



**GEARING UP FOR THE FUTURE**

**2016 SURVEY OF SCOTTISH  
INDEPENDENT LAW FIRMS**

# FOREWORD

Scotland's independent legal practices are feeling optimistic about the future. Financial performance is strong and firms are confident that their pipeline of client instructions will continue to flow steadily in 2016 according to the results of BDO's survey of independent Scottish legal practices.

For the first half of the financial year 2015/16, 88% of respondents reported higher fee income and 65% higher profit per equity partner ('PEP') than the same period in the previous year. In 2015, 82% of firms recruited additional staff and 35% of those have increased their headcount by over 5%. 88% predict that they will be recruiting additional headcount in the next 12 months. However, a number of firms did report that their numbers have remained the same which may be a reflection of an economy that is settling down. Overall, however, these are encouraging numbers.

Firms are showing robust financial and business management with additional capital being injected by 31% of firms. 23% of firms reported that other lenders and banks were keen to make facilities available. It is encouraging to see that the opportunities are there for those firms that are seeking external funds to expand their business. Borrowing is minimal and many firms remarked that they had no debt. This is a marked change from 2009 when 62% of firms were in discussions with their banks about additional borrowing.

From an internal perspective, against a backdrop of focus on improving PEP contributions, firms are also taking a tougher stance on the shape of their partnerships with 60% reducing an equity partner's interest and 40% demoting partners from equity to non-equity status. High lock-up days remain a concern to respondents but, as with last year, this may be a reflection of the continuing desire to manage cash and working capital more effectively. All firms are investing in technology to enhance the delivery of their services with 50% having already made a significant investment and 50% planning to do so.

67% of firms believe that the real estate and construction sector will perform strongly this year although this is a drop from 92% in 2015. Technology and media is expected to grow in equal measure and food, leisure and hospitality follows in third position at 47%. We reported confidence in this sector in our recently published food and drink report\*. Interestingly, all respondents believe that the downturn in the oil and gas sector will only have some or no impact.

It is clear that further consolidation of mid-tier Scottish firms or mergers with UK national firms is expected. 53% of firms stated that they had held merger discussions last year. For those who did not, the lack of cultural fit was cited as the main reason. Having said all of that, 69% of respondents believe that there are still too many law firms and lawyers in Scotland.

If you would like further information about our survey findings or you would like to discuss the challenges and opportunities for your firm, please do contact me.

Thank you to all of those firms who took the time to complete the survey. Your input has been invaluable and is much appreciated.



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\* We reported that the majority of Scotland's food and drink sector expected to see growth of up to 20% in the next year - BDO Food and Drink Report 2016 published in partnership with The Institution of Mechanical Engineers

# EXECUTIVE SUMMARY

## STRONG FINANCIAL PERFORMANCE

A resounding 88% of respondents reported that their financial performance exceeded the same period in the previous year with only 6% reporting that they were on or behind budget. No firms reported a drop in results. Most firms reported that profit per equity partner either exceeded or was consistent with the same period in the previous year. 81% anticipate that profitability per equity partner will increase in the next financial year. This is up from the 64% who predicted an increase last year.

## HEADCOUNTS CONTINUE TO INCREASE

82% of firms reported an increase in headcount and no firms have reduced their headcount this year. 88% confirmed that they plan to recruit in 2016. Meanwhile, 60% of respondents reduced an equity partner's interest in the firm, 40% demoted partners from equity and 70% showed poorly performing partners the door.

## PRACTICE MANAGEMENT CHALLENGES

Consistent with last year, there were few firms showing extreme concern about any practice management aspects. The most significant issue being the high number of lock-up days with 87.5% finding this concerning. Firms were concerned about staff not achieving budgeted billing hours (56%) and there was an increase in firms expressing no concern about the possibility of clients negotiating lower fee levels (50%). Encouragingly, no firms are concerned that they will see a reduction in the number of client instructions; property is not an issue either with no concerns around surplus property or rent charges.

## MORE SECTORS AND SERVICE LINES PREDICTED TO RETURN TO GROWTH

67% of firms predicted that both the real estate and construction and the technology and media sectors are most likely to see significant growth during 2016. However, this is a drop for the real estate and construction sector where 92% were predicting growth in 2015. Service lines showing strength include litigation (62.5%) and private client (56%). 44% of firms believe that corporate and commercial will grow this year and there is an upturn predicted in infrastructure and projects (37.5%).

## CHARGEOUT RATES INCREASING

There is an increase in the average hourly charging rates for equity partners which has increased to £271 from £234 in 2015. This is perhaps a reflection of increased confidence in both the economy and the flow of client instructions.

## SURVEY RESPONDENT FIRMS' PROFILE

The BDO Survey was undertaken in January 2016 and the 17 respondents\* are all firms in the Top 30 Scottish legal practices with the following profile:

Average number of equity partners	23
Average number of salaried partners	12
Average number of full time employees	217
Average hourly charging rate for equity partners	£271. Ranging from £225 - £300
Average hourly charging rate for newly qualified solicitors	£159. Ranging from £125 to £180

Please note that as some questions permitted more than one answer from respondents, percentage values may not add up to 100%.

\*There were 16 respondents in 2015.

## SLOWDOWN IN MERGER ACTIVITY BUT STILL PREDICTED

Slightly over half of all respondents (53%) admitted to holding merger discussions but there was also a rise in the number of firms that have not (47%). Consolidation in the market is expected to continue with 63% believing that it is likely or highly likely and it is predicted that we have not seen the end of firms becoming insolvent with 37.5% believing that it is either likely or highly likely.

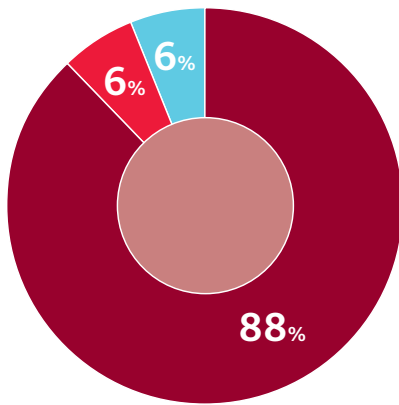
## STILL TOO MANY LAWYERS AND LAW FIRMS

The Scottish legal landscape continues to evolve due to the changing marketplace. As a result, many firms believe that the market is saturated with 69% of respondents stating that there are still too many law firms and lawyers in Scotland. This explains why respondents believe that more mergers and more insolvencies may be on the horizon. The economy may be settling down but the legal market still has some way to go before demand matches supply.

# CURRENT ECONOMIC CLIMATE

## 01

In the first 6 months of financial year 2015/16, how satisfied were you with your firm's financial performance?

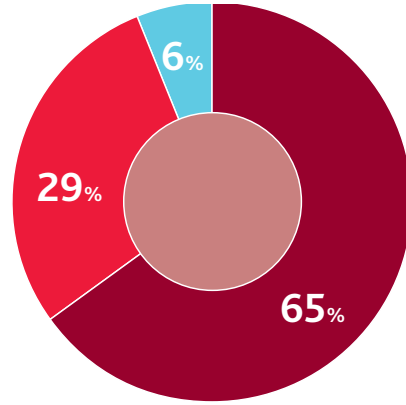


- Our fee income exceeded the same period in the previous year
- Our results were broadly consistent with the same period in the previous year
- Although behind budget we were not too concerned with the outcome
- Our results were lower than the same period in the previous year

Almost 90% of respondents have reported an increase in fee income compared with the first six months of last year. This is higher than last year and clearly demonstrates that growth in the sector continues. No firms reported lower activity in the first half of 2015/16 which is consistent with last year.

## 02

In the first 6 months of financial year 2015/16, how did your profit per equity partner perform?



- Our profit per equity partner exceeded the same period in the previous year
- Our profit per equity partner was broadly consistent with the same period in the previous year
- Our profit per equity partner is lower than the same period in the previous year

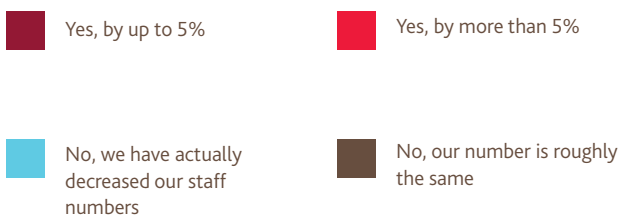
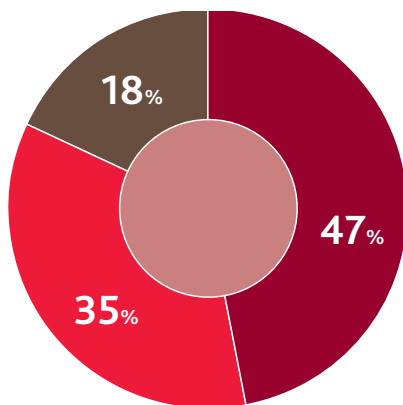
65% of firms recorded higher profit per equity partner in the first 6 months of this financial year than the same period last year. This is up from 44% in 2015. Only 6% reported lower profits in the first 6 months of the current financial year.





### 03

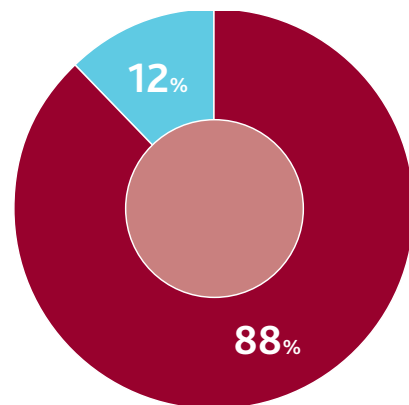
In calendar year 2015, have you increased your number of employees?



The headcount statistics paint a healthy picture. No firms have reduced their staff numbers in 2015 which is significant when compared with 2011 when 31% decreased their numbers. The percentage of firms increasing their headcount by more than 5% has gone up which is likely to be the consequence of some firms going into administration or restructuring through a merger in 2015 and other firms taking on their staff. In addition, some firms reported that their headcount has remained the same which is perhaps a reflection of an economy that is settling down.

### 04

As growth in the Scottish economy steadies, do you believe you will be recruiting additional headcount in the next 12 months?



No change on last year when it comes to recruitment. 88% of firms are still predicting that they will be recruiting in the next 12 months with only 12% stating that they do not have any plans to do so. This is a reflection of the responses to the first two questions where fee income is enjoying continued growth.



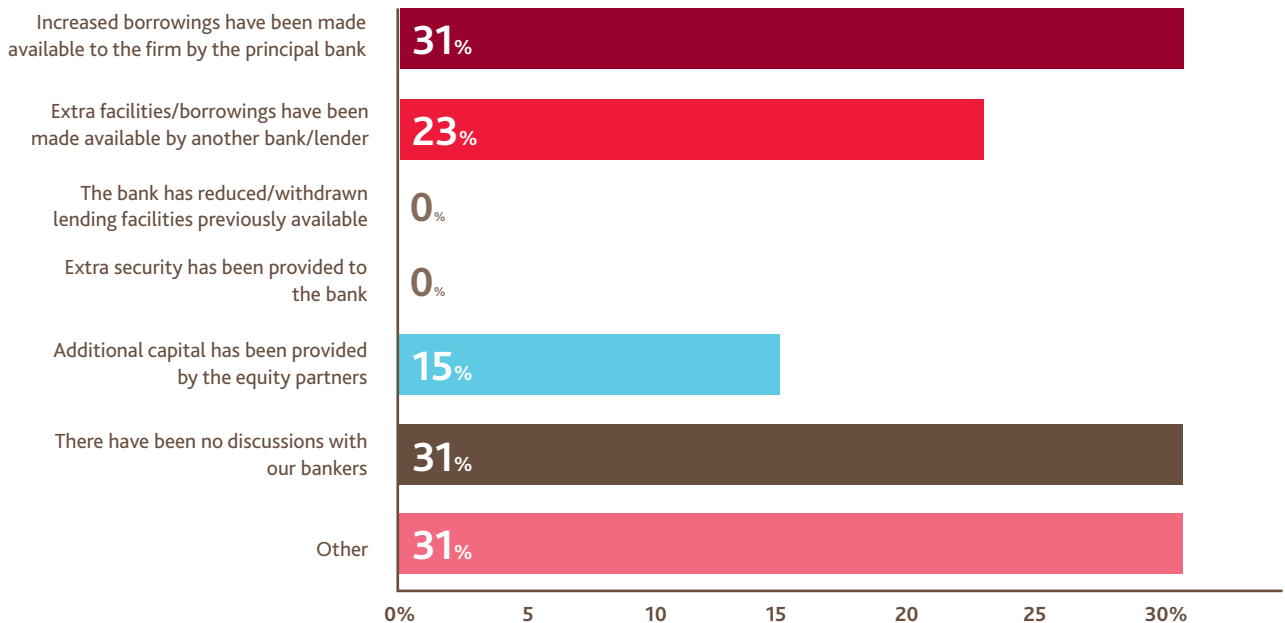
“ These results are very encouraging and show continued confidence in the future despite signals that the Scottish economy is not growing at the same rate as the years immediately following the recession.

MARTIN GILL



## 05

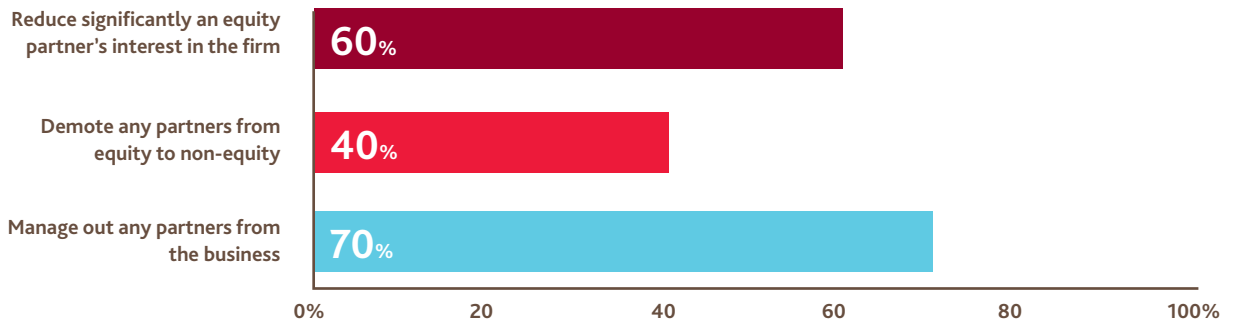
When considering your firm's banking position in the last 12 months, which of the following apply?



The number of firms increasing their borrowings with their principal bank has gone up marginally and other lenders and banks are clearly keen to provide extra facilities. This could be a sign that lenders have increasing confidence in the sector following further consolidation and improvements in the economy. Consistent with last year, no banks withdrew lending facilities previously available and no issues were reported in obtaining access to finance. Several firms commented that they had no debt.

## 06

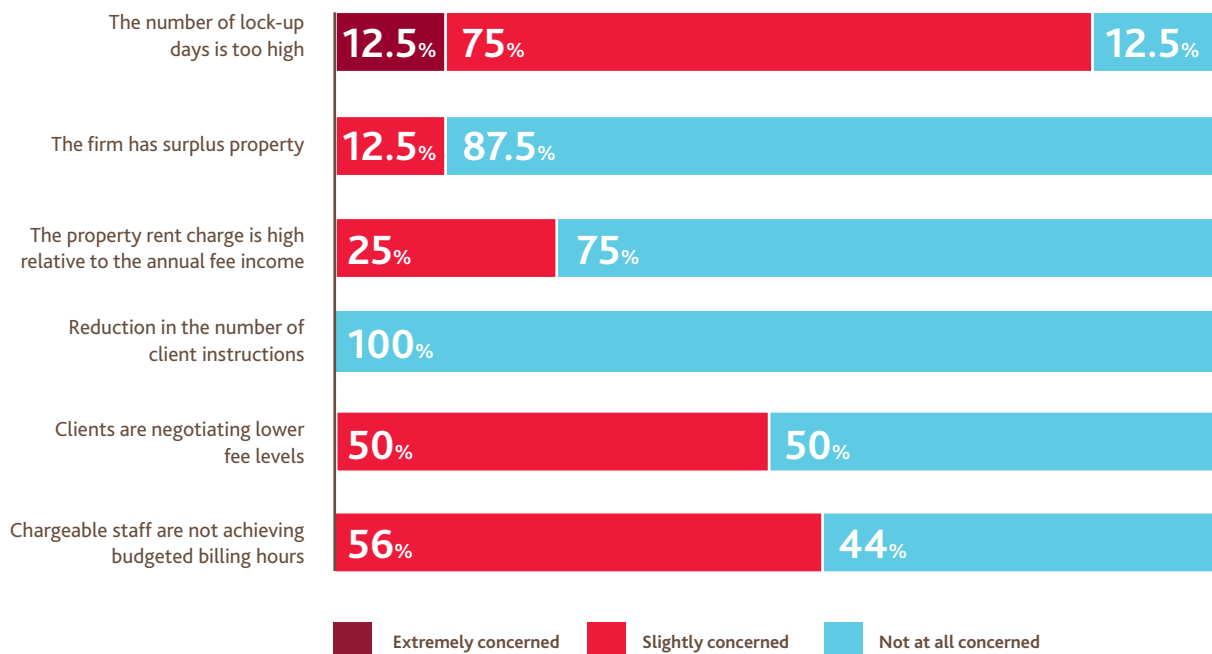
During 2015, did you do any of the following?



Responses indicate that firms are taking a tougher stance on reshaping the structure of their partnerships. The need remains for firms to actively manage poorly performing partners out of the business and there is significant activity around realigning profit allocation by reducing an equity partner's interest and the demotion of partners.

## 07

Which of the following practice management issues are currently concerning your firm?

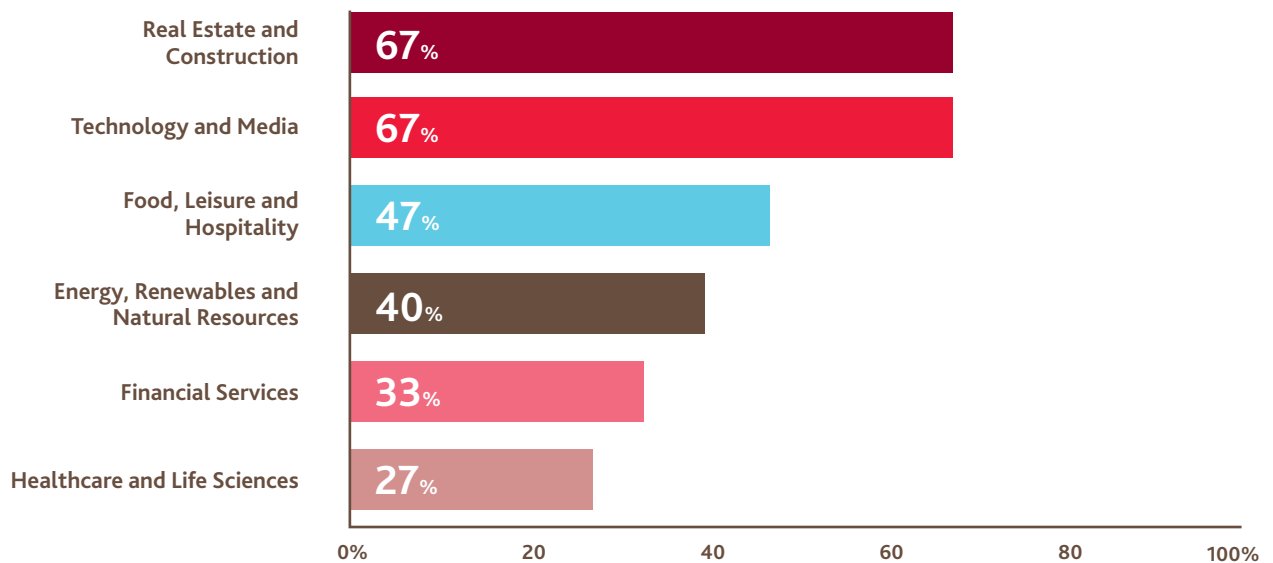


Practice management issues remain of paramount importance. Firms are still concerned that the number of lock-up days is too high. However, levels of concern across the board in this area are slightly lower than last year. Notably, there is absolute confidence in a healthy pipeline of client instructions and less concern about clients negotiating lower fee levels. This is a marked change from 2011 when 44% of respondents were extremely concerned about fees. There is a reduction in concerns about chargeable staff not achieving budgeted billing hours. Overall, these results are a reflection of firms improving their control of practice management issues together with the knock on effect that a more stable economy is having on the pipeline of client instructions and fees.

# LOOKING TO THE FUTURE

## 08

Which of the following sectors do you envisage seeing significant growth during 2016?



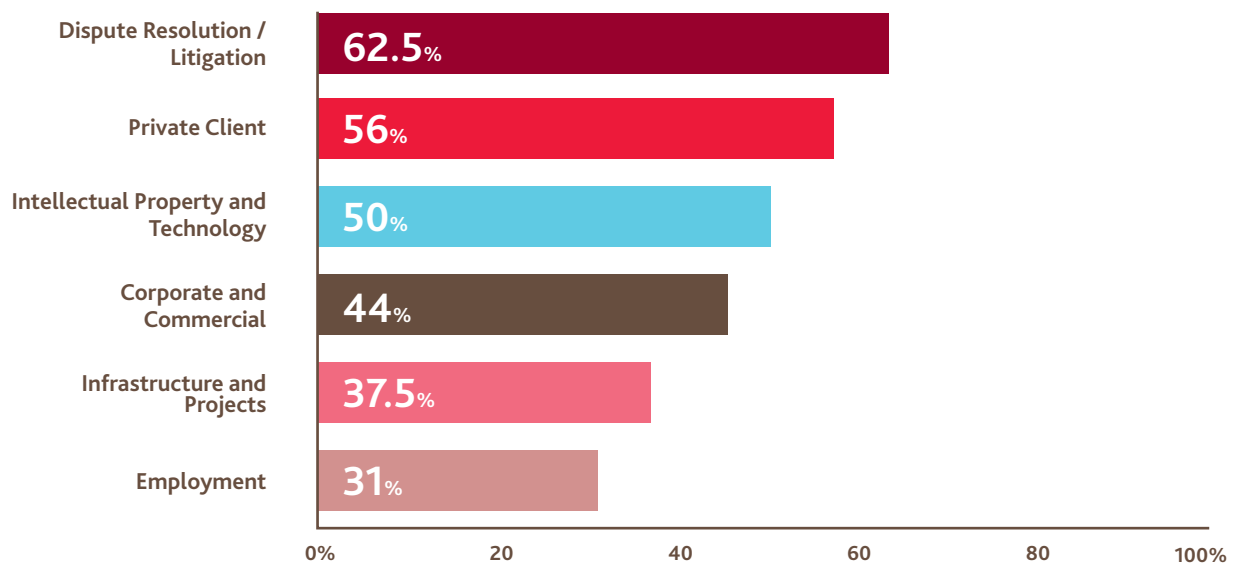
There have been some interesting changes in terms of the sectors predicted to see significant growth when compared with 2015. The above table shows the top six with residential property absent having fallen by 26% to 8th position. There is a drop in confidence in the real estate and construction sector falling from 92% to 67%. The technology and media sector is expected to perform well at 67%. The public sector, insurance and retail were other sectors where growth is predicted, albeit less significantly. One firm remarked that its focus is on winning market share and did not predict growth in any specific sectors.





## 09

Which of the following service lines do you envisage seeing significant growth during 2016?

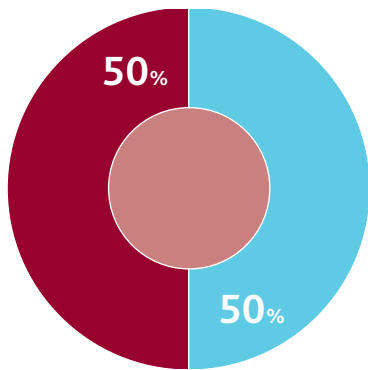


The table above shows the top six service lines predicted to see significant growth in 2016. Litigation is ahead with further growth anticipated building on the 2015 prediction of 54%. Private client work has dropped 21% from 2015 whilst Intellectual Property & Technology has seen a 35% increase. Corporate & Commercial is up to 44% which is perhaps a reflection of the levels of activity in the Scottish deal market in 2015 which is set to continue throughout 2016. It appears that a number of sectors that have struggled over recent years are coming back to life: Infrastructure & Projects and Insolvency are predicted to be on the increase with 37.5% and 25% respectively.



## 10

Technology is playing an increasingly important role in the delivery of legal services and may require significant investment. Do you plan to invest in this area?

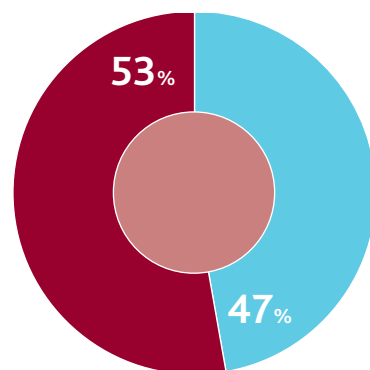


- Yes, we are planning to make a significant investment
- Yes, we have already invested significantly in this
- No, we do not feel that it is necessary

Investment in technology is clearly a given with no firms reporting that they feel it is unnecessary. All firms confirmed that they either have, or plan to invest significantly in technology to assist in the delivery of legal services.

## 11

In the last twelve months have you held merger discussions with another firm?



- Yes
- No

Unsurprisingly, merger discussions are continuing with only a slight reduction in the number of firms confirming that they have been in talks with another firm. This is a clear reflection of the fact that the consolidation of firms in the Scottish legal market is expected to continue.

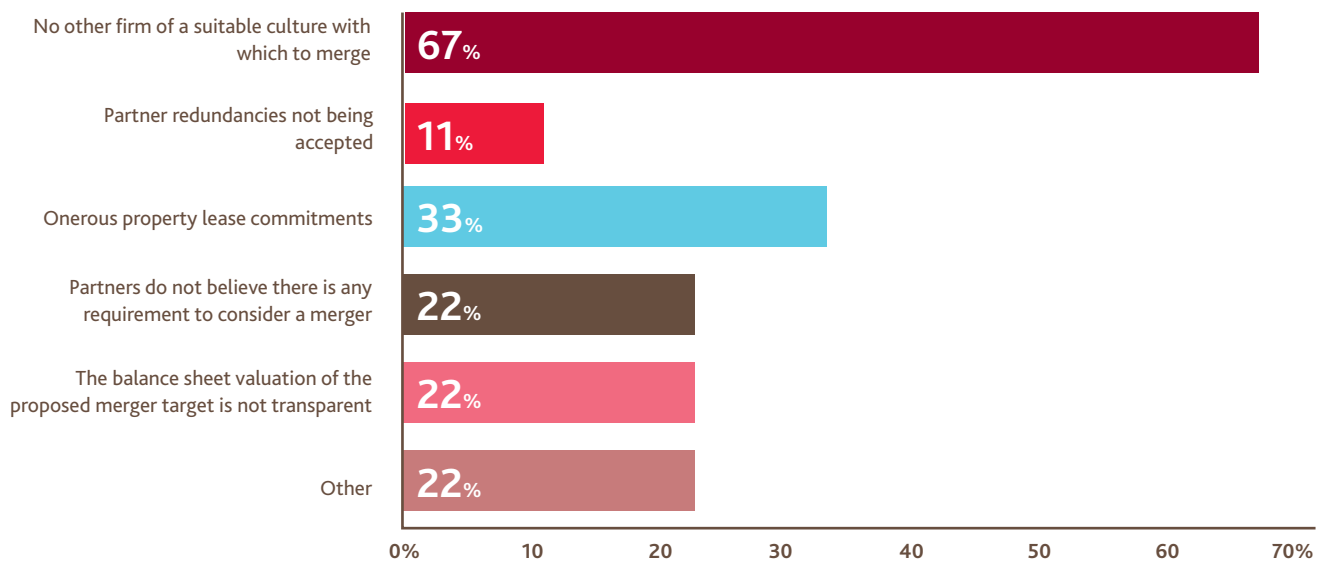
“ Firms are clearly taking some tough decisions and are gearing up for the future by restructuring partnerships and increasing the ratio of staff to partners whilst investing in technology to enhance the delivery of their services. More respondents are standing firm on merger discussions with many stating that they do not want to merge.

MARTIN GILL

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## 12

What do you consider to be the main barriers to your firm merging?



Consistent with the 2015 survey results, the most significant barrier cited is the lack of available firms with a suitable culture to merge with. A number of firms commented on the circumstances having to be 'right' and cited a willingness to consider opportunities if they arose. One firm commented that they simply did not want to merge whilst another remarked that they believed that a merger could 'stifle opportunities for good lawyers within the firm to progress.

# 13

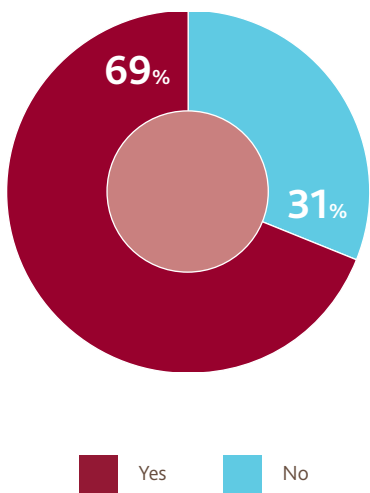
What do you perceive to be the significant changes that the sector will see in the next 12 – 18 months?

	Very unlikely	Unlikely	A possibility	Likely or highly likely
Increasing consolidation of mid-tier Scottish firms	0	6%	31%	63%
More mergers with UK national firms	0	6%	19%	75%
Increasing presence of Big 4 accounting firms in the Scottish legal market	0	31%	63%	6%
European law firms establishing a presence in Scotland	6%	75%	13%	6%
US law firms establishing a presence in Scotland	12.5%	50%	25%	12.5%
More insolvencies of Scottish legal firms	0	6%	57%	37%

The significant changes expected in the sector have remained largely the same and continue to be the further consolidation of mid-tier Scottish firms and mergers with UK national firms. It also appears that there is an expectation that there are further insolvencies of firms on the horizon.

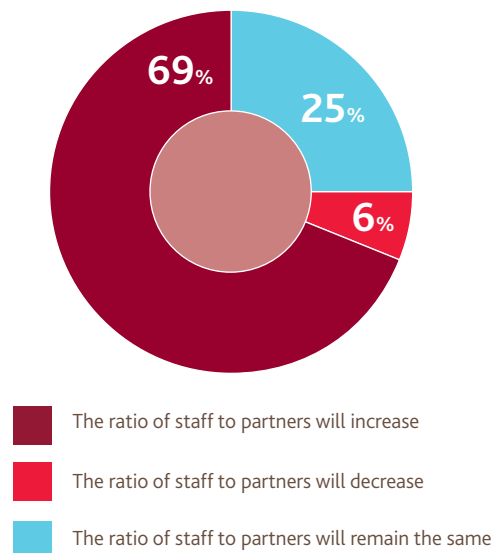
# 14

Given further consolidation in 2015, do you believe that there are still too many law firms and lawyers in Scotland?



# 15

How do you envisage your firm's staff to partner ratio changing in 2016?



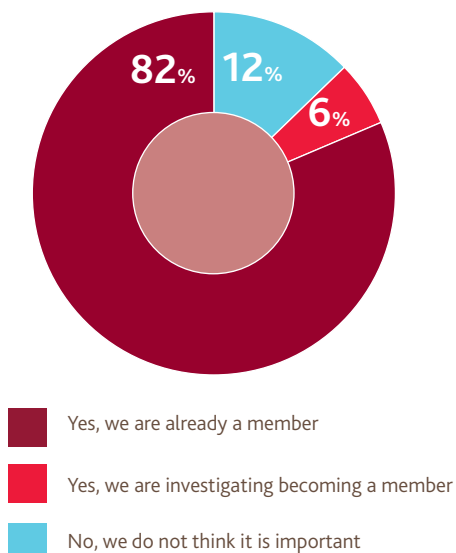
Despite the significant changes to the legal landscape in Scotland over recent years with a number of Scottish legal practices merging with UK firms and some firms becoming insolvent, seven out of ten (69%) of respondents believe that there are still too many Scottish law firms and lawyers.

It is perhaps not surprising that 69% of firms envisage that the ratio of staff to partners will increase in 2016 given that many have taken tough decisions such as demoting and managing partners out of the firm.



## 16

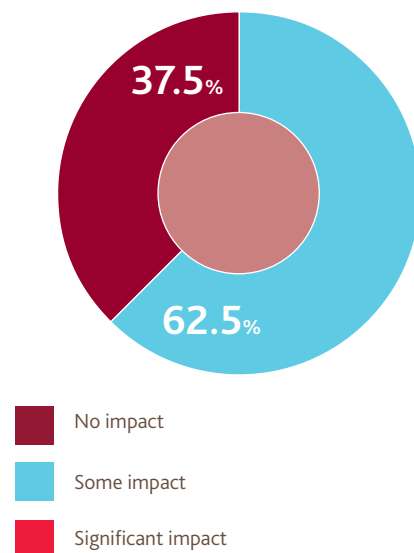
Do you think it is important to be a member of an international network of legal firms?



There is an increase in firms seeing the value of becoming a member of an international network with only 12% thinking that it is not relevant to their business. Globalisation of the economy shows no signs of slowing down and it is vital for firms to be able to service their clients' needs wherever they do business. International legal networks can be a cost-effective and practical way of achieving this.

## 17

In 2016, what impact do you believe that the downturn in the oil and gas sector will have on your business?

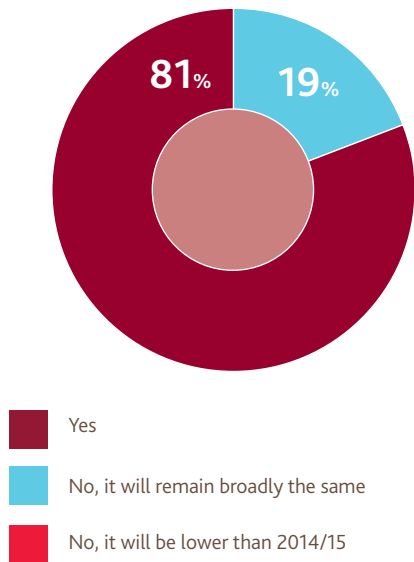


Given the significance of the oil and gas sector to the Scottish economy and the effect that the downturn may have, it is perhaps surprising that the majority of firms believe that it will only have some impact on their business. 37.5% believe that it will have no impact at all; surely this confidence is good news but what does the future hold? One firm commented that they believed that the impact would be primarily on their clients whilst another remarked that it had limited impact on their client base. However, there may be a knock on effect that is yet to emerge.



# 18

Do you expect that your firm's profits per equity partner for financial year 2015/16 will be greater than 2014/15?



Confidence continues to increase with 81% of firms believing that their profits per equity partner will be greater than 2014/15. This is up from 64% last year. Only 19% expect that their firm's profits will remain broadly the same and none predict that it will be lower than last year which is consistent with last year.

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**3,500** Staff

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**95%** of our clients would recommend us<sup>2</sup> | **77%** already have<sup>2</sup>

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### SECTOR KNOWLEDGE

Professional services has been a key sector for BDO for over 20 years. Our Scottish team forms part of a UK wide specialist professional services group delivering full service capability to firms across the industry in the UK and internationally.

1. Independent research (Mid Market Monitor 2012-2015) undertaken by Meridian West shows BDO has the highest client satisfaction rating among its peers  
 2. Client Listening Programme 2014/15



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