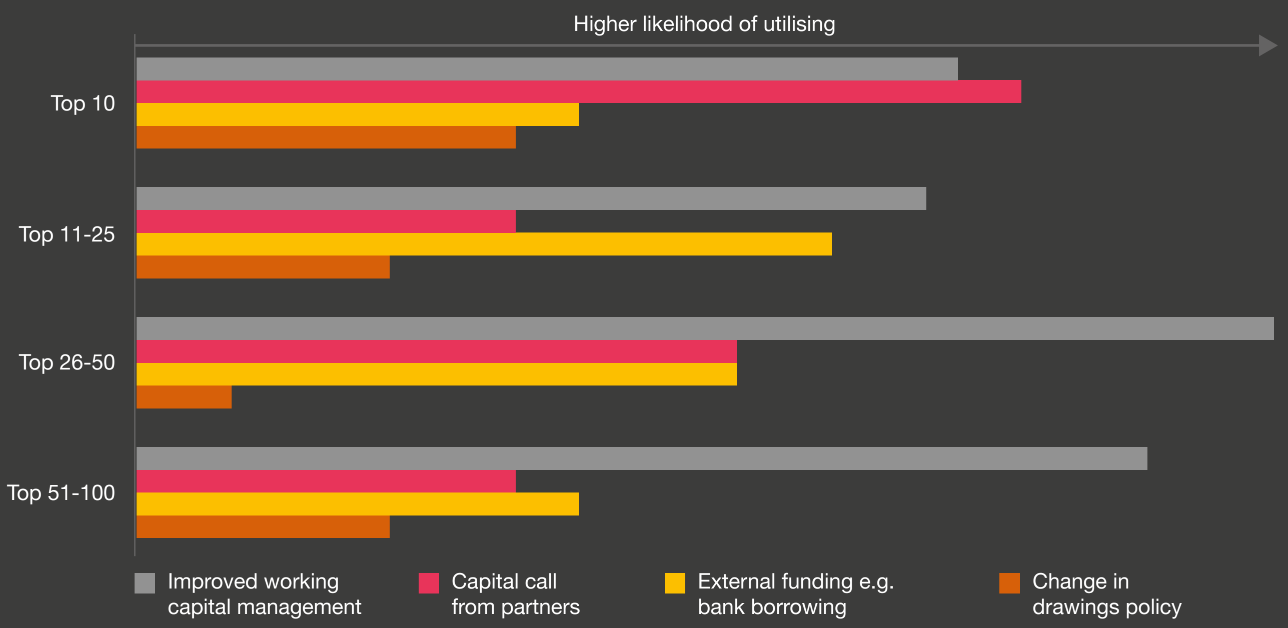
Basis period reform

- A number of Top 100 firms are planning to change their year end in response to basis period reform: (i) Top 10: 20%; (ii) Top 11-25: 38%; (iii) Top 26-50: 31%; and (iv) Top 51-100: 67%.
- Almost all Top 100 firms are planning to take advantage of the HMRC allowance to spread the impact of basis period reform over 5 years: (i) Top 10: 100%; (ii) Top 11-25: 85%; (iii) Top 26-50: 94%; (iv) Top 51-100: 93%.
- 'Capital call from partners' (60%) and 'improve working capital management' (40%) are the two main sources of funding for basis period reform for Top 10 firms.
- Bandings outside the Top 10 identified 'improve working capital management' as the main source of funding for basis period reform: (i) Top 11-25: 50%; (ii) Top 26-50: 71%; and (iii) Top 51-100: 64%.

Trend in UK average lock up days: 2017 to 2023



Plans to fund basis period reform



6. Business support and risk

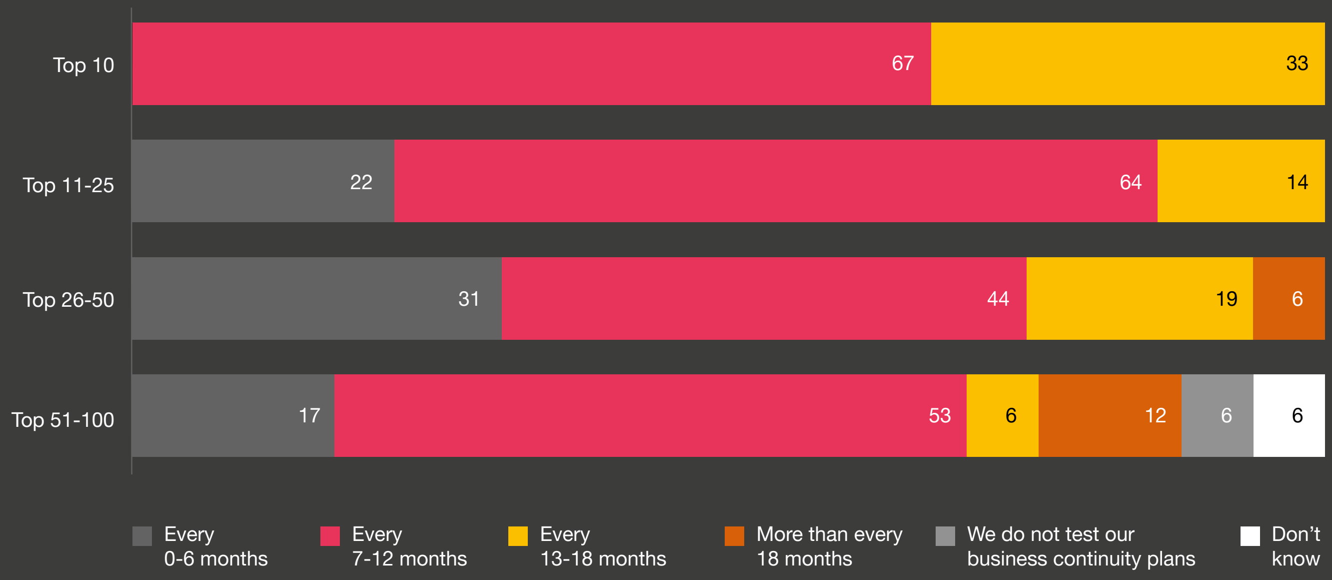
Business support

- 'Improve working capital performance' is the top priority for Top 10 and 11-25 business support functions, with 'standardise and centralise processes' also an important priority.
- Top 26-50 firms are mainly focussing on 'reduce cyber risk' and 'support improvements in legal service offering', whilst Top 51-100 are targeting 'use data analytics to make informed and timely decisions' and 'improve working capital performance'.
- Average IT spend per user has increased in the Top 10 (by 19% to £11.9k), Top 26-50 (by 1% to £8.6k) and 51-100 (by 12% to £7.6k), whilst falling in Top 11-25 (by 1% to £9.1k).
- Average investment in legal technologies (defined as innovative technology and software deployed to streamline and enhance service offerings) has increased across all bandings: (i) Top 10, by 52% to £2,160k; (ii) Top 11-25, by 13% to £1,716k; (iii) Top 26-50, by 65% to £1,454k; and (iv) Top 51-100, by 16% to £588k.
- Over the next two years, 83% of Top 10 firms intend to move 'work allocation' to a more technology-based or automated solution.
- In Top 11-25 firms, 57% identified 'learning and development', 'offboarding' and "onboarding' as areas for more technology based/ automated solutions.
- 'Cloud modernisation & migration' is the primary IT strategic priority for the next 1-2 years across all bandings: (i) Top 10: 83%; (ii) Top 11-25, 26-50 and 51-100: approximately 50%.
- Reducing cost is the lowest IT strategic priority across the Top 100 firms, illustrating the recognition from law firms that they need to invest in IT.
- In noting the above, a number of firms outside the Top 10 cited 'budget' as a key barrier for migrating to Cloud: (i) 50% of Top 11-25; (ii) 35% of Top 26-50; and (iv) 39% of Top 51-100.
- In the Top 10, the main barriers were privacy/ security concerns, general understanding of the Cloud at senior level and capabilities and expertise (50% of the Top 10 in each of these categories).

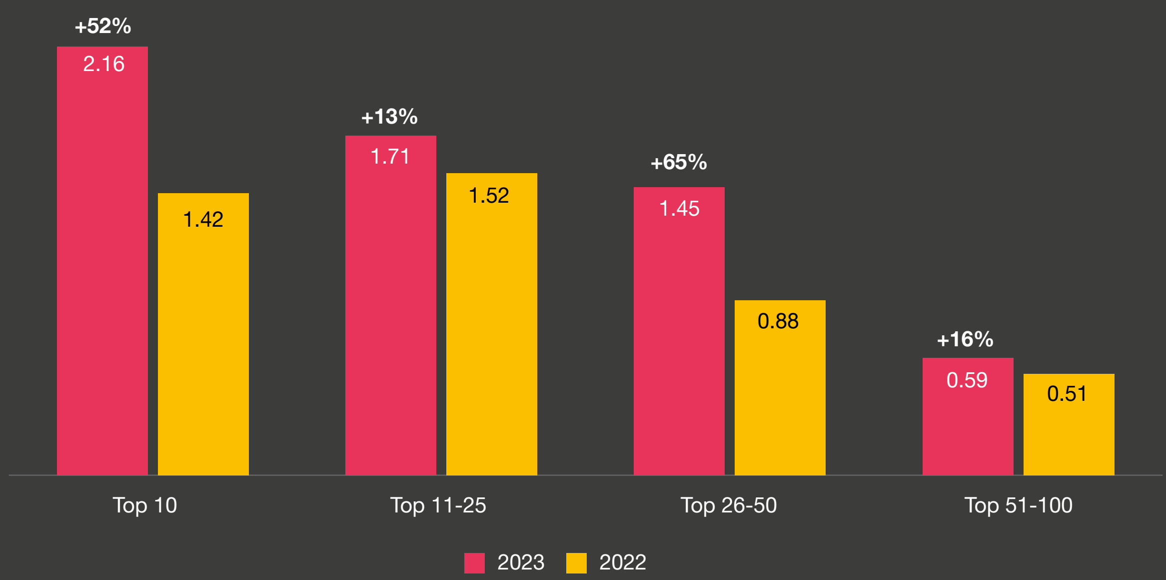
Cyber risk and security

- In the Top 10, 100% reported that they had a dedicated Cyber Security Chief or equivalent with responsibility for cyber security, with 64% of Top 11-25, 24% of Top 26-50 and 11% of Top 51-100 reporting the same.
- There are fewer firms across the bandings (except Top 11-25) who perform business continuity plan testing at least every twelve months when compared with prior year: (i) Top 10: 85% to 67%; (ii) Top 11-25: 79% to 86%; (iii) Top 26-50: 83% to 75%; and (iv) Top 51-100: 75% to 70%.
- A third of the Top 100 firms have not had senior management participate in a crisis management exercise in the last twelve months.

Regularity of business continuity plan testing



Average investment in legal technologies (£'m)



Appendix:
Key performance indicators

Key performance indicators (UK)

Top 10	2018	2019	2020	2021	2022	2023
UK fees per chargeable hour (£)	302	315	331	347	375	421
UK fees per full equity partner (£000)	2,935	3,063	3,187	3,360	3,649	3,668
UK fees per fee earner (£000)	395	415	414	442	476	504
UK profit per full equity partner (£000)	1,066	1,120	1,067	1,275	1,404	1,417
UK profit per fee earner (£000)	152	155	148	179	196	205
Profit margin (%) – before full equity partner remuneration	36.6	35.5	33.8	38.2	39.2	38.9
Staff cost ratio (%)	39.4	37.9	38.9	37.1	36.1	38.1
1->9 year PQE fee earner utilisation (hours)	1,478	1,465	1,341	1,387	1,379	1,419
Lock up days (year end)	123	122	120	115	131	130
Average number of full equity partners-UK	142	146	151	153	153	160
Average number of fee earners (incl. partners)-UK	1,065	1,165	1,137	1,107	1,116	1,141

Top 11-25	2018	2019	2020	2021	2022	2023
UK fees per chargeable hour (£)	266	285	300	293	312	312
UK fees per full equity partner (£000)	2,416	2,491	2,473	2,450	2,791	2,872
UK fees per fee earner (£000)	303	325	321	332	344	343
UK profit per full equity partner (£000)	729	734	710	768	868	807
UK profit per fee earner (£000)	95	98	95	106	106	104
Profit margin (%) – before full equity partner remuneration	28.8	28.5	27.5	28.8	29.3	27.9
Staff cost ratio (%)	41.8	41.1	41.4	42.7	42.6	43.9
1->9 year PQE fee earner utilisation (hours)	1,309	1,347	1,289	1,339	1,272	1,281
Lock up days (year end)	122	121	115	109	121	127
Average number of full equity partners-UK	74	70	72	73	69	72
Average number of fee earners (incl. partners)-UK	644	653	575	574	579	593

Top 26-50						
	2018	2019	2020	2021	2022	2023
UK fees per chargeable hour (£)	213	228	223	225	259	270
UK fees per full equity partner (£000)	1,974	2,037	2,228	2,149	2,494	2,432
UK fees per fee earner (£000)	224	237	223	224	261	265
UK profit per full equity partner (£000)	467	516	467	516	650	580
UK profit per fee earner (£000)	61	68	55	61	76	73
Profit margin (%) – before full equity partner remuneration	24.2	24.7	22.2	24.9	27.0	25.2
Staff cost ratio (%)	42.3	43.2	45.1	42.7	43.6	45.6
1->9 year PQE fee earner utilisation (hours)	1,230	1,235	1,216	1,210	1,167	1,148
Lock up days (year end)	129	128	126	116	118	119
Average number of full equity partners-UK	59	59	57	54	56	57
Average number of fee earners (incl. partners)-UK	536	513	539	528	553	556

Top 51-100						
	2018	2019	2020	2021	2022	2023
UK fees per chargeable hour (£)	201	200	213	206	217	231
UK fees per full equity partner (£000)	1,630	1,959	1,792	1,855	1,947	2,139
UK fees per fee earner (£000)	183	188	207	191	196	204
UK profit per full equity partner (£000)	381	460	452	445	464	479
UK profit per fee earner (£000)	47	49	58	52	52	52
Profit margin (%) – before full equity partner remuneration	24.6	22.9	26.3	24.6	24.3	23.7
Staff cost ratio (%)	44.7	45.3	44.7	45.5	44.8	46.4
1->9 year PQE fee earner utilisation (hours)	1,122	1,122	1,139	1,086	1,050	1,024
Lock up days (year end)	135	133	119	120	134	132
Average number of full equity partners-UK	27	25	28	29	30	29
Average number of fee earners (incl. partners)-UK	229	330	244	256	262	269

Key performance indicators (Global)

Top 10	2018	2019	2020	2021	2022	2023
Fees per all partners (£000)	2,065	2,154	2,167	2,213	2,320	2,534
Fees per fee earner (£000)	408	410	387	415	432	474
Profits per all partners (£000)	810	916	804	927	977	998
Profits per fee earner (£000)	158	158	142	171	180	186
Profit margin (%) – before full and fixed equity partner remuneration	37.9	38.0	35.2	39.9	40.4	38.2
Staff cost ratio (%)	40.3	39.4	40.6	38.6	38.0	40.7
Average number of all partners – global	473	481	489	499	510	500
Average number of fee earners (incl. partners) – global	2,354	2,640	2,666	2,592	2,671	2,634

Top 11-25	2018	2019	2020	2021	2022	2023
Fees per all partners (£000)	1,052	1,102	1,162	1,221	1,220	1,304
Fees per fee earner (£000)	270	293	285	310	321	336
Profits per all partners (£000)	362	370	375	431	454	448
Profits per fee earner (£000)	93	98	92	109	119	115
Profit margin (%) – before full and fixed equity partner remuneration	34.3	33.6	31.7	34.1	34.1	35.4
Staff cost ratio (%)	42.0	43.0	44.1	43.7	43.0	42.1
Average number of all partners – global	237	246	253	280	315	338
Average number of fee earners (incl. partners) – global	995	939	1,069	1,128	1,291	1,385

Notes

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