COMMENT

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Private equity can transform law

The announcement last week that Lyceum Capital, a mid-market private equity house, is devoting considerable resources to the legal sector and is already actively exploring private equity investment in legal services businesses is another sign that the market is gearing up for the change permitted by the Legal Services Act. I am a member of the advisory board that was established by Lyceum Capital.

The Legal Services Act enables law firms to take outside capital or, indeed, for new businesses owned by non-lawyers to provide legal services. It is important to appreciate that this enabling legislation does not force or require firms to change their business or ownership model. They only need to do so and will only do so if they see clear advantages to themselves and significant opportunities to develop the quality and range of clients that they are able to act for.

For many legal services firms, the use of outside capital, especially in the short term, will neither be necessary nor desirable. As a consultant to law firms, my clients are often surprised that I recommend them not to do a potential merger more often than not. This will apply equally in the case of private equity or other outside investment.

Where private equity will be particularly useful is where a firm is looking to develop aggressively over two to five years in order, fundamentally, to reposition itself in its market. It will need a clear vision of what it is aiming to achieve and the steps it needs to take to be successful. Growth or repositioning may be achieved through a series of mergers, lateral hires (teams and individuals), new office locations, more sophisticated use of client-facing IT, building a focused brand or facilitating a generational transition of the partnership. Any of these developments, if funded by partners through the profit and loss account, may place a massive strain on partner earnings (remember Hammocks' difficulties of a few years ago after a period of rapid expansion). Bank borrowing may be available but many partners will be nervous of a high level of bank debt even if it is limited in its recourse to the assets of the LLP.

In these circumstances private equity can play a crucial role. By enabling the business to move to a higher level, the partners are likely to find themselves in a more profitable and more sustainable enterprise. The private equity firm will get its slice of the proceeds, taken from a far larger cake.

Providing capital is not the only thing that the private equity house will be doing. As importantly, it will bring experience of developing other businesses and will assist in the development of the firm’s investment decisions and processes. One of the key attractions to me of Lyceum was that, as a mid-sized private equity house, it has had long experience of helping service businesses to grow and develop to the mutual advantage of all shareholders.

Over the last 20 years, law has been a supremely successful industry. Many of the top 100 firms have seen double-digit growth in revenue and profits year on year with only the relatively occasional slip. Most other industries can only dream of this level of consistent development. This success has enabled firms generally to shun consolidation by merger. It has simply not been necessary. It is unrealistic to expect that this level of revenue and profit growth can be sustained in the future.

Some firms are already preparing themselves for the challenges ahead, others are assuming that it will be business as usual. For those with the quality of leadership and clarity of vision to treat change as an opportunity the future is bright. Private equity is likely to be an integral part of that future.

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