

# YOU AIN'T SEEN NOTHING YET

## Tony Williams considers the changes that legal services reforms could have on law firm management

It is easy to dismiss the legal services reforms as occurring some time in the future or as not being of any interest to your firm. But, in a profession that has already changed profoundly over the past 20 years, such an approach is both wrong and dangerous. These reforms raise some interesting opportunities for firms, as well as some very real threats.

Until relatively recently, the role of a law firm's management team was to ensure that the back office ran effectively, that basic accounting and business disciplines were followed and that investments in larger projects, whether new premises or IT systems, were either avoided or at least the subject of some effective review. However, legal service firms no longer work in this relatively relaxed atmosphere, with the most successful firms being run much more effectively. Law firm management services are increasingly run by high-calibre professionals, applying rigorous financial disciplines, effective procurement policies and using contemporary marketing and business development initiatives. All lawyers are expected to perform effectively. The leadership of law firms is increasingly required to establish and execute a credible strategy for the firm's development which differentiates it from its peer group. This may necessitate refocusing a firm, developing new areas of business, de-emphasising others and even exiting certain types of work or locations. Leaders of the more successful firms do not avoid taking difficult and sometimes unpopular decisions.

The reforms will only serve to increase the pressure on a firm's leadership to perform effectively, and will operate at a variety of levels. At the most simple level, they will enable firms to take their professionals into partnership. This may give enhanced status, authority and career path structure to well-qualified professionals such as chief executives and finance directors. The next level will enable lawyers to work in partnership with other legal practitioners such as barristers, patent attorneys, licensed conveyancers and notaries. This may enable firms to develop a dedicated advocacy unit or a comprehensive intellectual property practice. At its third stage, firms will be able to operate in partnership with other professionals such as tax advisers, financial advisers, surveyors, estate agents, actuaries etc. Subject to potentially complex regulatory and conflicts requirements, this may enable firms to provide a "one-stop shop". At the most extreme end of the scale, law firms will be able to attract outside capital and even list on the stock market. Some may decide to sell out to new entrants, possibly parts of major financial or other corporate institutions, who will be able to provide services direct to the public.

It is important to appreciate that these changes are enabling. Firms will be free to continue to operate as they do now, which may cause some firms to discount these reforms as irrelevant. But even if a firm does not wish to take advantage of this liberalisation, it needs to consider the effect on its business if its peer firms do embrace these changes, or if new entrants enter its market sector.

Firms that take on high-calibre chief executives, finance directors and marketing directors as partners will have available a range of talent with experience from other business sectors that have also undergone profound change in recent years. If given room to operate, they may significantly improve the quality of the firm's operations and decision-making structure.

If firms obtain outside equity capital this may provide a war chest to fund investments in lateral hires and, increasingly, in team hires, client-facing IT and effective marketing and branding. Over time, this may have a significant impact on a firm's position in the market, its success rate on client panel reviews, and its profitability and attractiveness to new talent.

Some firms may choose to use some capital to smooth the transition of baby boomer partners into retirement, thereby ensuring a clear and profitable career path for younger lawyers. Given the introduction of age discrimination legislation later this year and the inadequacy of many partners' pension provisions, an orderly partner succession process is likely to become an increasingly contentious issue. It should be appreciated that whereas partnership profits are currently taxed at more than 40 per cent, a capital gain accruing to a partner may be taxed at a top rate of 10 per cent. The effect of this is that a capital payment after tax in the hands of a partner is worth 50 per cent more than the equivalent amount paid as a profit share.

Firms that eschew these changes will not necessarily be wrong. It is, however, important to appreciate that your competitors are likely to become more focused and aggressive. They will identify and target the best partners in their competitor firms. Any firm that loses two or three of its best rainmakers may risk losing 10 to 20 per cent of its revenue. In the short term, this may have a devastating effect on its profitability and possibly its ability to survive. Attracting, retaining and motivating the best legal talent is essential to a firm's success. The market

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has become more fluid and lateral movement at partner level is no longer the sign of a misfit. Firms that attract good lateral movers are likely to enter a virtuous circle of improving profile, reputation and profitability. Firms that lose good partners risk entering a vicious circle of instability and decline. In order to retain its talent, a firm will need to show that it is performing well against its peer group, both in terms of reputation and profitability. This will necessitate a far more rigorous approach to partner, lawyer and support staff performance. Under-performance will need to be addressed early and effectively. Continued under-performance will require the departure of the under-performer. Remuneration systems will need to reward appropriate partner behaviour and performance.

It is tempting to assume that these changes will only impact high street firms. Although new entrants are likely to focus initially on high-volume, commoditised services such as residential conveyancing, personal injury and probate, there is a risk that they will not remain confined to these areas for long. If new entrants use effective client-facing IT and know-how systems, call centre technology, high-profile advertising and brand positioning, and even off-shoring (to other common law countries such as Australia, India or South Africa) they could very quickly take control of the retail market. They are then likely to broaden their product range targeting small and medium-sized enterprises. Here, menu pricing for a range of services such as employment issues, terms of business and debt recovery are likely to be attractive to cost-constrained clients. It is all too easy for firms to discount this mission creep by saying that they operate at a more bespoke end of the market. Brutally, the part of the market prepared to pay premium rates for high-quality service and rocket science lawyers is far smaller than most firms think. Only if a depth of knowledge and quality of service is truly and consistently different from that provided by other law firms, will premium rates be attainable and sustainable.

Leading a law firm has never been easy. It always was far more than counting paper clips. The market has become more competitive and more stratified than ever before. But it has only just started to change. However difficult you think it is now, be clear, you "ain't seen nothing yet".

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