Shaping up for growth

Some firms are more than eager to welcome non-lawyer investment, but may be lacking the business structures that would make them an ideal candidate. Peter Scott reveals what investors are looking for

A great deal of debate (and hot air) has been generated about the potential opportunities arising from the likely future ability of non-lawyers to invest in law firms. Perhaps it is time to take a reality check before solicitors get too excited about the possibilities.

A law firm should be regarded just like any other business opportunity; an investor is likely to view it as such and apply normal investment and management criteria. On this basis, how many firms would be regarded as attractive businesses worth investing in?

Looking at it from a firm's viewpoint, how many partners could really accept a hard-nosed outside investor ruling the roost, given that, at present, many still cannot accept even a modicum of relatively benign management? However, there are partners who have seen these changes coming for a while and have been assiduously 'getting into shape' for the day Parliament decrees it will be possible.

So what kind of firm will be likely to attract the attention of potential investors or buyers?

To help answer this, it may be worthwhile to look at the (bad) experiences of those who, in the fairly recent past, invested in estate agents and accountants.

In many cases, they acquired businesses from owners who were the very same people who were fee-earning 'at the coal face' and in whom the goodwill of the business was vested. The result? As soon as those people left with their money, so did much of the goodwill and energy of the businesses.

Accordingly, if you are partners in a firm and thinking that you might be a suitable target for an investor, what should you be doing now to get your business 'into shape'?

A business dependent mainly on the daily fee-earning grind of each equity partner is perhaps unlikely to be attractive to an investor, because without the continuing work and energy of those equity partners, what is likely to be left?

However, if partners can divorce their ownership of the business from both the business's day-to-day operations and fee-earning by the partners – so that the business and its goodwill, together with sustainable income and profit streams, will be capable of continuing even after the partners have taken their money and disappeared – this may be a more attractive proposition to a potential investor or buyer. This will require partners to put in place a management infrastructure capable of running the business without them.

It will not be every type of law firm that will be able to divorce the day-to-day operational side from partners' ownership. This is because, in many firms, the partners are the business, and there would be very little business, if any, remaining were they to leave. Only where day-to-day operational input and fee-earning work by partners can be dispensed with is this likely to be achieved.

On the other hand, those firms that have developed along 'commodity' lines, such as volume residential property, debt recovery, mortgage recovery, defendant insurance, personal injury, re-mortgage and probate, are probably in pole position.

They have achieved this by maximising the use of IT and developing processes to drive down costs; taking the meaning of 'leverage' to new heights by maximising the use of paralegals and keeping equity partnerships tight; building market share and focus in well-defined and in-demand consumer law sectors; and efficiently managing their firms as businesses (not just as law firms).

They will probably be the first targets for investors, whether they are investors who see synergy with their own businesses or just plain simple investors out to maximise their returns, either by investment in part or acquisition of the whole.

There may still be other hurdles to overcome. For example, given the effort and cost involved, investors are likely to be attracted to larger targets rather than minnows. Law firms should be building critical mass and market share now by pulling together suitable firms or parts of firms into dominant forces in their market places, whether on a sector or geographic basis, forged together by strong and able management to create highly competitive and profitable businesses.

If partners can divorce their ownership from the business's day-to-day operations, this may be more attractive

Internally, where investment in part is proposed, there will be a need to accept standards and methods of governance, management and performance that have long been the norm in the corporate world. Some will see this as a harsher world and one they will not wish to be part of.

This brings us back to the issue of culture. Perhaps part of the problem lies with the nature of lawyers and the nature of partnerships (limited liability partnerships have not yet changed deep-seated cultural attitudes). Are partners in law firms really ready to 'let go', to become paid employees and managed in the manner in which middle managers in industry are managed?

Whether external investment will happen on a large scale throughout the profession is open to question. What does seem clear is that, to the extent it does, parts of the profession will be increasingly at risk of being unable to compete with large, well-funded, well-managed and aggressively competitive organisations determined to build dominant positions.

As the senior partner of an accountancy firm once reputedly said to his troops: 'For us, being competitive means destroying the competition.' That may be a taste of what is to come in the legal profession.

Instead of just allowing the worst to happen, law firms, particularly in the middle and smaller end of the market, should now be taking steps to get themselves into shape to ensure their future competitiveness. This may involve taking hard decisions and is likely to require consolidation on a scale not before seen.

It can be done, but it will need vision and leadership on the part of those who will be running tomorrow's law firms.

Peter Scott splits his time between running Peter Scott Consulting and being chief operations officer of Watford and London law firm Matthew Arnold & Baldwin