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Shaping the Future

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In the first of two articles, David Rowe looks at how the Irish legal market has fared over the past five years and predicts how things will change in the next five years

There is little doubt that the past five years have seen large changes for Irish law firms in terms of how firms do business, their profit levels and in how they are managed. The most dramatic changes have been in a boom-to-bust economy, professional indemnity insurance issues, the withdrawal of credit facilities by the banks, high level of personal indebtedness following property acquisitions, clients increasingly demanding more for less, coupled with transactions taking longer, and the resultant pressure on cash flow. For many firms, it has been an extremely tough period and, as we review it now in 2013, the most positive aspect of that period for many is that it appears to be coming to an end.

This period has also seen many changes in law firms – some visible and some less so. One of the more discernable insights is that the profession now operates in distinct layers, with the largest firms appearing to be in a completely different trading world compared with smaller practices.

Broadly speaking, we can break down firms into the following ‘market’ types:

- Private client firms,
- Private client firms with a number of niche-value practice areas,
- Medium-sized firms concentrating on a number of different niches,
- Medium-sized firms with a broad presence in all practice areas, and
- Larger firms driven by commercial work.

Commentary on the financial health of the market as a whole is now largely redundant, due to firms fitting into specific market types.

Slow-down show-down

The biggest changes over the period have been in the smaller practice sector. For most, these fall into the one-to-four solicitor category. Turnover may well be down 50% to 60% from peak. The Law Society’s Annual Report 2011/12 shows that the vast majority of practices in the country fall into this category. The reduction in turnover is largely due to the fall-off in litigation work due to the introduction of PIAB in 2004, which was then replaced by boom level conveyancing volumes from 2004 to 2008, which subsequently nose-dived during 2009. For most private client firms, personal injury litigation and probate has carried them through



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the last number of years, with evidence of improving conveyancing volumes more recently, albeit at low pricing.

Financial distress and a feeling of despair is widespread among small-practice practitioners. The challenge has been to make a living – profit above a basic salary becoming increasingly rare. A sizeable number of practices have bucked this trend. They tend to:

- Be general practices that also specialise in a specific legal field(s),
- Have a reputation of getting results for clients and for having high service standards,
- Have invested back into their businesses,
- Are well connected with other professionals and with institutions in their locality,
- Possess an intolerance of underperformance at all levels of staff,
- Are highly motivated – from the owners to support staff – and actively seek new work and new business.

In the middle

For medium-sized firms, the last five years have posed major challenges also. There has, undoubtedly, been a trend of larger corporate clients, who are often the mainstay of mid-sized firms, migrating to larger firms. This was driven by selective pricing reductions in the larger firms, the feeling of safety in large firms – partly because of the professional indemnity insurance (PII) crisis and the determination of the larger corporate firms to pick up good-quality work from smaller firms where they felt they had a wider service to offer.

Mid-sized firms came under attack from smaller firms also, who were operating on tighter overheads. Much private client work has now moved from larger and mid-sized firms to be the domain of one-to-four solicitor practices.

While mid-sized firms did face more competition, they have, on average, seen turnover fall about 25% over the period. New types of work have emerged, however, which they too have participated in. This includes different types of banking work, increased litigation and institutional work that have helped firms in this area to off-set the fall in transactional work and the downward pressure on their private client work. Additional light at the end of the tunnel is visible, due to the likelihood that transaction volumes are set to increase as banks show increasing signs of tackling legacy debt problems. There is evidence, also, that some semi-state/institutional clients are looking beyond top-ranking firms, where a medium-sized firm can deliver a quality service at a lower price.

Mid-sized firms have also invested heavily in systems over the period. This extends to technology, risk-management systems, accounting and practice-management systems, as well as precedents and know-how. While this was financially challenging (since it was done when turnover and profitability were falling), the firms that made the investment are now reaping the rewards.

The future looks bright for mid-sized firms. Larger firms are likely to become less interested in mid-sized corporate work and the current cut-throat pricing on tenders work has already



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begun to move upwards. Work has also realigned over the period and, for many mid-sized firms, the challenge is to convince institutional clients that a medium-sized law firm is equipped to do the work without having to rely on a larger firm.

Do I look big in this?

In the larger corporate firms, transactional work reduced substantially as lack of confidence and lack of funding in the economy took a grip. These firms reacted by selectively cutting rates and a new type of advisory work emerged which, while generally subject to more competitive pricing, compensated in some ways for the lack of commercial and conveyancing transactions.

The profile of work in the larger firms is a mixture of international work and national work, with a very sizeable proportion of the work being international and less effected by the slow-down. Larger firms also saw an increase in commercial litigation, and while this continues, the ability of business to fund it appears to be on the wane. Larger firms, therefore, had to make reasonably significant adjustments, but not at the same scale as medium-size and smaller practices. Turnover was broadly unchanged, but achieved in a different mix. The occasional national media commentary on the financial world within which these firms operate confirms to the average practitioner that they are worlds apart.

The view ahead

We are set to see even more change over the next five than we have over the past five. These changes will include:

- An improving economy, predominantly on the east coast, but with some impact nationwide. Dublin and surrounding counties are already seeing evidence of this,
- Work will continue to realign, with large institution and corporate buyers buying services from large law firms; medium-size corporates from medium-size law firms; and private client services continuing to migrate to smaller practices,
- Transactional work will recover steadily,
- Different business structures will emerge. The traditional, stand-alone, single practice will have to be very special to be profitable,
- Pricing will improve in commercial areas and for complex tendered work. It will remain tight in private-client areas,
- Firms will see fee income improve by up to 15% annually,
- Costs will begin to come under pressure, with salaries beginning to move upwards,
- The profession will see a shortage of talent in about three years. An improving market, the large numbers who have left the profession, and current low levels of entry to the profession will create these conditions,
- Smaller practices will have to look at wider options such as overhead sharing, alliances and mergers as economies of scale become more important,
- Many services will continue to be highly price sensitive. For such services, processes and systems, as well as a low cost base, will be the determining factors on making a profit or not.



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World of difference

The slow-down of the last five years has had visibly different effects on different parts of the market. There is now a world of difference between the challenges faced in the larger firms and those of the sole practitioner. These differences always existed, but have widened further in recent years.

For some smaller and medium-sized firms, survival itself has been an achievement. In some parts of the country, notably Dublin, other larger cities and along the east coast, there are positive signs of better times ahead. Whether any particular firm benefits from this depends on its own competitive armoury – its combination of talent, ability, working ethos, systems, type of services the firm is particularly good at, and the work available in its catchment area.

For other firms, the status quo will not be sufficient to earn a living – even if they are well equipped. Will the profession see different models emerge in how law firms are run? How will the *Legal Services Regulation Bill* affect the options available? When is a merger the right answer, and when is it not? These questions will be explored in the October issue of the *Gazette*.

Next month, David looks at the different business structures that are arising in law firms – including mergers, the sharing of facilities and overheads, and other forms of amalgamations.

Practice management seminars

Outsource is running a series of practice management seminars with local bar associations throughout the country in September. Please email reception@outsource-finance.com for details or to reserve a place.