HASLERS

chartered accountants & business advisers

Exit strategies for legal firms

www.haslers.com

Introduction

One of the hottest issues facing the legal profession is succession planning. Partners are having to face up to the changing ways that they can exit from the firm without losing strong leadership, key clients and talented young lawyers, as well as avoiding unfunded retirements or the break up of the firm.

Despite this, and with the average age of equity partners now reaching 60 years, many legal firms are still failing to plan for their exit.

Furthermore, with the prospect of fewer young lawyers being willing to invest in equity to enable the retirement of older partners, it is vital that firms start planning for the future, even if that means considering an alternative exit strategy.

That's where the team at Haslers can help. We can advise on the financial aspects of equity partner retirement, as well as the strategies for moving forward, and have produced this guide as an introduction to the issues that law firms need to take into account.

After considering the traditional approach to succession planning and the factors that are making this a more difficult proposition, we will discuss the alternative exit routes available.

The traditional approach to succession planning

Early succession planning is crucial in order to identify partner replacements and avoid sudden changes which may threaten survivability.

Traditionally, young aspiring lawyers would jump at the chance to purchase equity in a practice – therefore providing a ready-made exit strategy for senior partners.

Issues affecting this approach

With an increasing number of young women entering the legal profession, junior lawyers are becoming increasingly reluctant to risk the financial security of their families in order for substantial payments to be made to retiring partners who have built up a significant capital account.

Furthermore, following the abolition of the default retirement age, it is likely that partners will want to keep working for longer, making it harder to plan for when they will hand over to younger members of staff.

Problems are particularly likely to arise when combining requests for part-time working with the rigidity of traditional lockstep-based systems.

Indeed, even with fewer individuals being made partners, this rigid system can result in a large number of plateau partners. These partners typically earn up to two or three times more than entry level ones and can absorb much of the firm's equity. Without the flexibility required to enable partners to receive a smaller share of the profits in return for working fewer hours, this can become a significant problem.

However, adopting a more flexible style would enable older partners to receive reduced pay on merit terms or take on consultancy-style roles, enabling the firm to still benefit from their expertise.

If such issues are not effectively addressed, promising young lawyers may defect to competing practices where they feel their career prospects are better, so impeding the future growth of the firm.

Alternative succession strategies

As a result of the issues discussed previously, increasing numbers of law firms are considering alternative exit routes. These more radical strategies encourage potential partners to invest in the firm, enabling future growth.

Sale of the practice

The problems of replacing senior partners with younger ones can often result in the practice being put up for sale. However, while a flotation or private equity buyout provides the partners with their invested capital, there is no guarantee regarding the future of the firm.

Limited liability company

Such issues can be overcome by trading as a limited liability company (LLC), where partner capital accounts are replaced by share allocations, enabling the practice to be purchased from the original equity partners.

Indeed, this approach can attract younger lawyers to take director positions, purchasing their equity by receiving performance-based shares. Consequently, they are able to enjoy a healthy work/life balance as well as all the benefits of being a partner.

Employee buyouts

It also enables an employee buyout to take place. In such cases, the shares are owned by the employees or through a trust, so they can only be sold and bought by members of staff. As employees have a greater say in the running of the firm, their satisfaction levels are higher, resulting in greater productivity and reduced staff turnover. Furthermore, sharing the knowledge built up by employees means the firm is more resilient to any downturn in the economy.

Merger

Merging with another practice can enable a firm to become more competitive in the long term due to both the cost savings achieved and the opportunities for business development through cross selling. It can also enable practices to expand into more financially-rewarding specialist and niche areas, attract bigger clients and move to better offices with dedicated IT systems.

However, taking such action can also result in the firm losing some of its independence, and conflicts between the different cultures of the two practices.

Hire in dedicated expertise

For law firms that are looking to develop their expertise in a particular area, they can hire in a partner with the dedicated knowledge required.

This can be particularly helpful if an area is not particularly competitive or has been weakened by the retirement or defection of previous specialists.

Restructuring

A further option is restructuring the practice to concentrate on the specialisms of senior partners or to move from a lockstep system towards one based on merit.

While the latter of these would make it easier for retiring partners to work part-time and encourage younger lawyers to remain with the firm, it also requires investment in training, evaluation and feedback for upcoming associates.

Security considerations

With staff at law firms now being encouraged to work from home using company laptops and remote access to servers, there is greater potential for partners to take sensitive data with them when they leave.

Therefore, firms need to assess the risks associated with the use of such technology and devise a policy which safeguards this valuable intellectual property. This should include backing up the information on departing employees' devices, so that evidence is available if a breach is discovered retrospectively.

To find out more...

This guide only provides a brief overview of the options available to law firms. For more in-depth advice, tailored to your particular circumstances, please contact Lawrence Shafier or Hiten Patel. Both have considerable experience working with clients in the professional service sector, including solicitors.

They are able to provide solicitors with dedicated advice on issues such as working capital management and succession, as well as keeping them up to date with legislative changes.

Contact telephone: **020 8418 3333**

Lawrence Shafier
lawrence.shafier@haslers.com
Partner, Business Services Group

Hiten Patel
hiten.patel@haslers.com
Partner, Business Services Group

Contact Haslers

Scan Me!

Old Station Road,
Loughton,
Essex,
IG10 4PL

- Tel: +44 (0)20 8418 3333
- Fax: +44 (0)20 8418 3334
- E-mail: advice@haslers.com
- Web: www.haslers.com

Business Awards WINNER

ICAEW SOUTH ESSEX SOCIETY OF CHARTERED ACCOUNTANTS

ICAEW Essex Accountancy and Business Awards 2011
Accountancy Firm of the Year – Haslers

UK200Group
independent quality assured professionals

Haslers is registered to carry on audit work and regulated for a range of investment business activities by the Institute of Chartered Accountants in England and Wales.