



Shadforth Financial Group



The Legal Profession

Contents

Industry overview	2
The stress of being a lawyer	4
Personal pressures	4
Financial pressures	4
What makes a successful lawyer?	5
Obstacles to achieving financial independence	6
The Lawyer's Paradox	7
The heart of the problem	7
The retirement problem	8
How to achieve financial independence	9
The solution	10
The right professional for the right advice	10
Conclusion	10
About Shadforth Financial Group	11

ACKNOWLEDGEMENTS

The Shadforth Financial Group is committed to responding to the financial needs of many professionals, and the industry-specific issues that many people face on a day-to-day basis. In this document, we focus on the financial issues confronting the legal profession in Australia.

This project aimed to identify those factors that either contribute to, or impede, the ability of lawyers to realise a rewarding, successful career, an equitable lifestyle/career balance, and long-term financial independence.

The project involved a series of interviews with a wide cross-section of lawyers. Those interviewed included sole practitioners, partners, associates and junior lawyers. This document summarises this personal, qualitative research, and highlights key findings and insights. We thank those who contributed their time and perspectives.

Legal firms have traditionally operated under a partnership structure. However, this structure faces increasing challenges from a new generation of emerging lawyers. Today, for a number of reasons, there is less desire to work towards achieving partnership status in a legal practice. While the issues are often complex, we generally found that they could be summarised as follows:

THE DIMINISHING APPEAL OF PARTNERSHIP

Equity in a law firm is traditionally obtained through an offer of partnership. However, many younger lawyers, typically forty years of age and under, are often reluctant to regard the responsibilities of partnership favourably. This reluctance has increased with the recent publicity surrounding issues with Solicitors' Mortgage Funds. Consequently, partnerships are becoming increasingly harder to sell, and this makes it difficult for older practitioners to exit the partnership when they wish to retire.

THE ABSENCE OF ADEQUATE SUCCESSION PLANNING

There are limited succession planning opportunities once partnership is obtained. In addition, there is no liquid market in which to sell a partnership interest and, in most cases, the partners need to find willing buyers. Once a potential new partner is located, disagreements can emerge in relation to the valuation of the goodwill component.

Industry overview

HIGH TURNOVER OF EMERGING TALENT

There is a high turnover of junior lawyers who are often lured to larger metropolitan centres within Australia as well overseas following one or two years of local working experience.

GEOGRAPHIC CHALLENGES

There are geographic challenges, such as the difficulty often encountered in attracting and retaining quality young lawyers in regional areas.

THE CHALLENGES OF INCREASING COMPLEXITY

The growing complexity of the law is making it harder for lawyers to be knowledgeable across all areas. In order to have sufficient knowledge, some lawyers are specialising in certain areas such as estate planning. However, many lawyers are not convinced that there is sufficient work available to warrant this level of specialisation.

THE EMERGENCE OF COMMODITISED OFFERINGS FROM COMPETING FORCES

The commoditisation of legal services in areas such as conveyancing and online document providers is eroding many of the traditional revenue streams typically associated with the legal profession. In addition, other professionals including accountants, are encroaching into areas which were traditionally the domain of lawyers such as establishing and advising on company structures.

THE IMPACT OF LEGISLATION

The recent legislative changes in relation to personal injury claims has substantially reduced litigation work.

THE COST OF LITIGATION

The costs associated with litigation can be cost-prohibitive for many people. In particular, the decision to commence legal action can be difficult in borderline cases. Added to this, are the risks of an adverse costs order in the event of a lost case, which can have the potential to ruin a litigant financially.

THE INCREASING PREVALENCE OF ALTERNATIVE FORMS OF MEDIATION

Compulsory mediation has emerged as a growth area, which has effectively reduced the need for litigious action to resolve disputes.

A FLAWED BUSINESS MODEL?

The legal industry needs to develop a business model that can define and produce an ongoing asset that can be readily valued and sold to new partners as an attractive investment when necessary. The current model in many firms is not much different from a fair market salary for the work performed by company employees.

INCREASING COSTS OF BUSINESS

With the emergence of information technology and an increased focus on professional training, many practices are struggling to fund these costs when traditional revenue sources are decreasing. We are witnessing the gradual demise of the sole practitioner, as regulatory, compliance, and administrative costs continue to erode the bottom line.

THE IMPACT OF INDUSTRY CHANGES

The potential for consistent national regulation within the next 10 years will fundamentally change the legal landscape in Australia.

The stress of being a lawyer

The public perception of lawyers and the real life experience are vastly different.

From our research we discovered that the legal profession is stressful, and one which is constantly under siege from the public.

In particular, there are a number of apparent personal and financial pressures. Our findings are summarised as follows:

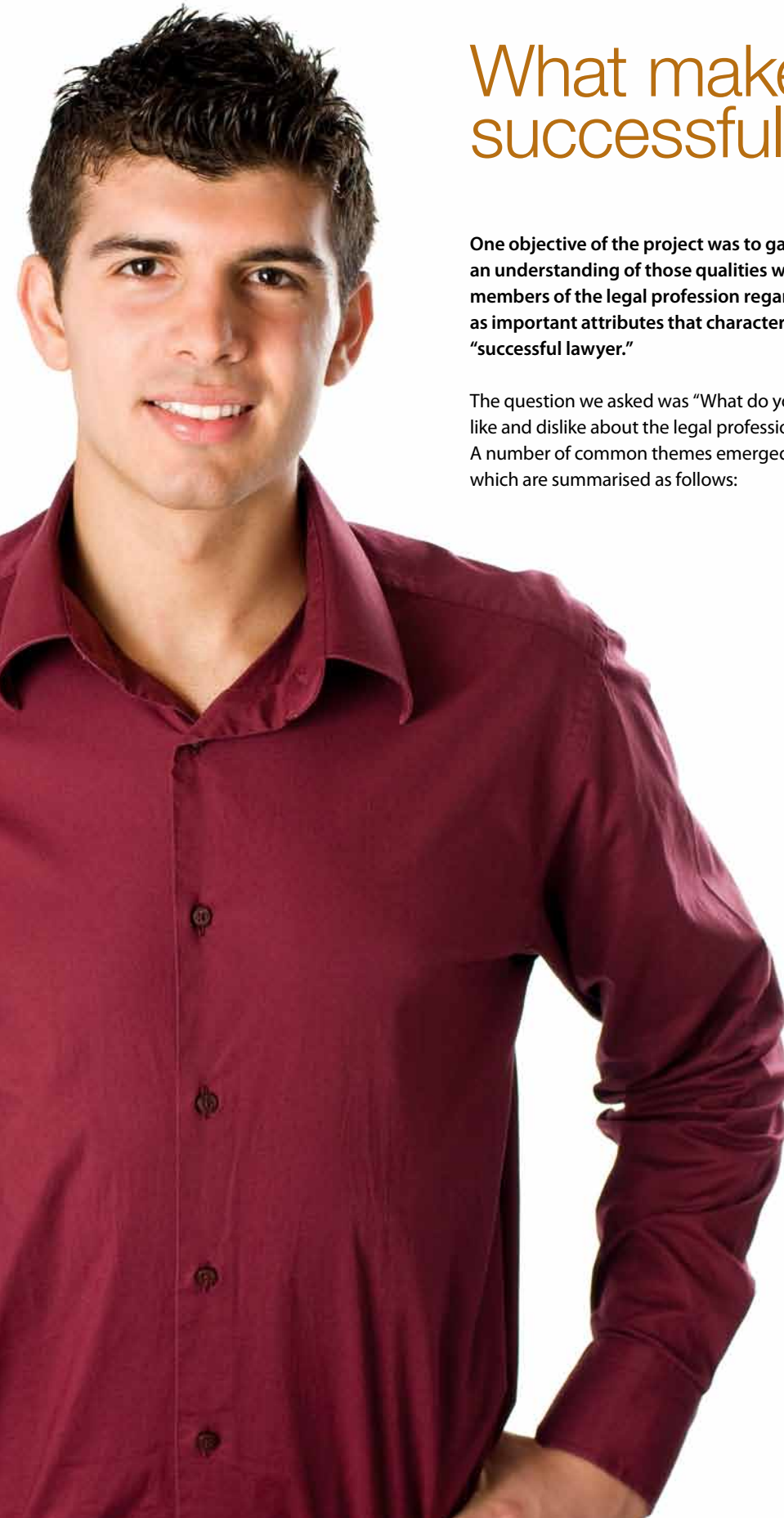
PERSONAL PRESSURES

- The increasing prevalence of the internet and email as 24/7 communications mediums has led to more frequent contact, information requests and demands from clients.
- Younger lawyers are more likely to feel that the law is caught in a “time warp.” This can lead to frustration and disillusionment with the profession. Associated with this is the belief apparent in many of the larger firms that older practitioners have taken their “foot off the pedal,” and this has placed an increasing burden on those in the 5 to 15 year admission period.
- The constant need to be working and meeting time charge-out targets.
- Trying to be all things to all people while responding to the constant demands of clients in a timely, professional manner.
- Maintaining a satisfactory balance between career and personal/family commitments.

FINANCIAL PRESSURES

- Obtaining an appropriate fee for professional services provided to clients.
- The demands to meet budget and charge-out time revenue targets.
- The tendency of junior lawyers to underestimate the value of the advice they provide and the failure to charge accordingly. An extension of this is the failure to increase charge-out rates in accordance with AWOTE and inflation.
- The public perception that non-face-to-face client contact (such as email) should not incur charges, yet it consumes a lawyer’s time and energy.
- The time and energy required to chase outstanding accounts.
- The lack of young lawyers coming through to buy into established practices.
- The conviction that lawyers are underpaid for their level of responsibility and accountability.





What makes a successful lawyer?

One objective of the project was to gain an understanding of those qualities which members of the legal profession regarded as important attributes that characterise a “successful lawyer.”

The question we asked was “What do you like and dislike about the legal profession?” A number of common themes emerged, which are summarised as follows:

LIKES

- Interaction with most clients.
- Maintaining and establishing networks.
- Intellectual stimulation often associated with “thinking outside the square.”
- The law (but often frustrated with the lack of time to research the law).

DISLIKES

- The constant need to be driving the business intensively.
- The lack of ongoing remuneration (in comparison to other professions such as accountants for example, where there is a regular client relationship and a predictable revenue stream).
- The potential personal liability.
- Being restricted to charging on a time basis and not on a success basis.
- Losing young lawyers once they have been trained.

Obstacles to achieving financial independence

During the course of our research, it became apparent that lawyers are more often than not operating in a highly stressful and increasingly demanding environment.

Lawyers are typically time-poor, and are often simply too pre-occupied with work-related issues and client concerns to pay due attention to their own personal and financial affairs. While many have a comfortable level of disposable income, often this income is not managed as effectively as it could be to create a secure, long-term financial future.

We identified a number of obstacles which can negatively impact a lawyer's ability to achieve long-term financial security. We have summarised these factors as follows:

- In many cases, little thought is given to superannuation as an effective way to generate future wealth and an income in retirement. We discovered that lawyers often fail to invest appropriately in superannuation until they are well into their forties, and in some cases older. Many point to the fact that as they are classified as self-employed under current superannuation legislation, there is no obligation to contribute to superannuation.
- We identified a lack of understanding regarding the concessional tax-benefits associated with superannuation.
- Salaries and drawings are often paid in lump sum payments (particularly in the case of partners and sole practitioners) and this makes budgeting on a month-to-month basis problematic.
- The ability of a lawyer to sell their stake in the partnership is often regarded as their future superannuation. However it can be difficult to place a value on this on a year-to-year basis.
- A number of firms have self-managed superannuation funds in place for all the partners. However, a common problem with this approach is that junior partners often have a different "risk tolerance" in comparison to older partners. Consequently, the fund asset allocation is not always appropriate for all members of the fund.
- We identified that many lawyers are reluctant to seek external advice as there is a perception that this advice is likely to be "sales based" and "product biased" rather than being personally customised to the needs and circumstances of the individual lawyer concerned.
- There is generally an absence of any defined exit strategy from a partnership and a lack of any structured valuation mechanism for retiring principals and partners. This often means that the retiring lawyer is forced through financial necessity to continue working as a consultant for the firm for longer than they would have preferred or had anticipated.
- There is a perception that the financial landscape is constantly changing, and this continuous flux has led many lawyers to believe that securing a comfortable degree of certainty about their financial circumstances, future planning (both in terms of lifestyle, career and finances) is simply beyond their reach. This has led to a "head in the sand mentality" and an uneasiness that it is "all too difficult".

The Lawyer's Paradox

Lawyers invest in many years of study and training to develop skills and earn a comfortable income. However, as this income is inevitably linked to personal exertion, they more often than not endure financial and lifestyle pressures that, if left unresolved, may lead to financial hardship and in some cases, personal and financial crisis.

A lawyer's most valuable asset is their ability to earn an income. The longer they have left in the workforce, the greater this asset becomes. However, this asset is often left unprotected with the absence of adequate insurance cover such as income protection cover, trauma cover, death, and total and permanent disablement cover.

The potential future income of a lawyer declines over time and, as the illustration below shows, is deteriorated by lifestyle costs. In simple terms, a lawyer's reliance on their own exertion to create an income means their lifestyle is in direct conflict with their earning potential, which in turn creates stress and pressure.

THE HEART OF THE PROBLEM

The issue for most lawyers is the failure to turn excess income into capital. This in turn excludes the potential for another source of income.

There are a number of reasons why lawyers fail to turn their income into capital. These include:

- Lawyers spend many years learning their profession and paying off debt. This delays the start of capital accumulation.

- By the time lawyers have reached partnership or senior associate level, or alternatively established a successful sole practice and begin to earn a reasonable income, they have typically accumulated considerable outgoings associated with a family, mortgage, or buying into the partnership itself.
- Many lawyers have significant funds tied up in their own home, and depreciating assets such as motor vehicles and boats. While there may be significant lifestyle benefits associated with these assets, they are generally not income-producing and are illiquid and inflexible.

It became clear that many lawyers do not possess the financial skills to plan, structure, and manage their personal and business financial affairs at an appropriate level. This is reflected in statements which emerged during the course of interviews with a number of lawyers:

"We are just too busy looking after everyone else's problems to worry about our own."

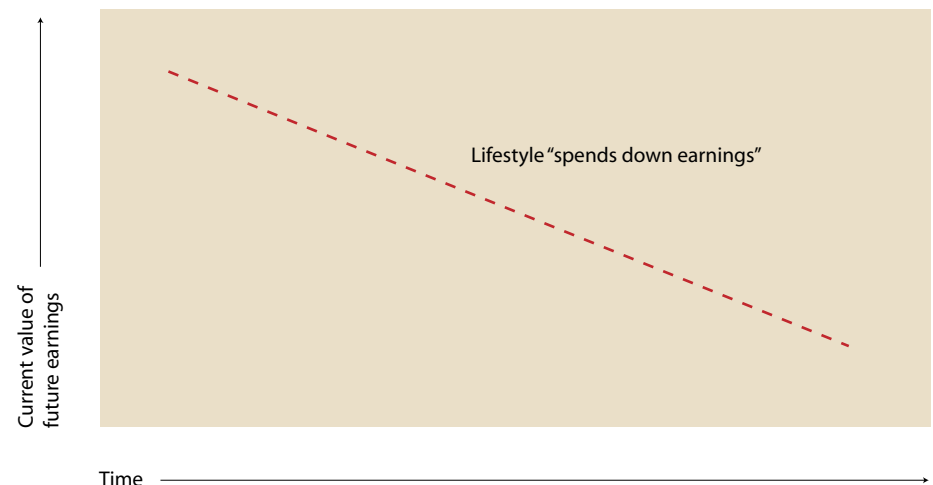
"In the end we are quite good at making money but we have no time to decide what to do with it."

One pleasing aspect of the study was that the emerging generation of younger members of the profession understand the importance of planning for the future:

"I spend 30 minutes each week looking at my own affairs and making sure I am on target to reach my financial goals".

"I use a financial adviser because if you find the right one they save you significant financial heartache over the long term".

Current value of future earnings over time for a lawyer



The retirement problem

The career, lifestyle and financial pressures confronting most lawyers become consequential when lawyers start thinking about retirement. Many talk of having to work longer or harder than they would prefer. Others point to the relentless demands of the profession taking a toll on their health. This can lead to early retirement becoming a necessity rather than a luxury.

This decision can become harder for those with insufficient capital, as retirement income is often as low as 30% of their earnings as a lawyer. Yet the desire to maintain the lifestyle they enjoyed previously remains.

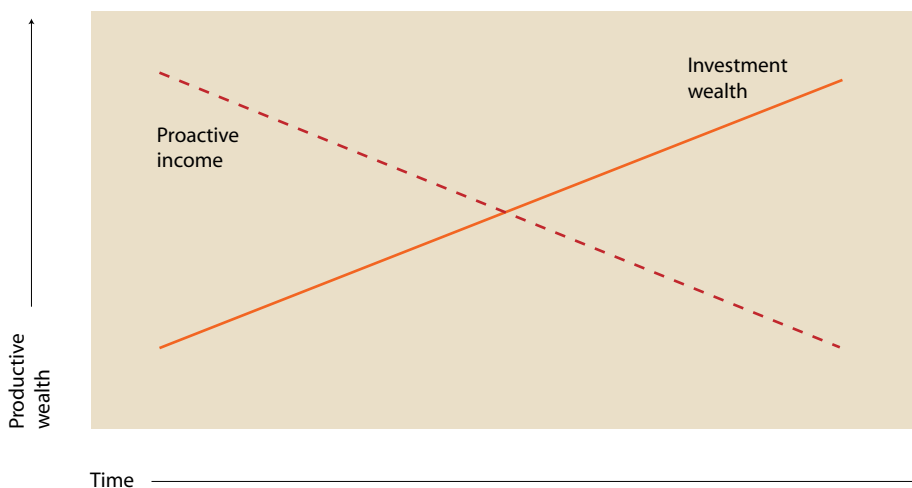
The key issue facing most lawyers is the need to create a strategy which converts high incomes into a lump sum of capital large enough to produce an alternative income.

This is real financial independence – the ability to maintain your lifestyle without working.

Contrary to popular belief, financial independence need not wait until retirement. And it's not a function of income – it's a function of planning. In fact, many people accumulate significant sums for retirement despite earning a moderate income.

Present value of future earnings decreases over time as productive wealth increases.

Wealth creation over time for a lawyer



How to achieve financial independence

If financial independence was easy to achieve then everyone would enjoy it. However, statistics suggest that only 8% of those who retire enjoy the lifestyle of their choice. Our research suggests that some lawyers miss out on the benefits of financial independence.

There are a number of reasons why so few people are financially comfortable. These include:

- A lack of knowledge in relation to financial matters and the failure to seek assistance.
- Lack of foresight – we need money to survive. However, it can only come from three sources: your own work, your money working for you, or a handout (government/inheritance or charity).
- The desire for immediate gratification often supersedes the importance of planning for the future. In other words; the “must have it now” mentality.
- Borrowing for things that lose value.
- The lack of any goals and/or poor planning.
- Confusing good current income with financial independence.
- Poor mental attitude.

The table below outlines how much money you will need in order to attain an income of \$50,000 (net) in retirement based on various rates of return. Our calculations are based on the following assumptions:

- Inflation averages 3% per annum.
- You are male and 40 years of age.
- Your current superannuation balance is \$100,000 (a combination of your own and your spouse’s superannuation portfolios).

- That income of \$50,000 per annum (in today’s dollar term) is drawn from the superannuation on retirement.
- You wish to retire at 65 years of age.
- You do not have any funds outside the superannuation structure that can provide you with an income stream.

Retirement Age	Life Expect	Real rate of Return %	Capital sum required \$	Contribution required per annum \$
55	25.92	2	1,003,683	50,256
		4	797,722	30,845
		6	649,302	17,600
57	24.19	2	951,533	40,551
		4	765,969	24,103
		6	629,784	12,778
59	22.49	2	898,518	32,961
		4	732,595	18,861
		6	608,588	9,065
61	20.84	2	845,326	26,907
		4	698,005	14,706
		6	585,908	6,150
63	19.24	2	792,060	21,992
		4	662,256	11,355
		6	561,731	3,825
65	17.70	2	739,172	17,955
		4	625,662	8,662
		6	536,232	1,951

Please note these figures are intended as a general guide only.

The solution

There are a number of financial strategies that may be suitable for members of the legal profession to assist in securing their financial future.

These include:

- Re-structuring your financial affairs to minimise the amount of tax payable.
- Structuring your affairs to protect your assets.
- Re-structuring debt and minimising the amount of non-deductible debt held.
- Ensuring that your insurance needs are adequately covered.
- Increasing the amount of money that you contribute to superannuation either via a salary sacrifice arrangement, or alternatively, if you are a partner or a sole practitioner, making a deductible contribution to superannuation.
- Establishing a regular savings plan aside from superannuation and using these funds to invest in growth assets.
- Taking advantage of changes in the Federal Budget.

Once a financial strategy has been agreed upon, it is important that this is reviewed at least half yearly. Some of the areas which require reviewing at twice a year or more include:

- Your cash flow and savings capacity.
- Tax minimisation strategies.
- Performance of your superannuation fund.
- Performance of your non-superannuation assets.
- Personal asset allocation.
- Your risk tolerance and comfort level with existing investments.
- All assumptions regarding inflation, taxation and superannuation.
- Legislative changes and their impact on your financial situation.

THE RIGHT PROFESSIONAL FOR THE RIGHT ADVICE

It is a peculiarity of professional life that many professionals carefully advise their clients on their affairs but neglect their own affairs. This is why doctors are advised not to treat themselves and why accountants forget to lodge their tax returns. It is also why it's essential for members of the legal profession to outsource their financial planning to a suitably qualified expert.

At Shadforth Financial Group, we meet many cash rich professionals who have busy professional lives and are often time-poor. In addition, we have assisted many clients on modest incomes to enjoy comfortable lifestyles through effective financial planning.

CONCLUSION

You can secure your future financial wellbeing by adopting a strategic and structured approach to your financial situation. Developing and implementing a strategy aimed at turning your cashflow into capital can enable you to build an alternate source of income more rapidly. Ultimately, this strategy gives you the freedom to retire when you choose and to enjoy your chosen lifestyle.

Building an alternate income stream frees you from the personal and professional pressure of relying on your profession to meet your commitments. If family, health or lifestyle considerations affect your ability or desire to work, you will be at liberty to make that choice.

As the income from these alternative sources increases, the reliance on your personal exertion income decreases. This approach reduces the financial and lifestyle pressures associated with working as a lawyer over the longer term.

Engaging a financial planner to manage your financial affairs frees your time to focus on things that matter to you. You'll have more time to spend on your business, giving back to the profession, spending time with your family, or enjoying your interests.

About Shadforth Financial Group

HELPING SUCCESSFUL PEOPLE MAKE SMART DECISIONS ABOUT MONEY

The Shadforth Financial Group Limited (SFG) is one of Australia's leading privately-owned financial advisory firms.

Our aim is to help clients generate and maintain wealth over time. We have many clients from all walks of life who are supported by 300 employees in 14 Practices across Australia.

We are united in our commitment to act with the highest standards of ethics and integrity for the benefit of our clients, providing quality financial advice and best of breed solutions and services.

This includes low cost and highly diversified core investment options.

Being privately-owned, we are free of ownership or control by the large banks and insurance companies that dominate Australian wealth management. We provide transparent, fee-based advice.

Today, our experienced, highly qualified and dedicated Private Client Advisers offer clients uniquely personalised financial advice, and develop financial solutions and services that are tailored to each client's unique set of circumstances and objectives.

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