The profitability rankings of the top 50 UK law firms are not just a means for partners to keep score with their colleagues in rival firms — they are becoming more relevant in the search for the best clients, argues Tony Williams

Tiers that bind

The recent profitability tables of the top 50 UK-based law firms (*Legal Week* 20 July) demonstrate that the fragmentation of the UK market which became evident a couple of years ago is now established.

The figures must be viewed with some caution. Figures in any one year may be distorted by special factors, including a premises move or the cost of partner de-equitisation. As an increasing number of firms become limited liability partnerships, audited figures will become available using similar accounting conventions, thereby enabling effective comparison between rival firms. In the meantime, variations between firms in profit per equity partner and revenue per fee earner of up to 5% can probably be discounted as 'rounding differences'.

Our first analysis was to look at profit per equity partner. Any firm can rapidly increase its profits if it starves investment in recruitment, training and IT so a sustainable trend of improving profit per equity partner (PEP) is far more relevant as to a firm's position in the market.

We identified four clear tiers of firms based primarily on PEP.

Magic circle

Although firms in this elite group are not always the most profitable, they have developed an enviable position in the market. They have a breadth and depth of practice and reputation that, subject to client conflicts, almost gives this group a right of pre-emption to be involved in any major corporate or financing transaction.

There are, however, interesting variations between the firms. Slaughter and May is by far the smallest magic circle firm and primarily operates internationally via top-ranked 'best friends'.

This is the Cravath Swaine & Moore of London. It remains highly profitable but faces an increasing challenge in the international deal league tables.

Allen & Overy — traditionally one of the most profitable magic circle firms — put in a slightly disappointing performance. This may be due to its underweight corporate practice, compared with the rest of the magic circle, or it could be connected to its forthcoming London office move.

The stars

These firms are generally as or more profitable than the magic circle. They have especially strong practices, often in corporate. However, they probably lack the geographic and/or practice depth or breadth of the magic circle. These firms have performed strongly and, with the magic circle, have placed clear blue water between themselves and the rest of the UK market. Together with the magic circle, they constitute the premier league of UK firms. Indeed, it is likely that the strengthening London and European practices of the major US firms are — and will be — far more potent competition for the premier league firms in the UK than the firms currently occupying the lower tiers.

The inbetweenies

These firms have produced good earnings growth and are now generating profits of not less than £550,000 per equity partner. However, this tier is unlikely to last long. Firms will either move up or down from this tier as the stratification of the market becomes more apparent. Berwin Leighton Paisner, after very strong growth over the past few years, is the most likely candidate for promotion to the next tier — if it can maintain that momentum.

The solid ones

As we work through the tiers, the differences between firms become less stark. The firms here are performing well, in some cases after a difficult few years.

This group will see considerable flux. Some may merge in the UK, others will contemplate a US merger (Richards Butler has already agreed to merge with Reed Smith) and some will drift off the pace. But the firms below this tier will face an even more uncertain future.

Unfortunately, in the legal sector there is no one killer statistic to use for ranking law firms. Above, we used PEP as a proxy for a well-run, profitable and well-regarded practice.

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In the magic circle, Slaughter and May is the most profitable firm and uses very few non-equity partners

UK LAW FIRM RESULTS YEAR TO 30 APRIL, 2006

Firm	PPEP (£m)	Turnover partners	Equity partners	Non-equity fee earner (£k)	Revenue per partner
Magic circle					
Slaughter and May	1,100	350	120	9	459.9
Linklaters	1,062	935	400	122	362.3
Freshfields	830	882	521	0	349.7
Clifford Chance	810	1030	380	195	320.8
Allen & Overy	788	736	342	82	324.8
The stars					
Macfarlanes	940	92	45	20	353.8
Herbert Smith	839	296	120	86	280.6
SJ Berwin	711	155	83	59	274.3
Travers Smith	705	68.1	47	9	302.7
Ashurst	701	214	125	27	295.2
The inbetweenies					
Berwin Leighton Paisner	630	145	74	71	289.4
DLA Piper	604	366.7	135	324	203.5
Lovells	572	396	232	85	271.2
Taylor Wessing	571	79.1	55	44	243.4
The solid ones					
Olswang	531	77.7	45	28	281.5
Irwin Mitchell	525	112	52	44	120.7
Clyde & Co	500	125	81	55	247.5
Richards Butler	500	90	54	42	240.0
Field Fisher Waterhouse	485	60	39	48	199.3
CMS Cameron McKenna	476	181.3	130	0	217.1
Trowers & Hamlins	472	56.4	23	54	268.6
Addleshaw Goddard	472	161.2	110	61	226.7
Simmons & Simmons	470	227	146	73	204.7
Lawrence Graham	465	66	51	39	240.9
Nabarro Nathanson	451	107.3	82	27	237.9

Source: Jomati Consultants

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It is not quite that simple. The use of non-equity partners has a major distorting effect on profit per partner. In the magic circle, Slaughters is the most profitable firm and uses very few non-equity partners. Indeed, the tightness of its equity and the quality of its partners is its key selling point. If Freshfields Bruckhaus Deringer used non-equity partners to the same extent as Clifford Chance and Linklaters or perhaps applied harder performance criteria to its existing equity partners, based on its revenue per lawyer it would be significantly more profitable.

The recent announcement of the 'retirement' of 30 Freshfields partners should significantly address this issue. Elsewhere the use of non-equity partners is more mixed; from CMS Cameron McKenna with none, to DLA Piper with plenty. To be a senior equity partner in DLA Piper it helps to be called Nigel.

Revenue per fee earner is a useful indication of the quality of a firm's practice, the price it can charge and the consistency of its pipeline of work.

We identified five tiers of firms on the basis of revenue per fee earner. From this table a number of factors are clear. In the magic circle, the sheer quality of the Slaughters offering shines through. As a relatively small firm it is not as tempted to do the more routine and price-sensitive work undertaken by its magic circle colleagues. The Linklaters efficiency drive of recent years has clearly borne results, but the rest of the magic circle are closely grouped. Macfarlanes is the only other firm that achieves comparable revenue per fee earner. For many firms the challenge is to significantly improve their revenue per fee earner. For firms seriously aspiring to be members of 'the stars' group, revenue per fee earner of £275,000 is necessary. It is noticeable how the use of non-equity partners, which can have such a profound effect on profits per equity partner, tends to unwind when looking at revenue per fee earner.

THE LINKLATERS EFFICIENCY DRIVE OF RECENT YEARS HAS CLEARLY BORNE RESULTS, BUT THE REST OF THE MAGIC CIRCLE ARE CLOSELY GROUPED

The most noticeable example is DLA Piper, which has strong equity partner profits but far less impressive revenue per fee earner of £203,500, significantly below the leading national firm, Addleshaw Goddard, and below the recently troubled Hammonds.

These rankings are not just a means for partners too keep score with their colleagues in rival firms. They are becoming more relevant in the search for the best clients and for attracting and retaining the best legal talent. As client panel reviews become more rigorous, clients will increasingly look for firms that have the expertise they require, are stable and offer a pricing model appropriate to the work being outsourced.

For more complex work, the magic circle and star firms are likely to be approached first alongside those US firms with the necessary breadth and depth in London. With the better performing firms entering a virtuous circle of better work and better profitability, talented partners and associates will migrate to them.

Law firm leadership will need to be increasingly realistic as to their position in this fragmenting market. If they wish to move to a higher tier they will need to outperform the market consistently over several years. This will not be easy to achieve and will require a clear strategy executed with determination and rigour. It will be far easier to sleepwalk into relegation than to gain promotion to the next tier and to stay there.

Tony Williams is the founder of Jomati Consultants.

UK LAW FIRMS REVENUE PER FEE EARNER YEAR TO 30 APRIL, 2006

Firm	Revenue per fee earner (£k)
Magic circle	
Slaughter and May	459.9
Linklaters	362.3
Freshfields	349.7
Allen & Overy	324.8
Clifford Chance	320.8
Revenue per fee earner over £275k	
Macfarlanes	353.8
Travers Smith	302.7
Watson Farley & Williams	300.6
Ashurst	295.2
Berwin Leighton Paisner	289.4
Olswang	281.5
Herbert Smith	280.6
Revenue per fee earner £250k-£275k	
SJ Berwin	274.3
Lovells	271.2
Trowers & Hamlin	268.6
Holman Fenwick & Willan	267.8
Revenue per fee earner £225k-£250k	
Clyde & Co	247.5
Taylor Wessing	243.4
Lawrence Graham	240.9
Barlow Lyde & Gilbert	240.6
Richards Butler	240.0
Nabarro Nathanson	237.9
Withers	233.0
Stephenson Harwood	231.1
Addleshaw Goddard	226.7
Revenue per fee earner £200k-£225k	
Denton Wilde Sapte	224.2
Ince & Co	218.3
CMS Cameron McKenna	217.8
Norton Rose	213.8
Hammonds	212.8
Bird & Bird	211.6
Simmons & Simmons	204.7
DLA Piper	203.5
Burges Salmon	202.2

Source: Jomati Consultants