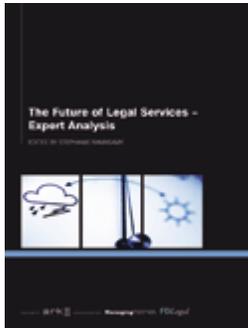


***The Future of Legal Services - Expert Analysis***



**Issued: 15th January 2010**

**For immediate release**

**Download full contents and summary [here](#).**

**Press Release: Top legal experts unveil their vision on the future of legal services**

“There are certain moments in history when you can look back and say things changed forever after that. I believe that the legal sector has been through one of those momentous periods.”

**- Sir Nigel Knowles.**

The sought-after views of some of the top legal experts have been made public in a report published by the Ark Group on *The Future of Legal Services – Expert Analysis*. This report reveals renowned experts’ vision of the future of legal practice as firms look to 2010 and beyond.

The next three years is said to be the “unprecedented period of change” and a “once-in-a-lifetime revolution in legal practice” is taking place. Robert Millard of Edge International states: “We need to consider how the world will be different in coming years, once this crisis subsides, before we think about how our strategies need to adapt.”

This in-depth legal market analysis reveals some thought-provoking conclusions. It is predicted that by 2012 many small law firms will disappear: “The recent professional indemnity renewal round is estimated to have caused, at least, 500 law firms to close” already. Large elite firms are also going to struggle as they “fight it out and price their work at a realistic level”, according to DLA Piper chief executive, Sir Nigel Knowles.

The Legal Services Act 2007 will lead to “profound changes” in the internal structure of law firms, heralding a “new world of legal services”. Potential investors will bring “their own cultures honed in the ruthless shareholder value environment”.

Lord Hunt warns law firms that “they must be aware of the high ethical standards that are expected of them” or they face punishment if they fall short of the required standards.

**The report includes articles written by the following top legal commentators:**

- Author of the Hunt review, **Lord Hunt of Wirral** explains the need to raise the standards for regulation and compliance for law firms ;
- Specialists on law firm finances – **Dan DiPietro** of The Law Firm Group Citi Private and **Peter Scott** of Peter Scott Consulting outline the new remuneration and pricing structures and the increasingly important role of financial management

in the law firm;

- Legal consultants – **Alan Hodgart** of H4 Partners, **Tony Williams** of Jomati Consultants LLP, **Nigel McEwen** of SSG Legal, **Laurie Young**, fellow of the Chartered Institute of Marketing, and legal technology writer **Charles Christian** examine the strategic and organisational consequences of the Legal Services Act 2007 and the economic downturn on law firms;
- Specialist regulatory solicitor – **Frank Maher** of Legal Risk LLP discusses the revolution in legal risk and compliance;
- President of the Law Society – **Robert Heslett** portrays the future role of the Law Society;
- Head of forensic at the SRA – **Mike Calvert** reveals the triggers of an onsite risk investigation and how to avoid them;
- Business strategist – **Robert Millard** of Edge International takes a broader view of the shifting global economic and socio-political factors impacting law firms worldwide; and
- Senior and managing partners – **Joy Kingsley** of Pannone and **Sir Nigel Knowles** of DLA Piper discuss the outlook for small, medium and large-sized law firms.

One reader commented: “The report had a number of benefits – it confirmed the challenges that now face our profession and offered some very useful strategies and advice on how we can deal with these. For those who had not given these issues much consideration, it provided the wake-up call needed. Whilst there are core themes and a consensus of opinion throughout, it is very helpful to read different experts’ interpretation of the issues discussed.”

For more information or to purchase this report readers can contact Robyn Macé on +44 (0) 20 7566 8229/ [rmace@ark-group.com](mailto:rmace@ark-group.com).

#### Editor's Notes

If you are interested in receiving a free copy of this report for reviewing please contact the editor Stephanie Ramasamy on +44 (0) 20 7549 8667/ [sramasamy@ark-group.com](mailto:sramasamy@ark-group.com)

Ark Group is committed to delivering practical advice and expertise to legal professionals worldwide through our range of specialist magazines and reports. Visit us at [www.ark-group.com](http://www.ark-group.com) for more information.

## Expert analysis 2: Financial management in the challenging legal world of tomorrow

*By Peter Scott, management consultant and solicitor, Peter Scott Consulting, and Mark Feeney, consultant and chartered accountant, Consergo Limited*

WE ARE now in an unprecedented time of change for legal services in the UK. The worst recession for over 70 years has dealt a severe – and in some cases – a fatal blow to many law firms, with most firms, even some of the strongest, having to shed people as never before. Another key challenge has been the reduction in finance available to law firms, which came about at a time when firms have needed more cash to repair the damage caused by the recession. The lack of easy credit has forced firms to improve their financial delivery.

The recession has increased pressures to become more competitive in an industry where clients are no longer prepared to pay for inefficient organisations, high cost methods of production and services they no longer want. Law firms will have to employ new methods of operating through efficient organisations and providing new services, which clients do need (including, for example, outsourcing). They will need to do this if they are to provide clients with ‘value for money’ services, which will be at the heart of a law firm successfully gaining competitive advantage in the years to come.

Professional indemnity insurers are looking harder at whether law firms can adequately manage their risks. This has created severe financial problems for many

law firms, particularly smaller firms. Many firms have had to pay substantially increased premiums, cease to practice or go into the assigned risks pool.

Dealing with these issues has already tested to the limit many of those responsible for managing finance in law firms. The process has shown that many current incumbents are not of sufficient calibre to deal with challenges as they currently exist. Tomorrow, however, those challenges are likely to be far greater and the level of financial management in law firms will need to improve by leaps and bounds if firms are to not only survive, but prosper and become the highly-profitable businesses they should be.

To add to all of these challenges, law firms now find themselves engulfed in a government-driven headlong rush to change the face of the provision of legal services in “the interests of consumers”. These regulatory changes are, however, applicable to all law firms and not only to those which provide legal services to consumer clients. The effect of these changes is already being felt.

### **The role of financial management in driving performance**

Given current difficulties and the ‘brave new world’ facing law firms, what should be the role of financial management in law firms of tomorrow? To begin with, it is important to understand the role financial management and, that of financial managers, should play in the challenging legal world of tomorrow.

Law firms are 'people businesses' and every aspect of the performance of law firms (including financial performance) depends upon the attitudes, behaviour and individual performance being aligned with the clear objectives of the business. Financial results can, therefore, be seen as the consequence of how well the people in the business – and the expectations of clients – are managed. Financial management is not, therefore, a separate discipline isolated from everything else that requires to be carried out in a law firm. It is an intrinsic and inseparable part of the overall management of the business and, as the drivers of change increasingly take hold, ever higher levels of financial expertise will become necessary as part of the infrastructure of all law firms.

And it follows – from the need to align financial management with getting the best out of everyone in a law firm – that not only will the roles of those managing financial performance need to become more extensive and far reaching, but everyone in a law firm will need to have a greater role to play in financially managing their work, their colleagues, their clients – and themselves. Pressure on raising performance levels across a range of work areas, functions and roles is already happening in many firms as they feel the heat of competition. Criteria to measure and manage performance need to be devised and, financial measurement criteria have an important part to play.

### **The role of financial management in driving profitability**

Beyond the need to drive performance, firms will face the decision of which services and clients they should deal with, in order to make a profit. Too many firms have not yet analysed profitability. The recession has exposed poor market choices in many

firms, which have previously been hidden by surplus profits earned elsewhere.

Given the pressures now being exerted on law firms, it is becoming clear to those involved in their financial management that it should be seen not only as the domain of the finance director. Increasingly, managing partners are making it their business to ensure that they can hold their own on financial issues with their finance directors, and this in turn is encouraging and requiring finance directors to raise their game. It is not a question of managing partners trying to do the jobs of their finance directors, but more a case of their needing to have, at least, as deep an understanding of what impacts on the financial performance of the business and what levers they need to pull to achieve given results, if they are to successfully manage the business.

As we move into an era of rapid change in the way legal services are provided, it is necessary for managing partners and others with management responsibilities, as well as finance directors to have a total grasp of cutting-edge financial management techniques, if they are to succeed in managing their firms to meet the undoubted challenges of the future. Indeed, we would go further and state that financial management will, in reality, need to be a partnership between everyone in a law firm.

However, if this is to be the case, then there will need to be far greater emphasis on financial education and training for people at all levels in firms, to enable them to better manage their performance and, as a consequence, improve the firm's overall financial results. Currently, from our experience of dealing with law firms and their people, there is a serious lack of understanding of the most basic financial principles relating to how a law firm operates, makes profit and generates cash. It is clear that law firms of the

future will not be successful if this situation is allowed to continue unchanged.

### **The impact of funding shortages**

Law firms have been largely built on borrowed money. The traditional partnership structure meant that profits have been paid out in full and capital has been provided by personal loans. All of this was fine as long as the economy was roaring ahead and there was a ready supply of easy and cheap credit.

This model has abruptly come to an end with the recession and the dearth of available finance. A large number of law firms have been forced into insolvency (or other forms of capital/debt reconstruction) and more still are attempting to implement turnaround plans. Most firms will be facing the unpleasant realities of lower profits, lower drawings and the need to increase capital alongside some tough business decisions.

While the banking crisis has catalysed this state of affairs, it would be a mistake to believe the world will revert back to pre-credit crunch days anytime soon – if ever. Law firms will need to reduce risk by creating more stable funding structures. This will, perhaps mean that capital will be real capital and not borrowed money. There is already a move to retain profits within firms and not to distribute them in the form of drawings or dividends. Overall, there will be a reduction in debt carried by law firms.

Furthermore, any growth in fee income as firms come out of the recession will create a greater working capital requirement. It is unlikely that this will be met by higher banking facilities. Ironically, therefore, an improvement in business conditions may push some firms closer to solvency problems. A recovery will not mean a return to the 'good old days'. For many firms, it could mean lower drawings, more capital and much tighter lock up management.

Overall, therefore, firms need to take a serious look at their medium and longer term funding needs. Weak management of financial performance within a firm will have much more serious consequences in the future. The reality is that pressures on funding will encourage law firms to seek external investment and take advantage of the regulatory changes outlined further.

### **The impact of regulatory changes**

What will tomorrow's law firms look like once the provisions of the LSA have been fully implemented in 2011? And what 'extra' will they need by way of financial management?

While it is always difficult to crystal-ball gaze, there are clear indications that several types of law firms are likely to emerge from the current regulatory changes being put in place. Much of the talk in the run up to the LSA relates to the establishment of large legal businesses providing so-called 'commoditised' legal services in areas such as personal injury, insurance claims, conveyancing, remortgages, repossessions and debt recovery. Such businesses already exist and many are large scale, complex and well run. The financial management of many of these firms has tended to keep pace with the growth in their businesses, although many have suffered in the recession as a result of a severe downturn in certain markets. Some of these law firms are now being groomed to take advantage of the LSA, in order to take in external investment or to sell the business.

The potential non-lawyer organisations likely to invest in such law firms will probably be those which recognise synergies between their own businesses and certain types of law firms such as insurers, retailers and others already providing consumer services. Or, they may just be investors seeking to maximise their returns from the legal sector,

which is seen as returning high margins. However, how many of these potential investors are likely to be content with the levels of financial management performance they are likely to find in law firms?

They will bring with them their own cultures and management techniques honed in the ruthless and totally bottom-line driven 'shareholder value' environment of the large scale and, very likely, publicly-owned corporate. Such investors will most likely be seeking returns greater than currently being generated by the firms in which they invest and, as a result, they will put in place financial management from outside the law to implement this objective. Some investors may also be seeking to 'cluster' together a number of law firms to build market share with a view to ultimate sale or floatation. Current levels of financial management in most law firms are not up to handling these matters and will be replaced by a new breed of financial managers with far higher levels of expertise.

However, the pressures to now become more competitive – and to survive – will, in particular, impact most high-street firms. Some will fall by the wayside; others will seek opportunities to consolidate, by merging with other law firms or, post 2011, with other professionals such as accountants, estate agents and Independent Financial Advisers. In doing so, they will be seeking to build competitive advantage by creating businesses of a sufficient critical mass, breadth and depth of expertise. This should enable them to have access to the necessary resources of a professional infrastructure and, in particular, of enhanced financial management, to enable them to more efficiently deliver their services and so better compete in their markets.

Above all, it will be good management (including financial management of a high level), which will be critical if merged

high-street firms are to be fused into well managed, business-like and highly-profitable businesses. This task is likely to be even more difficult if professionals from different disciplines are to be brought together under one banner. We argued previously that financial management should be about managing people to get the best out of them. Those managing the finances of a multidisciplinary firm will need to be extremely good 'people managers' if they are to succeed in melding together the different cultures of lawyers, accountants, estate agents and others, as well as in the process, drive up financial performance.

The mention of financial management in the context of multidisciplinary practices leads to another relevant issue which needs to be addressed – regulation. Who will regulate these entities in the future? In particular, which regulator will regulate those who carry out the financial management functions in such businesses and what will this regulation look like?

A law firm can currently establish an LDP under which non lawyers (for example, a finance director) may own up to 25 per cent of an LDP, provided that such non lawyers are also 'managers' – defined as someone who is either a partner in a partnership, a director of a company or a member of an LLP. In addition, a non lawyer cannot have any ownership unless he/she is also an approved individual. However, LDPs are only the 'warm up act', in anticipation of ABSs, which are likely to be implemented in 2011 and become the vehicle for external investment in law firms in the future.

What will the post-ABS world look like and what will the requirements be in relation to the financial management of ABSs and those who will perform these functions? The detailed regulations for ABSs are not yet available, but from the legislation, it is clear

each ABS will need to nominate a head of finance and administration, who will need to be approved and be responsible to the appropriate regulator.

Currently, a law firm does not need to obtain approval from the SRA to the appointment of its finance director. Likewise, large organisations which may wish to invest in law firms are not required to obtain a regulator's approval to the appointment of their finance directors (unless they are in a regulated industry). How attractive will it be for such organisations to invest in the legal services sector which – following the current moves in the financial services industry away from light touch regulation – is now likely to become heavily regulated?

If investors are going to want to drive up financial performance, extract higher returns and maximise the value of their investments by sale or floatation – as they would expect to do in the unregulated world of commerce – will those understandable commercial aims be reconciled with the heavy hand of regulation? Only the explanatory note on how existing law firms should complete the form for annual renewal of recognition as part of firm-based regulation extends to 46 pages.

It is a reasonable guess that the level of regulation for ABSs will be heavier than 'light touch', given their potential to have total non-lawyer ownership. Will an investor which is seeking to drive financial performance be happy to ask for approval from the regulator every time it wishes to change the finance director? We await with some anticipation the detailed ABS regulations.

Financial management in law firms of the future will demand greater skills, knowledge and expertise, combined with entrepreneurial flair as the demands and complexity of organisations providing legal services grow, and the requirements of clients become

more demanding and 'consumer savvy'. Will law firms and their finance directors be able to rise to these challenges in the face of heavy regulation?

We began this article by discussing how law firms are currently coping with the changes affecting the legal sector in order to maintain their competitive edge. The LSA was intended to liberalise the marketplace and increase competition. Could it be that the intended vehicle for this liberalisation process – the ABS – will be so heavily regulated that there will not be an even playing field for the new entrants to the market?

It has been clear for many years that the financial management in many law firms has not been of a sufficiently high standard, which is why some currently find themselves in financial difficulties. Whatever else happens, law firms will have to invest in the very best financial management resource they can afford if they are to successfully compete and become the highly profitable businesses they should be. And, if they cannot afford the best, then there will need to be more consolidation between firms to build larger units, which will be able to afford the higher level of financial management expertise necessary if tomorrow's law firms are to be successfully managed and developed to achieve their full potential.

*Peter Scott is management consultant and solicitor, and was for eight years the managing partner at Eversheds' London and European offices. He can be contacted at: [pscott@peterscottconsult.co.uk](mailto:pscott@peterscottconsult.co.uk).*

*Mark Feeney is a chartered accountant who has worked with law firms for over 15 years and now specialises in strategic financial management. He can be contacted at: [mark.feeney@consergo.co.uk](mailto:mark.feeney@consergo.co.uk).*