

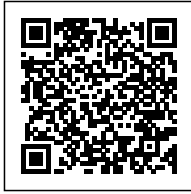
# THE FUTURE OF LEGAL SERVICES – EMERGING THINKING

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“ The political will to carry out such changes in the face of determined industry resistance is unlikely to be sustained indefinitely. If prosperity returns, it will become increasingly more difficult to propose. ”



## **Before being attractive to outside investors, UK law firms need to solve a number of key management challenges**

UK law firms seeking outside investment when the Alternative Business Structure (ABS) regime – often known internationally as Tesco Law – becomes available in mid 2011 need already to think about what changes to make in order to be appealing to those investors.

Muchas firmas de éxito si se analizara su gestión interna disuadiría a numerosas empresas. Las empresas, actualmente, exigen una gestión interna profesional y responsable, no solo a nivel de la Junta Directiva sino también en la dirección de áreas de negocio como finanzas, RRHH, tecnología y marketing. Esta exigencia es común en muchas empresas pero no entre los despachos, que hasta ahora han obtenido beneficios a menudo, al margen de su gestión.

It is important to appreciate that outside investors are professionals. Constantly presented with a wide range of investment opportunities, they reject most of them. And it is likely that any outside investors will demand a higher return than that usually demanded by bank lenders. Indeed, it is the increasing scarcity of medium-term bank finance that is causing many firms to consider outside capital.

It follows that a firm will need a clear and credible plan for the use of such capital. A "business as usual" approach is unlikely to produce a sufficiently high level of future return to satisfy outside investors. Furthermore, any disposal of part of the business for cash which cannot provide the return wanted is effectively a forward sale of the present and future partners income stream, which creates a complex range of intergenerational issues that are likely to be extremely problematic.



Capital can be used in part to reorganise a firm, possibly by easing the route to retirement of baby boomer partners and thereby releasing future profits for younger partners and the investors (indeed with UK Capital Gains Tax at between 10% and 18% as against a top income tax rate of 50% this may be very attractive). It can also be used to develop a firm's profile and reputation whether by the smarter use of client facing technology, a war fund for mergers, team or lateral hires and geographic and practice group expansion.

“ Unfortunately, increasingly busy arbitrators have led to greater delays in issuing awards. It is incumbent on arbitrators to do their work quickly and intensely once the parties have finished theirs. ”

Linked to any investment, a firm will need to consider the extent it will use the discipline of outside investment as an opportunity to change its internal management. Investors will expect professional and accountable management, not only at Board level but also in the Head of business functions such as finance, HR, operations, IT and business development/marketing.

Many law firms, which for so long have enjoyed healthy profit margins operate in a way which would surprise and deter many investors. The leaders of law firms and their Boards will need a clarity of decision-making processes and a focus on the likely returns on any investments that they will make. They will need, on a continuous basis, to reexamine the market they operate in, the processes they use, their pricing models and their cash flow and profitability forecasts.

Such an approach is common in many businesses but relatively rare within law firms who up to now have generated relatively high financial returns often in spite of themselves. Linked to this is the whole concept of accountability across the organisation, including partners. Clear job descriptions, operational targets and metrics will need to be established with consequences for both success and failure. This may all sound very challenging.

At one level it is. However the disciplines required and the capital available could produce legal service providers that are able to grow and prosper in the more competitive legal landscape that we are likely to face. Indeed this more focused, professional and businesslike approach may produce substantial returns to the partners even after the relatively high cost of outside capital. These changes will take time to achieve and partners will need to be persuaded of their need.

If this level of change does not appeal, it is still necessary to consider its implications by a major competitor. If such a well-run and well-financed competitor aggressively approached your ten best partners what would the result be if just five of them left you. This is not imaginary. In February 2010,

Allen & Overy took 15 partners out of the leading Australian firm Clayton Utz to establish its new Australian office. Such moves both domestically and internationally could become the norm if well run firms have investment funds available.

Many of these changes will, of course, be necessary to succeed in a more competitive legal market whether or not outside capital is required. And in a changing legal market, both in the UK as well as across Europe, outside capital will increasingly play a role.

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