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Brexit uncertainty likely to weigh on top UK law firms' profits

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Vote set to increase pressure on firms already hit by falling profit margins

The UK's top law firms are suffering from falling profit margins with the sector likely to face more difficulties because of uncertainty in the wake of the UK's vote to leave the EU.

Profit margins from UK operations at the top 50 law firms fell an average 1 per cent to 1.4 per cent in the reporting year up to April 2016 even as overall revenue grew, according to a survey of the 100 largest firms by professional services group PwC.

David Snell, head of PwC's law firms advisory group, warned of further pressure because of uncertainty surrounding the Brexit vote.

The drop in margins came after many law firms had gone on a hiring spree in anticipation of continued economic recovery. Instead, they met with a tailoff in demand as uncertainty set in ahead of the vote.

"The difference between the expectation of growth and the tailoff was quite marked," Mr Snell said.

"Spare capacity is now an issue for firms," he added in a statement issued with the survey's release. "This situation is likely to be exacerbated following the EU referendum vote in favour of Brexit. Profit per equity partner and rate per hour are under pressure in a sector where supply outweighs demand."

Law firms have scrambled to advise clients on the impact of Brexit as clients grapple with the wide-ranging implications for tax, employment, financial regulation, intellectual property and company law, as well as the dismantling of the existing trade regime.

Lawyers have sought to act as a channel into government to represent client concerns as well as advise on contingency plans such as a possible exit from the country.

Outside observers have forecast a bonanza for law firms because of the Brexit advisory work. But Mr Snell questioned whether the increase in regulatory work could compensate for the potential fall in transactions.

"The effect of Brexit is a sense of uncertainty and that means people stop doing transactions. There will be an increase in regulatory work. But whether this increase in regulatory work will compensate for the tailoff, I'm not sure it will," he said.

Tony Williams, head of Jomati, the UK legal management consultancy, and a former managing partner of Clifford Chance, said the already significant slowdown in major real estate transactions did not augur well for a potential drop in M&A work and other transactions.

“Lawyers don’t really mind if the market is going up or down, they just want activity. The thing that really hurts is when everyone sits on their hands. And that seems to be what’s going on now,” Mr Williams said.

The falling pound could cause investors to seek to acquire cheap assets, but the outlook is far from clear, Mr Williams added.

Law firms with the biggest global footprint were best hedged against the risks, Mr Snell and Mr Williams said. The so-called magic circle firms would gain from the falling pound with 60 per cent of their earnings coming from outside the UK, Mr Williams said.

PwC’s annual survey of top firms for 2016 showed “almost all the increase in profit in the international operations of the top 10 law firms was because of currency movements”, Mr Snell said.

Top 10 firms notched up a 0.7 per cent fall in global profits for 2016 before accounting for exchange rate movements, but after these movements were taken into account global profits were found to be up 2.1 per cent, the PwC survey found.

Global profits per partner in 2016 were down 2.3 per cent for top 11-50 firms, however, with UK performance falling on average 7.9 per cent, the survey found.

Recognition is growing among law firms that they must invest heavily in new technology in order to compete, he said. “That’s one reason why we are starting to see more mergers.”

The recently announced three-way merger between CMS UK, Nabarro and Olswang was an example of this trend, he said.

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