

# UK law firms under pressure

LONDON, UK: Law firms in the United Kingdom will see continued downward pressure on profitability from market conditions and regulatory changes, a recent PwC survey shows.



The profitability of the UK legal sector has remained under continued pressure in 2011 as law firms respond to a combination of very difficult market conditions and a rapidly changing regulatory environment, reports the latest annual law firms' survey from PwC

In response to these twin challenges, firms have been looking hard at their operating models, both in terms of the delivery of legal services and also in respect of their own infrastructure, the survey, now in its 20th year, points out.

The Top 10 firms have maintained their profitability at a similar level to prior years through a combination of scale and their ability to flex their business models. Net profit margins range from close to 50% for the highest performing Top 10 firms, to half this level for other firms in this banding.

Outside the Top 10 profitability has come under continued pressure and overall profits continued to decline sharply, widening the gap between the larger firms and the rest. Average profit per equity partner for Top 10 firms remains at over twice that of the Top 11-25 firms for the second year running (£908 000 Top 10; £443 000\* Top 11-25). The firms that have seen the greatest pressure on profitability have largely been those who are most likely to be impacted by Alternative Business Structures (ABS).

## Headcount starts to drift upwards

Working capital performance has held up reasonably well during the recession. However, 2011 saw a deterioration particularly among those firms that struggled to get bills out sufficiently quickly.

Alistair Rose, partner and leader of the professional partnerships advisory group, PwC said: "Surprisingly this year, despite market conditions, headcount has started to drift up again. Utilisation rates for professional staff have been flat or even in slight decline. Equally surprising, given the focus on support costs, has been the renewed upward trend in the numbers of back office staff for many firms. "

At the same time, the larger firms are starting to grasp the nettle when it comes to business support functions as they try to remove complexity and cost from their businesses. For many firms it is early days but the leading ones are using any one or more of the following: business process outsourcing, legal process outsourcing, onshoring, offshoring and now 'North shoring', the survey shows.

Rose added: "Pricing pressures are here to stay so firms are now looking at different pricing models but most are still highly reliant on the hourly system. This is an area where firms have a chance to differentiate themselves among their key clients and we would expect to see more of this trend in an increasingly competitive market."

## **Newcomers providing a challenge**

The survey also supports the already well documented fact that a number of new entrants to the market are focussed not only on volume areas of legal practice, but are also increasingly looking at areas of law traditionally the domain of medium-sized firms.

In addition, the gap between UK and international performance has continued to narrow, especially among the larger firms. It is interesting that a large proportion of international revenues still come from Western Europe and clearly the current eurozone crisis will have a potentially significant impact on those.

There have been a number of well documented mergers, both domestic UK and UK/US over the last 12-18 months. There will undoubtedly be more of these as the survey tells us that 70% of the 11-25 expect to merge in the next two to three years.

Rose concluded: "Despite their many challenges, UK law firms remain optimistic about future revenue growth. This optimism is matched by plans to further increase fee earner headcount by up to 70%. However, history has often proved that firms have been overly optimistic in their predictions. With global economic conditions having worsened since we completed our survey, we recommend firms consider the impact of different economic scenarios for 2012 and beyond and prepare a 'Plan B'."

*\*Exchange rate at time of posting: £1=R12.89*

For more, visit: <https://www.bizcommunity.com>