

Back to the Future

David Rowe is managing director of Outsource, a company that provides practice management and financial management support to Irish law firms

In the second of two articles, David Rowe looks at...

In the first of this series of two articles the effects of the recession on Irish law firms of different sizes and type of have been discussed. The conclusion from this is that while there has been significant change for all firms in the market, those most challenged in terms of earning a living are the one to three solicitor firms, especially those in private client areas.

Fragmented Profession

The statistics in relation to the number of solicitors per firm make for interesting reading. Of the firms in the country, 43% fall into the one solicitor size and an astonishing 82% fall into the three or less solicitor size. Only 1% of firms have 21 solicitors or more. This evidence shows that the financial turmoil of the past five years has led to more fragmentation and that the recession has resulted in firms having lower number of solicitors, to match the work available. As we (hopefully) begin a new phase of improving fee income and ultimately profitability, how can the small to medium Irish law firms make it easier on themselves? Are there options outside of merging? Why is all of this necessary?

Economies of Scale

A recent merger we were involved in showed that if four sole practitioners came together, there was an additional income of €30K per partner simply by merging and saving on expenses. In many firms profit levels are struggling to reach €30K, so doubling this by simply merging is presumably an attractive proposition. However, mergers get a lot of negative press; with the one that does not work overshadowing the 19 that successfully come together and change existing partnerships.

For many practitioners a merger is the right answer. By merging, practitioners bring in different contacts and a different client bank leading to less dependence on one or two key clients, can separate practice areas and thus become better than average in one or two, share costs and achieve economies of scale and use the individuals in the enlarged firm in their different areas of strengths.

The challenges revolve around the ability to work together and to recognise that partnerships are seldom exactly equal every year. Relationships are also a huge factor, many sole practitioners who are used to making their own decisions, struggle with being answerable and having obligations to others. There is visible change in the profession with younger practitioners being more open to partnership and many of the more recent start-ups indicating that they do not see sole ownership as the correct long-term business model. The number of new firms which are multi-partner confirms this.

Avoiding the costly mistake of merging with the wrong firm or set of individuals is achieved through going through the 'getting to know you' and due diligence phases in a planned way, rather than making decisions solely on instinct and first impressions. Dealing with difficult issues pre-merger give a good indicator on how potential partners will react to difficult



out•source

decisions post-merger. The number of successful mergers out-numbers the ones that have run into difficulty by about 20 to 1 and the practitioners within those that have succeeded will say they achieved more in one year than they would have done in five years of organic growth on their own.

Peas in a Pod

For firms who do not see themselves merging there are a number of workable alternates such as overhead sharing arrangements. There are several offices throughout the country where a number of law firms share the same premises, share facilities, share staff but keep their own fee income, have their own professional indemnity insurance record and each firm ends up with a different profit. Typically all firms have their nameplates on the door and there is a system, often in rotation, for off the street call-ins are steered to one firm or another. I have seen this work very well and it has all the advantages of merging, in terms of economy of scale, without a full commitment to each other. There are elements missing with this arrangement such as the lack of marketing, specialisation in different practice areas; and each of the firms within the building are competing with each other. Where we have seen this arrangement, it is in operation with practitioners who are well disposed towards each other but do not want to be in partnership together. The arrangement is something similar to having a law firm with the administration and resources pooled centrally and paying a service charge for the use of those resources.

An alternate is to have like-minded individuals with different catchment areas (and therefore not competing with one another) in a formal or loose alliance where they share market knowledge, facilities, know-how and challenges together. In Outsource we have a number of Managing Partner forum groupings which achieve this for our clients. In our experience, if the individuals are like-minded, open, and the information shared is used within those practices only, these groups succeed. There is potential within these groups to develop common systems that require a lot of effort and cost for firms to invest in individually; such as case management systems, risk management systems, libraries, precedents etc.

We are beginning to see a trend of practitioners shutting down their own practices and going to work for others under a larger firm umbrella in a financial arrangement that is linked to the clients and fees they bring in and to contributing to the overhead base of the larger firm. Often in these arrangements the former smaller practitioner will be working for a fixed salary together with a performance related bonus, but is freed from the burdens of ownership and running a practice individually. For the larger firm they are achieving economies of scale, making a profit and spreading their own overheads over a greater number of fee earners.

Other professions have more diverse ownership structures such as an overseas parent firm or a franchise arrangement. Accountancy practices and estate agents are good examples of this. The medical profession have medical centres. We work with one entity in this sector where each of eight firms retains its own separate identity but there is a joint venture which gives this group of eight the capacity, expertise and geographical cover to pitch for national work. There is no doubt that there is scope for similar alliances of law firms, particularly smaller to medium ones, in going after particular tranches of work. The franchise type arrangement, so common with estate agents, does not appear to meet current regulatory requirements.



Future Options

More radical options may well become available to practitioners in the future. These include admitting barristers as partners and forming multi-disciplinary partnerships with other professions. The publication of the Legal Services Bill opened up the possibility of multi-disciplinary partnerships, but experience in other jurisdictions would indicate that take-up is likely to be low.

Another potential development through the Legal Services Bill is the introduction of limited liability partnerships and limited liability companies. In addition to the protection of personal assets, this will create a number of potential tax planning opportunities. In the UK, all of this has gone a step further with the introduction of alternate business structures meaning that law firms need no longer be owned by a lawyer, leading to multi-nationals entering the UK legal services market.

Conclusion

For many smaller and medium sized practices the reality is that their current business structure is not viable. For others, life could be made much easier by sharing the challenges and opportunities with others. Merging with another practitioner or another firm creates the best environment and provides the most comprehensive practice arrangement within which to address the challenges ahead. Larger small firms are more profitable, share resources and can be easier to run and they are more competitive, leading to an un-equal tussle for work.

For many the realities of the last number of years have been about survival but it is now time to look up and outwards. If you are a smaller practice and merger is not for you then there are huge advantages in either an overhead sharing arrangement or a friendly alliance with a number of other practices in similar towns facing the same challenges. More radical options loom but are not immediately available. In 10 years time I suspect we will look back at a much changed profession where practices have come together, either formally, informally or in business alliances to enable smaller and medium size practices compete on an equal footing with larger firms. For the outward looking, the opportunities are here now.

