CAUTIOUS OPTIMISM PREVAILS

As the Irish economy continues to grow, the outlook for professional services firms across the country remains positive as more property and corporate transactions continue to drive demand for legal and financial services across multiple sectors.

For legal services firms - most of which have recorded strong growth in recent years - the outlook is cautiously optimistic. Slowing growth rates, margin pressure from increased wage and office costs, plus the looming threats of Brexit and increased competition from US and UK firms entering the market, will all present their own unique challenges.

Smith & Williamson, a company who specialise in working with legal firms, according to the most recent Smith & Williamson Annual Survey of Irish Law Firms for 2018-2019 – which surveyed 130 firms around the country – both revenue and profit growth for the past few years have been strong with 69% of firms reporting increased revenues in 2018 while 60% have increased their profitability. In addition, the outlook for the next 12 months remains broadly positive, with 50% expecting it to improve while 46% expect it to remain stable, according to Paul Wyse, Managing Partner of Smith & Williamson.

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One of the most significant things about the sector is that it has recovered well from the recession and most firms have grown their revenues and profitability. The growth is particularly noticeable in Dublin, where many of the top firms are based, building from 2015 onwards. For regional practices, the growth started to occur after 2016. It has taken a little bit of time for this growth to gain momentum in regional practices, but they have all seen significant revenue growth over the last few years and the challenge now is around maintaining profitability in light of increased staff costs. These have shot up over the last three years, just as accommodation costs in city locations have started to increase quite dramatically as firms look to expand,” he says.

“Brexit has resulted in some of the larger UK and international firms setting up offices in Dublin. What does this mean? Effectively they would have used the larger firms in Ireland to do their work in the past. Now, however, they are building...”

KEY ISSUES FACING THE LEGAL SECTOR OVER THE NEXT 3 YEARS

- Maintaining profitability
- Recruitment & Staff Retention
- Economy
- Brexit
- Pressure on Fees
- Managing Cash Flow
- Regulation
- Adopting new Technologies
- Cyber Risk
- New Forms of Competition
- Other

Source: Smith & Williamson

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According to the Law Society Annual Report, there were 10,799 registered solicitors in 2018. However, 90% of them work for firms that employ fewer than five staff and this could pose an obstacle to the widespread adoption of newer technologies which will help drive efficiencies. Their own teams in Ireland and some have stated that they intend to be a Top 10 firm in their own right within a number of years. This will inevitably lead to some displacement with teams being poached; we could see some change to the order of firms we have in terms of size,” says Paul.

He points out that the recruitment and retention of staff is the single biggest issue facing the legal services sector at the moment.

“Recruitment and retention is the biggest issue for the sector today. Competition for staff, particularly among the bigger firms in Dublin is intense and has been for some time. This problem has been compounded by competition from some of the newer firms - from the UK, in particular - which are staffing up. This is having a knock-on effect on wage costs as firms look to hold on to key staff. So, while the survey shows there has been significant revenue growth, this hasn’t necessarily translated into significant profit growth because a lot of that is going on increased salary and office accommodation cost which, in turn, is squeezing margins. Overall, I would say the fee pressures are greater regionally while the recruitment pressures are greater in the urban centres like Dublin. Addressing the squeeze on margins is now paramount,” he says.

“There are two things firms are doing to address the margins squeeze: the first is targeting higher margin work. Secondly, many firms have increased their charge-out rates or done less low margin/ discounted work over the last three years, whereas there was a huge nervousness about doing that post-recession. Firms are also looking at ways they can be more efficient. That’s where new technologies are being adopted, particularly by the larger firms.”

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“There is significant IT development in the legal sector; notably in artificial intelligence and data analytics, and in particular, among the large international firms in the UK. The adoption of those technologies is only really starting, and I think in the next five years we’re going to see some significant change in the way law firms do things and the type of people they’ll take on. It will probably impact the larger firms first and then work its way through the sector to smaller firms,” says Paul.

“The bottom line is clients will always want to have interaction and engagement with people and they will not want robots doing their legal work for them. What they don’t want is to be charged for things that can be done more efficiently by technology,” he says.

As competition in the marketplace continues to intensify, he points out that the structural challenges facing the market will continue to act as a deterrent to any large merger and acquisition activity.

“Significant mergers in the Irish legal sector have been few and far between over the last five years. Most of the mergers have involved smaller firms, often designed to deal with effective succession or to deliver scale in a specialist area. In contrast, for larger firms, growth has been mainly organic, supplemented by lateral hires and expansion into international markets. There has, however, been a notable increase recently in merger activity in the Irish legal market. The most notable was that between McDowell Purcell, one of the mid-tier Dublin firms, and Fieldfisher from the UK. We have also seen Clark Hill set up in Dublin, merging with the practices of O’Grady solicitors and JP Galligan solicitors andLK Shields merger with Kilnoy Solicitors.

“However, if we are starting to see partner equity in firms build up again as profits increase which enables people to plan for the future. A lot of partners put off retirement ten years ago because of what happened and they are now looking at retirement and thinking about succession planning again. There are significant opportunities for smaller and younger firms to grow on the back of established practices with client bases where people are retiring and there’s a huge opportunity there from a banking perspective to help people bridge the gap to enable a goodwill or work in progress payment that gives the acquiring practice the opportunity to expand and build something worthwhile in terms of scale and size.”

“As it stands, more than 90% of firms have less than five solicitors and this may be a longer-term vulnerability leaving firms without the firepower to improve their technology base, compete on salaries and working conditions, or build specialist expertise. However, many lawyers want to run their own practice and, it appears consolidation and M&A activity will continue to be limited and piecemeal,” concludes Paul.
with the Irish service sector a key contributor to economic growth, there has been an across-the-board rebound in the fortunes of many professional services firms since the most recent economic downturn. Notwithstanding the possible impact of Brexit and other possible global and regional economic challenges, the outlook remains cautiously optimistic, according to Ciaran Foley, AIB Sector Strategist for Business and Professional Services.

“As we approach the third quarter of 2019, the Irish economy remains in a strong position and services sectors remain cautiously optimistic that the next 12 months will yield further growth. Indeed, the most recent AIB Ireland Services Purchasing Managers’ Index mirrored this cautious sentiment reducing in April to 54.7 from 55.3 in March. This suggests that the Irish economy is continuing to expand and, given the positive correlation between the prosperity of professional services firms - including legal firms - and the wider economy, the outlook is positive,” he adds.

He adds that while professional services firms, in general, have experienced growth, “there remains a two-speed recovery when it comes to larger national and internationally-focused legal firms and the many regional and local firms.”

“There are also macro trends and risks such as Brexit, a slowing global economy, political uncertainty and tighter regulation and compliance requirements that can affect the sector but also micro trends and risks which will shape its future, including wage inflation, disruptive technology, pressures on cashflow and blurred revenue lines,” Ciaran says.

In terms of Brexit he points out that while the services sector could be considered less exposed than other sectors in the Irish economy, the customer base of legal firms may be highly impacted by any Brexit outcome.

“Firms should be cognisant of the concentration of risk in high-risk sectors such as agriculture, manufacturing, logistics and retail. Brexit will have an impact on the economy and the impact it will have on professional services sector will ultimately depend on whether or not there is a hard or soft Brexit,” he says.

He points out that some of the other key challenges legal service firms face include wage inflation and pressure on fees. “Top line revenues at most legal practices have been increasing as a result of new business generation, however, margins remain tight as wage inflation and pressure on fees continues to be a feature of the sector. In addition, increased upfront costs to cover work in progress can contribute to cashflow difficulties,” says Ciaran.

“We are also seeing year-on-year increase in salaries as a percentage of turnover and it is a concerning trend for the professional services industry.”

“While lock-up capital is a by-product of the industry, legal firms have become more focused on efficiencies and collection periods to control overhead costs. They are also implementing proactive strategies like using working capital facilities from banks to ease the burden on cashflows as well as promptpay and insurance premium finance products to smooth out the peaks and troughs over the trading year,” he says.

“In a review of business financials, we are also seeing year-on-year increase in salaries as a percentage of turnover and it is a concerning trend for the professional services industry. This pressure is likely to continue into 2019 and beyond with the sector considered at full employment. While cost management is essential, AIB recognise that while firms are acquiring and embedding new staff, there is a cost and it will take a period of time before the acquired talent produce fee earnings at capacity. Key performance indicators for legal firms will be reflective of this,” says Ciaran.

With the overall economic climate now more favourable, he points out that M&A activity is likely to pick up pace in 2019. As businesses expand their national footprint and invest into regional areas, some of the largest legal firms are following their domestic clients and are also looking to capitalise on increasing foreign direct investment into the regions. This is exemplified by both Matheson and William Fry recently opening offices in Cork.

“Succession planning and practice acquisition are expected to feature in the second half of 2019 and beyond once the uncertainty surrounding Brexit becomes more transparent. The recession extended the working lives of many legal practice equity partners, however now firms on growth paths are seeing opportunity to acquire well branded and well located practices and practice owners are seeing the opportunity to realise value and exit. Succession planning is something all practices and partners must plan for to maximise opportunity. When the time comes, our expert Private Banking team are available to work through pension and investment opportunities,” says Ciaran.

“AIB has a positive view of the sector and remains committed to supporting the circa 2,300 legal practices and the 18,000 people directly employed in the sector in Ireland. AIB has an in-depth knowledge of the sector and has teams of dedicated Relationship Managers and Business Advisors spread across the country supported by a knowledgeable and centrally based sector team that is mandated to work with and provide insights to customers. We will continue to support the legal sector through the provision of working capital facilities, prompt pay facilities to cover partner annual tax liabilities, practice certification premium as well as capital expenditure and capital acquisition loans, asset finance and insurance premium finance facilities as well as other financial supports and services which the bank offers, concludes Ciaran.”
Two legal firms talk about their challenges and opportunities facing the sector.

One client told me recently that it has been said of us that ‘when you are at the top, Pj’s stay close to you, but when you are down at the bottom, they stay even closer.’

While the firm employs a mixture of family and non-family members, Elaine says that it has managed to retain the original ethos of looking out for both clients and indeed everyone working for the firm.

“This has been a huge source of strength to us as it underpins tremendous staff and client loyalty,” she says. “And we make it clear that we are in this business for much more than just the financial return.”

She says the firm works closely with its business clients and understands that some of these businesses will often have a number of other advisers.

“We like to think that whatever their issue or problem, we are the ones they will call first because we know and understand them so well;” adds Elaine. “One client told me recently that it has been said of us that when you are at the top, Pj’s stay close to you, but when you are down at the bottom, they stay even closer.”

Given the firm’s prominence in Cork, recruiting and retaining staff has not been that challenging in recent years. “We are lucky that we find it easy to recruit good people,” says Elaine. “That may be for a number of reasons: our name has become a brand name at this stage, we are considered a great place to work and we have a great location right in the heart of Cork City.”

She points out that Pj O’Driscoll & Sons has enjoyed a strong relationship with AIB down through the years. “We have been a client of the bank and its predecessor, the Munster and Leinster Bank, since 1989. We are particularly impressed by the knowledge our relationship managers have not just of our own business, but of our sector generally. Over the years we have received some enormously helpful insight, feedback and suggestions,” she says.

The challenge is to differentiate ourselves as an employer so that we ensure that we are recruiting, retaining, incentivising and supporting quality people. I am confident that we have the capacity to continue to deliver to clients the quality services we offer.”

“We have looked at specialist bolt-ons to enhance and complement the existing services we offer to our clients. For example, we brought in Rachel Liston who is very well-regarded as a medical negligence expert and who has capacity to bring in work by virtue of the standing and the profile she has. Likewise, Claire Morgan, who joined our Corporate & Commercial Department in 2016, has given us a major shot in the arm. So, it’s about bringing in the best people and doing top quality work for our clients,” he adds.

With the recruitment and retention of staff high on the agenda of many legal firms, particularly in Dublin, Peter says that it is no different for Orpen Franks.

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