

THE BENEFITS OF PERFORMANCE DISCLOSURE

Lack of transparency is not helpful to stakeholders

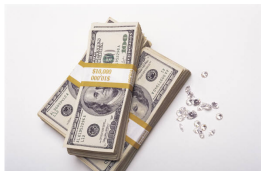
(Sep – Oct 04)

A plethora of surveys have been published over the northern summer and considerable press coverage has resulted. Among the surveys are the Legal 100, The Legal Business Global 50 and The American Lawyer 200. The reports were accompanied by a degree of hype not seen in the southern hemisphere and included performance information such as fees, profits and client lists.

The prospect of similar rankings being published here concerns some who have expressed reservations at the prospect of staff and clients having access to performance data. These people miss two essential points: there is considerable misinformation/conjecture already in the market, and calculating real information is a relatively straightforward process. In my experience most assistants overestimate their own firm's profits and partners' incomes, quite often by a considerable amount. As for clients, their perpetual 'beef' is fee increases that have exceeded CPI by a comfortable margin for decades. This leads many to get deeply cynical about partnership profits and overheads. A report in the UK broadsheet 'The Independent' of Tuesday 31st August raised a few eyebrows about earnings growth compared to the private sector and raised the spectre of '**profit before ethics**'. Some firms are cited as having seen partner incomes grow by 100%+ in 6 years.

Disclosure is already occurring at one level in Australasia. A major publishing house has recently purchased a benchmarking facility in Australia in which ± 7 New Zealand law firms participate. This could indicate that those participating firms are happy to share information among themselves but not have it 'published', begging the question, why? It is worth noting that information 'leakage' is rife. Restricted circulation and other constraints do not prevent locally generated reports reaching London and elsewhere.

Law firm performance need not be a mystery. A pocket calculator, some public domain information and the application of some common sense should enable anyone to work out, with a high level of accuracy, the total fee income of ANY firm. The more difficult aspect is margin. Here too, public domain information is available. Regular reading of the commercial and specialist press frequently reveals margin information. Some partners just don't seem to be able to keep figures to themselves when confronted with good journalists. For example, an article in the Australian 'BRW' of 5th August 2004 gave informed readers the opportunity to calculate profits at Freehills.



All this misses the point about the purpose of benchmarking and who might benefit from performance disclosure. Benchmarking at its simplest is a chance for firms to see how they measure up to their competitors and to see what operational adjustments can be made to lift future performance. This is based on an underlying assumption that continuous improvement can be an achievable goal. It may be interesting to note that in jurisdictions where performance indicators are in the public domain, productivity increases have occurred faster than elsewhere. Chargeable time and utilisation rates continue to improve in England and the US but, for many, have become 'stuck' in New Zealand and Australia.

As for the specific information in the overseas public domain, the following measures have come to be adopted as 'norms':

- Turnover + change on previous year
- Net income (profit margin)
- Revenue generation (costs per lawyer + profits per lawyer = revenue per lawyer)
- Profit per partner (PPP)

Inevitably this is what grabs the headlines and some truly staggering information is published. For example average partner earnings (PPP) at US firm Sullivan & Cromwell were NZ\$3,135,440 for 2003, taking average exchange rates into account. Not surprisingly no Australasian firms made it into the top 50. A few firms outside the top 50 generate even higher profits but lack the critical mass to make the top 50 league table.

For the curious, set out below are the 'raw' performance details of the top 5 firms in the 'Global 50', based on gross revenue figures. All figures are in £Sterling. The Source of the information is Legal Business, issue 146 (August 2004). The publication is available on subscription.

Firm name + home city	Gross fees (2003) £Ms	Profit margin %	Profit per partner £	Top 5 clients by billing value
Clifford Chance (London)	950	24%	558,000	Barclays Citigroup Deutsche Bank JP Morgan Chase Merrill Lynch
Skadden, Arps, Slate, Meagher & Flom (New York)	855.6	43%	995,000	Cendant Citigroup Deutsche Bank Goldman Sachs JP Morgan Chase
Baker & McKenzie (Chicago)	830.8	27%	363,000	BP Hutchison Pepsi-Cola Shell Sony
Freshfields Bruckhaus Deringer (London)	800	43%	665,000	Deutsche Bank Goldman Sachs Hewlett-Packard Kingfisher P&O
Linklaters (London)	720	32%	670,000	Citigroup CSFB Ernst & Young PricewaterhouseCoopers RBS

The dominance of financial institutions among the client base is clear and seemingly Deutsche Bank and Citigroup have no problems with the different margin earned by the various firms they instruct.

Hopefully the local profession will embrace the benefits of disclosure if only to quell propagation of misleading information!

As firms grow to sizes unimaginable only a decade or so ago partnership as an operating structure is under pressure internally and externally. Some partnerships have already abandoned the notion of equality of income under 'lock-step' arrangements, yet are forced to retain joint and several liabilities for any debts. In the management context law firms do not demonstrate unique organisational behaviour and follow other major service industries. If financial services are used as an example for comparative purposes, growth of banking partnerships occurred to a point where further expansion was frustrated by inadequacies in their capital base. Banking partnerships became 'joint stock' companies and the number of banks declined. If this pattern is repeated in legal services consolidation may reach a point where partnerships will be unable to operate without external capital. This may lead to the creation of limited liability or other similar structures. Taken a stage further, it is debatable whether New Zealand can support the current number nearly 1400 law firms. At the top end there are too many firms chasing too little public/large company work and conversely the demand for very diverse services from sole principals introduces some risk.

The inevitable outcome of structural change from partnership to some form of limited liability is financial disclosure, particularly among the 'great and the good'. No bank is going to risk lending tens of millions to a law firm to buy its competitor or fund an IPO if secured by a series of complex family trusts and skills that come up in the lift each day.