



Crowe Horwath Financial Performance Benchmarking Study of Australian Law Firms

Crowe Horwath are delighted to partner with Australian Legal Practice Management Association (ALPMA) to deliver the financial performance benchmarking study of Australian law firms.

This landmark study has been produced using Crowe Horwath’s proprietary benchmarking tool, Open Measures (www.openmeasures.com.au), enabling Australian law firms to compare the financial health of their practices to that of other firms. Below is a guide to the definitions and calculations used.

PROFITABILITY

Gross Contribution %	$\frac{\text{Gross Profit Contribution}}{\text{Revenue}}$	<p>Gross Contribution Margin represents the percentage of revenue left after direct professional staff costs have been covered.</p> <p>This is an important measure as it captures the pricing of work and the productivity of staff.</p>
Indirect Labour Cost %	$\frac{\text{Indirect Labour Cost}}{\text{Revenue}}$	<p>The Indirect Labour Cost percentage indicates the proportion of revenue consumed by non fee earners.</p>
Rent %	$\frac{\text{Rental Expense}}{\text{Revenue}}$	<p>The Rental Expense percentage indicates the proportion of revenue that is allocated to provide firm occupancy.</p> <p>This fixed expense commitment is a major cost that is required to be met from gross contribution.</p>
Profitability %	$\frac{\text{Profit before Interest and Tax}}{\text{Revenue}}$	<p>Profitability % represents the operating performance of a firm expressed as a return on revenue after all expenses have been covered (except interest and tax).</p> <p>This is important as this is the amount allocated to the Partners to draw, and pay interest to their funding providers (usually banks).</p>

WORKING CAPITAL

Debtor Days Lock-up	$\frac{\text{Total Debtors (x365)}}{\text{Revenue}}$	<p>The Debtor Days Lock-up measures the number of days taken to collect outstanding debts.</p> <p>This is one of the most common measures of the effectiveness of cash collection processes.</p>
WIP Days Lock-up	$\frac{\text{Total WIP (x365)}}{\text{Revenue}}$	<p>The WIP Lock-up days measures the number of days WIP is held in a period before invoicing.</p> <p>It indicates the time taken to complete matters and to invoice the client.</p>
Working Capital Absorption Rate (%)	$\frac{\text{Working Capital}^*}{\text{Revenue}}$	<p>The Working Capital Absorption Rate represents the amount invested in working capital as a percentage of revenue.</p> <p>This important ratio indicates the amount of cash that will be absorbed by working capital when the volume of fees increase, provided the working capital drivers remain unchanged. If the working capital absorption rate is greater than the gross contribution percentage then an increase in the volume of fees will generate negative cash flow for the business.</p> <p>* Working Capital is the combination of your WIP and Debtors balances less Creditors.</p>

PERFORMANCE

Activity Ratio	$\frac{\text{Revenue}}{\text{Working Capital} + \text{Non-current Assets}}$	<p>The Activity Ratio is a measurement of how efficient the firm is – that is, how efficient the generation of revenue is from the capital employed by the firm.</p> <p>This measurement reflects the amount of revenue generated by each dollar of total capital employed. The major drivers are accounts receivable, WIP, accounts payable and non-current assets.</p>
Return on Capital Employed (ROCE) (%)	$\frac{\text{Profit before Interest and Tax}}{\text{Working Capital} + \text{Non-current Assets}}$	<p>The Return on Capital Employed provides a dynamic measurement linking the operational performance in the profit and loss account with the performance in the balance sheet. It is the relationship between profitability and the total capital employed. It provides insight into the adequacy of the firm's profitability and effectiveness of working capital management.</p>

ASSUMPTIONS

Notional Salary Notional Salary for Partners used in this survey for calculation purposes:

- \$150,000 for Partners practising in the regional areas
- \$200,000 for Partners practising in the CBD or suburban areas.

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