



20 October 2009

**ALL TALK NO ACTION AS ANTICIPATED LEGAL MERGERS DECLINE  
DESPITE THIS BEING “THE PRIME OPPORTUNITY FOR  
LAW FIRMS TO CONSOLIDATE OR ACQUIRE”**

The number of managing partners who think that their firms will grow through acquisition has dropped in the past 12 months by 28% (from 43% to 31%) according to the annual *Litmus* research conducted by Network MP with BDO LLP and Jomati Consultants LLP. This is in sharp contrast with areas where firms see opportunities for growth with team acquisitions, up 70% from last year (from 23% to 39%), and individual hires, up 44% on last year (from 32% to 46%).

**Colin Ives, BDO Partner, Professional services, commented:**

“It is quite remarkable that firms are losing their nerve when it comes to mergers and acquisitions. The current downturn is actually the prime opportunity for law firms to consolidate or acquire. In a downturn disparities are evened out and partners are more accepting to the need for consolidation. Mergers and acquisitions in this market give the best of both worlds - a chance to cut overheads and a sudden influx of new clients. Fortune favours the bold and law firms should seize this opportunity. Berwin Leighton and Paisner & Co merged after the dotcom crash in 2001 and have become highly successful.”

An incredible 82% of those surveyed said that they thought consolidation within the industry would be the greatest change to the marketplace over the next few years, with 48% citing redistribution of work as the greatest change, perhaps heralding the loosening grip of the Magic Circle. These figures stand in stark contrast to the fact that fewer firms are actually expecting to be involved in a merger.

67% of law firms had engaged in discussions about a merger or acquisition in the last 12 months, virtually the same as last year, however only 31% said they expected to be involved in a merger, down 28% from the 43% figure who thought the same the year before.



The overwhelming majority of those who were considering merging said that they were planning to merge with a smaller organisation, with 11% expecting to merge with a larger firm - a great increase from just 3% looking to larger firms last year - and 15% expected a merger of equals.

**Tony Williams, Principal, Jomati added:**

"It's interesting that many firms expect widespread consolidation particularly in the mid-tier market and that many have been, or expect to be, involved in merger discussions. Perhaps however firms are showing a lack of imagination by only wanting to contemplate mergers with smaller organisations. With the market changing so rapidly such conservatism may be misplaced."

#### **HOURLY BILLING - Death by 1,000 cuts**

The research highlights how the dominance of hourly billing is in fast decline - 46% used hourly rates less over the last 12 months and a further 54% are planning to cut their use of hourly rates over the next 12 months.

The research also reveals that 69% of law firms were planning to increase the use of success-based fees, a 35% rise on those increasing the use in the past 12 months (from 51% to 69%); while none expected to decrease the use of this fee structure. 59% of firms have also now increased the levels of discount they are offering clients in comparison to previous years - as a rough average firms are offering average discounts of 12.8%.

**Colin Ives commented:**

"Pricing strategies at law firms are changing significantly and the once dominant hourly-billing model is in full decline. Also our survey has revealed that firms readily admit to discounts of up to 25%, although I expect that real discounting is as high as 50% at some firms.

"Discounts should be considered where there is a long-standing relationship with the client, or a long relationship is expected. However, there is a danger that firms in the current economic climate are making knee-jerk reactions in a bid to keep clients. One firm, for example, desperate to keep clients, did a project for the nominal sum of £1. This is of course unsustainable. It may be preferable to look at different options on fees such as fixed and success-based fees in order to ensure that quality of work is not compromised and the brand of the firm is not undermined. It is also a pricing model that will work when the good times return."



**Tony Williams added:**

"The challenge for law firms is to understand the financial implications of discounted and fixed fee arrangements. The compound effect of lower activity levels and lower pricing will decimate a law firm's profitability if it does not fundamentally change its way of working."

**Deborah Hill, Head of Network at Network MP added:**

"While the use of hourly-rates continues to decline, this remains the preferred pricing structure for complex work, with three quarters (76%) of firms set to use hourly rates as the most used pricing structure for technical and strategic work. When it comes to offering fixed pricing, firms are clearly more willing to offer this option on low margin work: half of firms (51%) frequently offered fixed pricing on low margin work last year against 20% for high margin work. Firms are hoping to pull back on this as the economy recovers with fewer than half (43%) expecting to use fixed-prices frequently on low margin work, a 16% decrease from last year."

The research has also revealed that larger firms (those with a turnover over £50m) are significantly more likely to use fixed-pricing and discounts. For instance about two-thirds (64%) of smaller firms (those with turnover under £50m) are increasing the use of fixed-pricing compared to 91% of larger firms; 58% of firms with a turnover under £50m plan to increase their use of discounts compared to 80% of larger firms.

**Tony Williams added:**

"The rapid fall off in larger transactional work has clearly significantly impacted the larger firms. General Counsel now realise that they have buying power and are exercising it. Not only do they want reduced fees but they want certainty, hence the rise in fixed pricing".

**Other highlights of the research include:**

- Law firms are seeing a shift in their banking arrangements and expect to source funding from the banks. With 40% expecting to source additional funding over the next 12 months, 74% of those expect to source this as a bank loan. Distrust still remains with almost 60% of firms considering dual banking to spread risk. 39% of firms meanwhile have noticed banks have become stricter with their lending policies.
- Half of all firms also expect to increase bad debts over the next 12 months. Only 13% expect to decrease it.



- 46% of firms consider individual lateral hires to be their greatest growth opportunity over the next 12 months, whilst 44% of firms consider new clients to be their greatest growth opportunity.
- Managing Partners are even bullish about turnover and PEP. A quarter of Managing Partners envisage turnover increasing by up to 5% and another quarter by between 5 and 10%; 20% of Managing Partners expect PEP to increase by up to 5%, 16% expect it to increase by between 5 and 10%, and a quarter expect it to increase by over 10%.
- In order to reduce their cost base, 76% have/are considering reducing headcount of professionals, 80% have/are considering reducing headcount of support staff and 76% have/are considering freezing salaries. 80% of firms however won't even consider outsourcing the fee-earning work.
- 31% of firms expect to be involved in a merger or acquisition over the next 12 months; of those, 74% expect this to be with a smaller organisation.
- Outsourcing remains generally unpopular, with 80% of firms not outsourcing HR and 73% not outsourcing technical processes (e.g. legal process outsourcing). Over half of firms, however, outsource training.

**Colin Ives continued:**

“Our research shows managing partners are quite bullish about growth, expecting to increase turnover on average by 5% next year. However, it is worrying that law firms see new clients as one of the main growth opportunities. With the economy in recession and little growth likely in the demand for legal services, a new client for one firm will be a loss for another. While if discounts are being made, much more work needs to be sold simply to stand still. Winning new clients is costly and time-consuming, so firms should instead put emphasis on maximising well-established client and referrer relationships to increase cross-selling”.



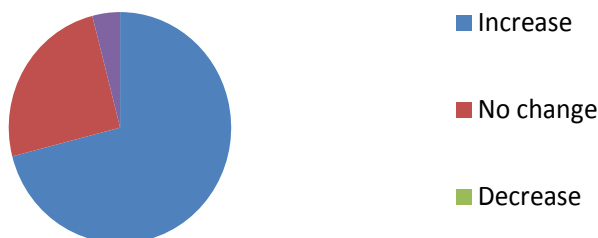
Charts:

**How do you envisage the frequency with which you use Hourly Rates will change over the next 12 months?**

Source: Winmark



**How do you envisage the frequency with which you use Success-Based fees will change over the next 12 months?...**



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### **Notes to Editors**

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The study entitled 'Leadership Litmus' took place between August and September 2009 and was conducted amongst 55 law firms.

81% who responded were either Managing Partners or Chief Executive Officers with the remainder either Chief Finance Officers, Finance Directors or Chief Operating Officers.

### **About NetworkMP**

NetworkMP is a community of Managing Partners and CEOs of leading professional services firms. Being at the heart of this network enables members to interact with peers and gain genuine insight and business advantage through learning forums, research campaigns and other resources.

### **About Jomati**

Jomati Consultants LLP is a UK based strategic consultancy to the legal profession. It advises on a wide range of issues including law firm strategy and execution, remuneration and appraisal, practice development and strategic mergers and other developments. It clients range from 5 to 500 partner firms in the UK and worldwide.

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