Law Firm Benchmarking 2020

Providing clarity in the legal sector

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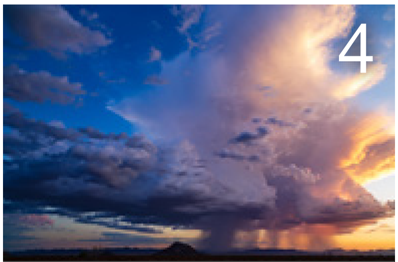
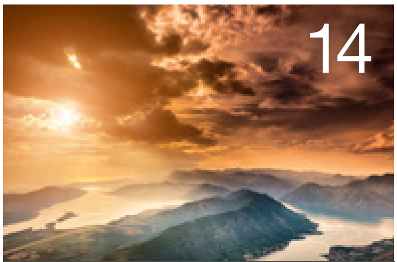
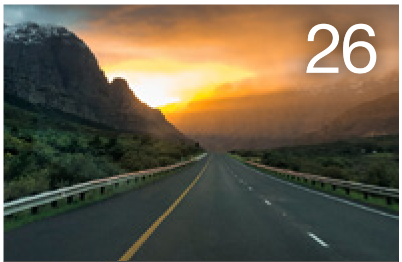
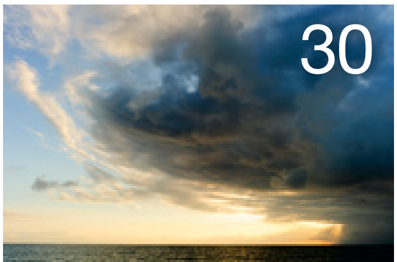
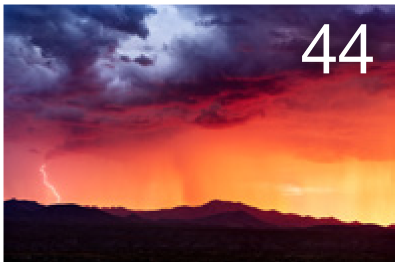







The big picture

Our benchmarking is based primarily on data submitted by UK law firms with a financial year ending in early 2020. With many of those firms having March and April 2020 year ends, the results provide an intriguing snapshot of their financial position as they braced themselves for the beginning of the pandemic, along with an indication of how they responded in the first six months of this unprecedented event.

In our 2019 benchmarking published last year, participants had mixed views on what the 2019/20 year might bring. Against a backdrop of Brexit uncertainty, more than half carried a negative outlook for the UK economy but over three-quarters remained optimistic that there would be opportunities for their firm in the coming year. It seems unlikely those firms would have anticipated that a global pandemic should be high on their risk register.

So, how were firms doing in the lead up to the pandemic crisis? For some, better than ever. For others, a challenging year.

We outline what actions firms took at the start of the pandemic and how firms found the lockdown transition to home working. We also find out how the firms see the current 2020/21 year panning out and their current areas of focus.

Participant firms will be receiving bespoke reports analysing their performance against others, adding further detail to the comment within this full synopsis.

This report will help others gauge their own performance in the market place, what that market has been doing and the areas of focus within other firms.

Revenue - a very polarised year

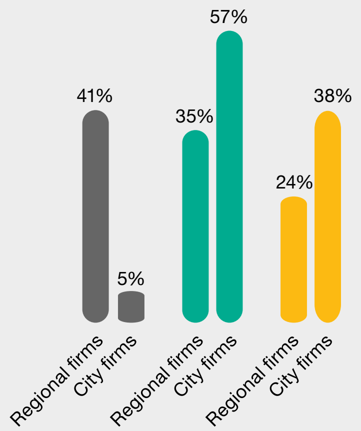
Our 2020 results show average revenue growth of 6.7% across the all-participant population, which is consistent with our 2019 reported figure of 6.5%. This year, it is the City firms leading the way with aggregate growth of 7.4% compared with 5.2% for regional firms.

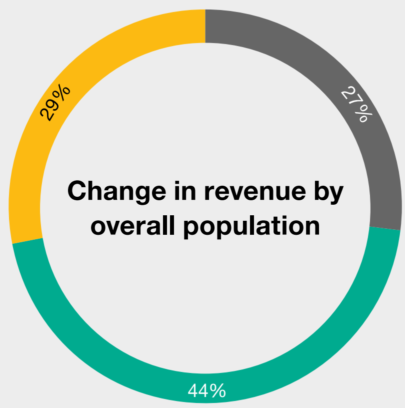
Looking behind the headline figures, we once again see participants experiencing a very polarised year; while over a quarter of firms saw strong revenue growth in excess of 10%, almost the same proportion contracted and suffered a reduction in their reported top line.

The pressure on fee income was felt most in the regions, where 41% of participants grappled with declining revenues; one of the highest proportion of shrinking firms we have seen since we began our law firm benchmarking series in 2014. Thankfully, for many of these firms, the income drop was not catastrophic as the average decrease in revenue was 4.6%.

In contrast, only one-in-twenty City firm participants saw a fall in revenues this year, reversing a trend which peaked at one-in-six firms last year. It appears that City firms were showing the more resilient position as they approached a challenging 2020/21 year, dominated by the pandemic.

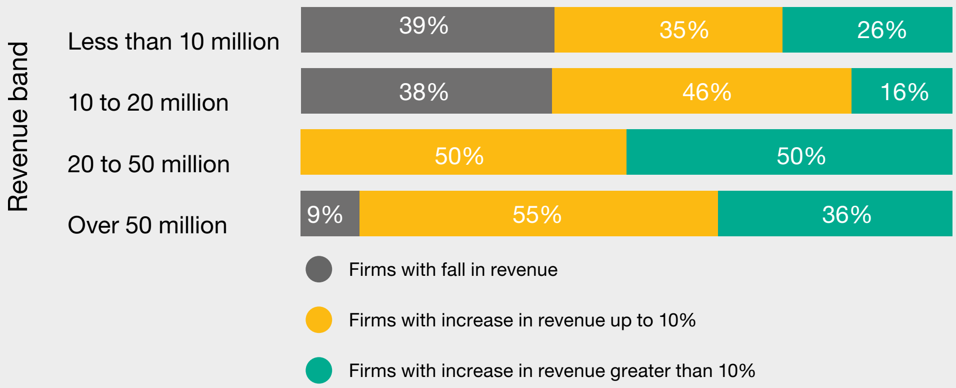
Growth in revenue



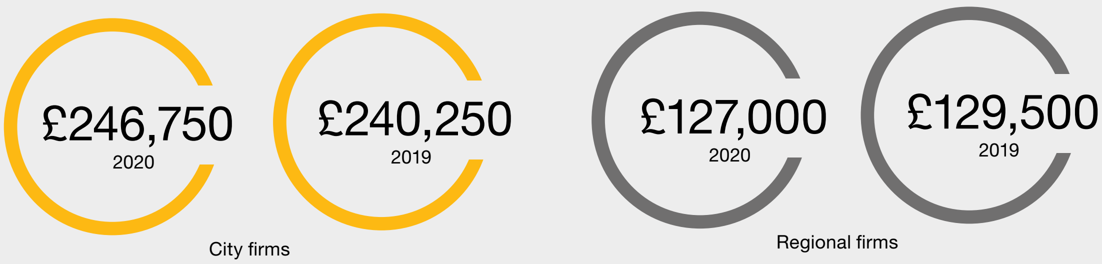


- Firms with fall in revenue
- Firms with increase in revenue up to 10%
- Firms with increase in revenue greater than 10%

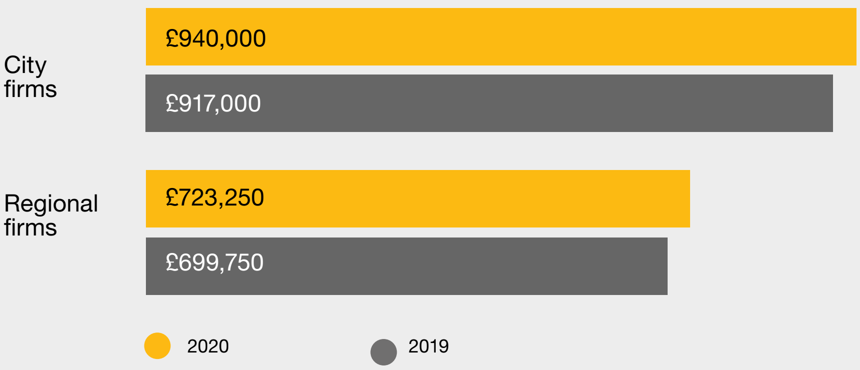
Change in revenue by firm size



Fees per fee-earner



Fees per partner



Profit – pools shrink for more firms this year

This year's results contain more variation in individual firm profitability than the headline 5% increase in all-participant profit pool would suggest. We also see a very different picture between City and regional firm profitability, with the City firm participants' aggregate profit pool growing by 7% but the regional firm aggregate pool falling by 2%.

More strikingly, 44% of participating firms saw a decrease in their overall profit pool – up from around a third in our 2019 benchmarking.

Again, it was the regional firms who fared worse, with almost three-fifths of regionals turning in a reduced bottom line compared with 'just' a fifth of City firms.

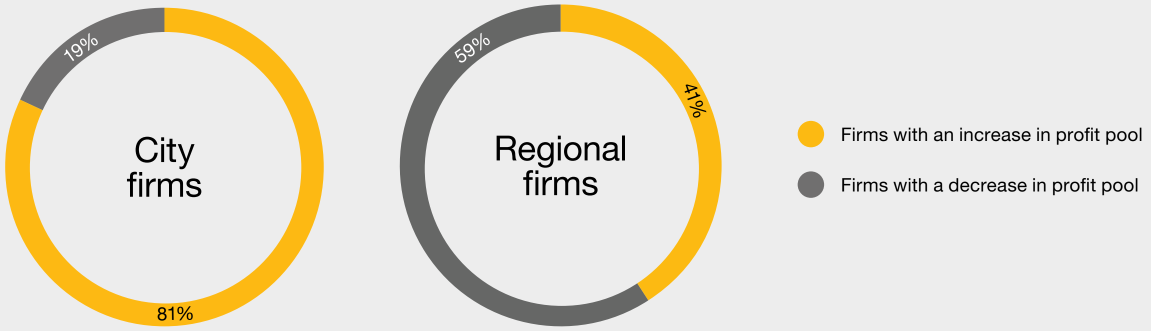
Perhaps of greater concern was the level of the fall in profits for these firms. On average, where profit pools fell, the decrease was around 20% this year; much more significant than the 7% drop we saw in our 2019 results.

While there was expected correlation between those firms experiencing falling revenue and those reporting reduced profits, this wasn't the case for all participants. This suggests some firms may have been dealing with other structural change, such as gearing up with extra capacity or perhaps investing in additional technology solutions or property. Here, a short-term reduction in profit may have been planned for in exchange for future mid-term gains.

More reassuringly, for those 56% of firms who did increase their bottom line profits, over half did so by more than 10%. We have previously commented that a number of firms appear to have winning strategies and are taking market share from their competitors and it is hard to see how the sector will become any less competitive in the coming years.

Average Profit per Equity Partner (PEP) for the City firms should not surprise. Average PEP increased by 9% to £547,000 in this year's participant population, driven by the 7% increase in average profit pool and a steady 4% increase in the number of top-tier partners. There is more individual variation here though, with almost 30% of City firm participants actually reporting a fall in their PEP metrics. This, at least, represents an improvement on last year's PEP results where this proportion was 40%.

Changes in profit pool

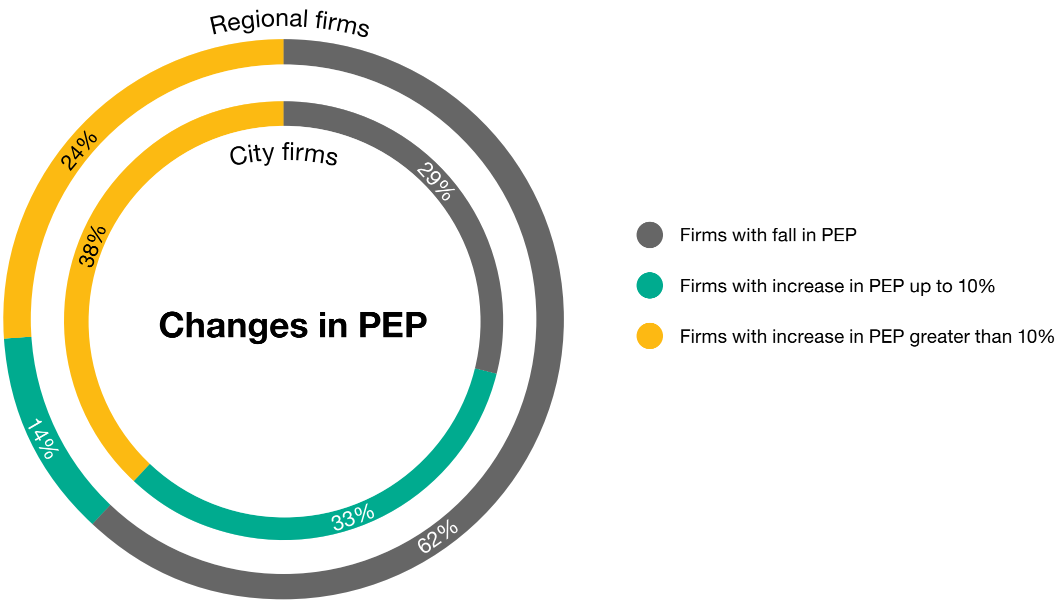


With a greater percentage of regional firms reporting falling profit pools, the regional firm participants' mean PEP decrease of 6% to £187,500 is expected. However, close control of top-tier equity and profit share has mitigated the impact on PEP for some.

Profit per equity partner (PEP)

City firms
£547,000 ↑ 9% from 2019

Regional firms
£185,750 ↓ 6% from 2019



People – more heads in the sector overall but a scale-back for some firms

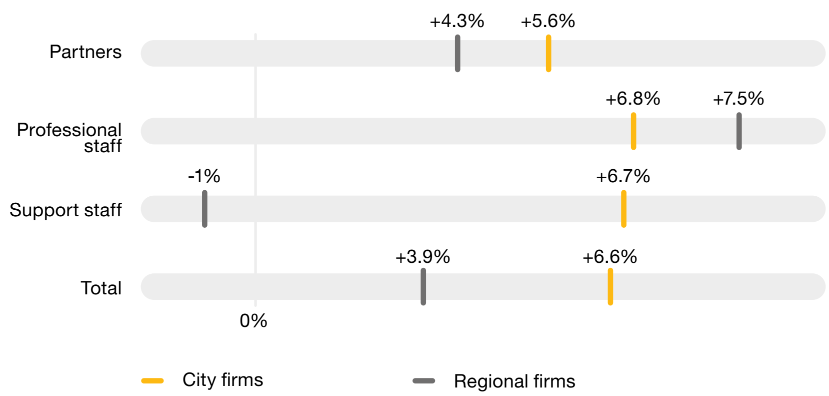
The ongoing investment in people continued into 2020 with over half of participating firms increasing their headcount this year and a 5.3% overall increase in the all-firm number of heads. Again, headline growth in the overall sector headcount, generally driven by the larger and City-based firms, masks a scaling back in the smaller firms who are more often based in the regions.

Consistent with their revenue growth, over 70% of City firm participants increased their headcount with only 14% making cuts. With a greater proportion of regional firms struggling to maintain revenue levels, it does not surprise that half of regional firm participants reduced their headcount this year, most likely in order to preserve profit levels in the immediate future.

We see further contrast in the way that these recruitment and reduction strategies have manifested in the team structure. The all-City firm headcount pool showed similar increases (around 6.75%) in both non-partner fee earner and support staff headcounts. In regional firms, it was all about growing fee earner heads where 7.5% of extra capacity contrasts significantly with a 1% scale back in support staff numbers; something which may be driven by technology and outsourcing solutions.

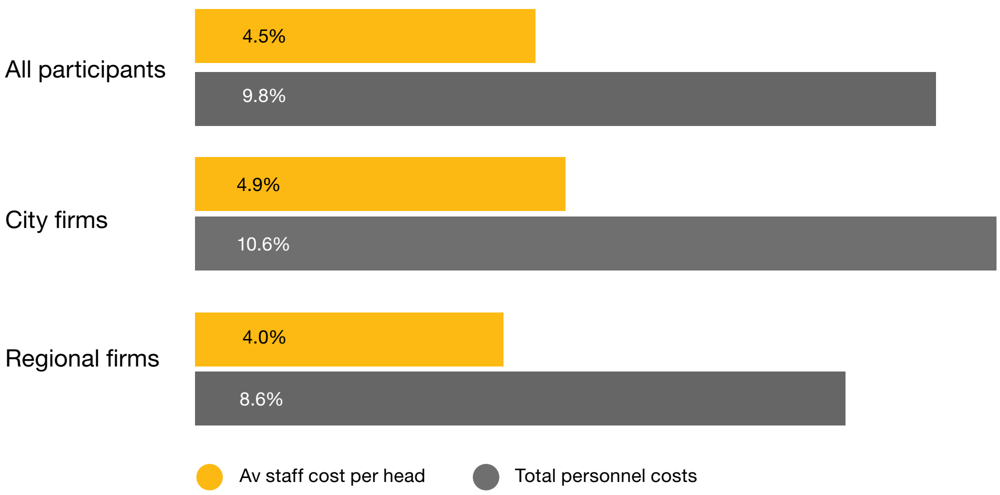
Makeup of total headcount (%)

Change in headcount



Has recruitment come at a price? It has certainly contributed to a higher total payroll cost with personnel costs in the City participants increasing by 10.6% overall, closely followed by 8.6% in the regions.

Change in personnel costs



In terms of average cost per head, the all-firm increase this year is an above-inflation 4.9%. Wage pressure was slightly lower in the regions, where the average cost per head rose by 4.0% to £38,442, compared with a 4.9% increase to £66,757 per head in the City. While pressure on salary inflation will be playing its part, the change in fee earner to support staff mix is also likely to be contributing to this rise in the regions.

Average employment cost per head

City firms

£66,757 ↑ 4.9% from 2019

Regional firms

£38,442 ↑ 4.0% from 2019

Average fee earner: Support staff ratio

4:2 City firms

4:3 Regional firms

Staff costs as a percentage of fee income

Digging further into the detail, City firms have managed to generate greater revenue out of their people than their regional counterparts. For our sample population, average fees per fee earner rose by 2.7% to £247,500 for City participants whereas regional firms saw a 1.9% decline to £127,000.

With retention of key people and availability of people with the right skills continuing to be two of the top business critical risks identified by participants, the impact of the pandemic on both the availability of high-quality individuals and the ease of training and developing new starters and junior team members is uncertain. This could make resource planning a bigger challenge for 2020/21 and beyond.

COVID-19 response

Our benchmarking data was submitted by firms during October 2020, more than 6 months into the COVID-19 global pandemic and during a period of unprecedented uncertainty, challenge and change. We asked participants how they tackled the lockdown, what strategies they employed and how this event has made them consider what the future looks like for their firm. The results provide a valuable insight into how the legal sector has responded so far.

Initial impact

Financial measures

In spring 2020, law firms were beginning to get to grips with the potential impact of the pandemic and most took rapid action to stabilise the firm's position. The priority was to build as much resilience as possible in order to manage extreme levels of immediate uncertainty in client demand, personnel availability and cashflow.

We asked this year's participants what financial measures formed part of their response strategy.

City firms

74%
Deferred partner profit distributions

68%
Reduced partner drawings

53%
Suppressed discretionary expenditure

Regional firms

64%
Reduced partner drawings

64%
Reduced headcount

50%
Reduced working hours for employees

As expected, restricting payments to partners featured strongly for all firms, with around two-thirds of participants cutting monthly drawings levels. The majority of City firms (around 74%) also deferred partner profit distributions, although this figure falls to 39% of regional firms who put a hold on paying out prior year earnings.

Impact on the workforce was, perhaps, inevitable at this stage in the pandemic and over half of respondents took actions to reduce their headcount. The impact was much greater in the regions where this proportion rises to almost two-thirds of regional participants, compared with just under a third of City firms who made cuts.

Around 40% of firms renegotiated pay and benefits packages with their people; many will have had the goal of preserving as many jobs as possible and providing greater flexibility in working practices. In addition to the Coronavirus Job Retention Scheme, half of the regional firms also reduced working hours for employees, something the City firms were more reluctant to do with just over two-thirds choosing to maintain existing contracted hours.

When it came to cost control, around half of participating firms suppressed discretionary expenditure but only one-in-eight participants deferred capital expenditure.

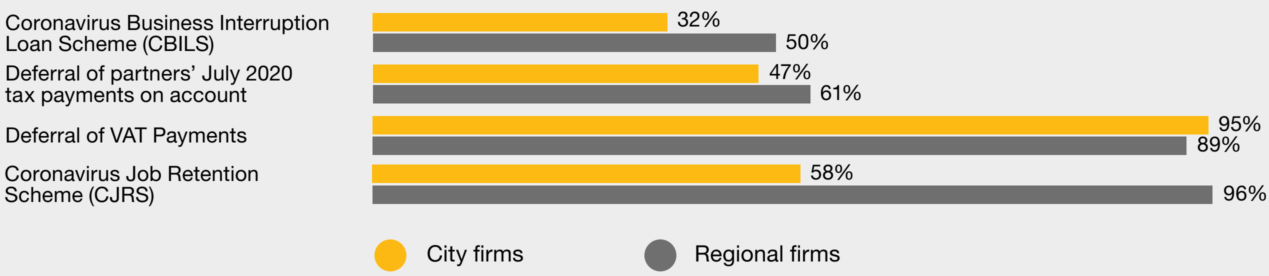
Either projects were already in progress or were deemed strategically important to justify the cash outflow.

In terms of cashflow management, regional firms were more likely to agree a capital or interest payment holiday with their existing funder, with around a fifth of respondents taking this route. Notably, only one-in-ten regional firms raised funding through a partner capital call, something the City firm participants avoided completely.

Government support initiatives

Throughout the pandemic, the Government released a suite of initiatives to support business and we asked this year's participants to report which of these formed part of their initial COVID-19 response strategy.

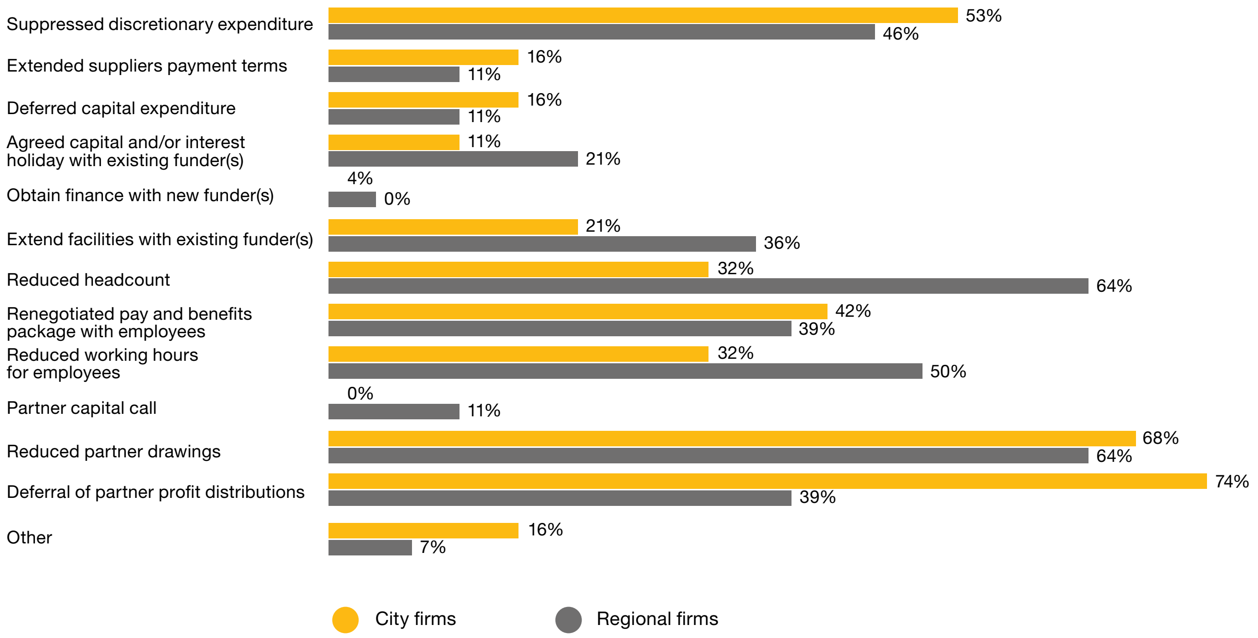
Which of the following COVID-19 government initiatives did you utilise to mitigate the financial impact of the COVID-19 pandemic?



Almost all participants opted to use the VAT payment deferral mechanism; probably as it was both one of the earliest initiatives and the easiest to implement quickly. The repayment mechanism also continues throughout 2021 if firms wish to do so.

Around half of participants also deferred partners' July 2020 tax liability payments on account, with slightly more regional firms doing so than City participants. As these payments are in respect of personal tax liabilities of the partners, many will have viewed this as a restriction on drawings or a short-term pseudo capital call.

Which of the following further financial measures formed part of your firm's strategy?



Almost all of the regional firm participants utilised the Coronavirus Job Retention Scheme (also known as 'the furlough scheme') but the proportion drops to 58% of City firms. For many firms, this scheme provided time to assess people requirements, protect jobs in the short-term and put other structural strategies and operational changes into place.

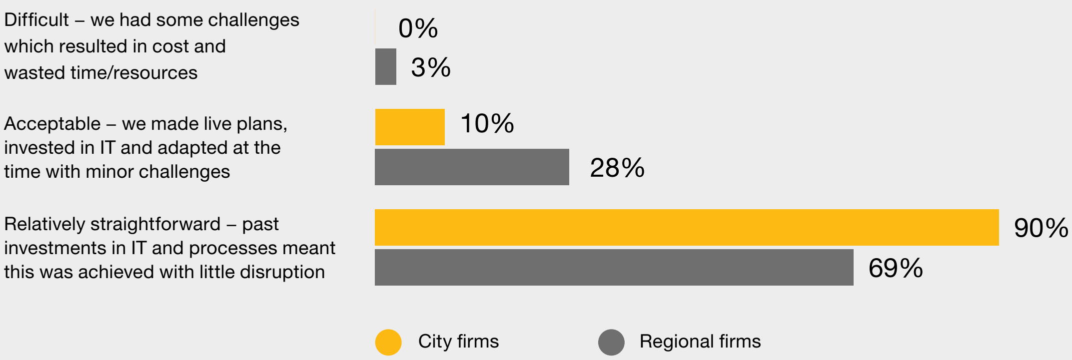
In terms of introducing fresh funding into the business, the Coronavirus Business Interruption Loan Scheme (CBILS) provides additional debt funding using a government guarantee mechanism. This scheme was favoured by regional firms, with half of participants taking out CBILS loans compared with just a third of City firms.

We note that a number of firms in the legal sector have since taken the commercial decision to opt to voluntarily repay amounts received under these support mechanisms once they were satisfied that they did not require government support. We anticipate this being a sensitive area in the post-pandemic period when businesses will inevitably come under scrutiny by stakeholders who will form views on how they responded during this event.

Transition to remote working

The lockdown and social distancing restrictions enacted by government resulted in the need to transition whole firms to remote working. While this task undoubtedly required significant management time and focus, most firms, on reflection, found the process ran smoothly. Only 3% of regional participants deemed it to be difficult and that it created challenges which resulted in them suffering additional cost, lost time and wasted resources.

The transition to remote working for the entire firm was:



In what should please many of those responsible for risk management and operational planning in their firms, 90% of City firm participants considered the transition to remote working to be relatively straightforward – past investment in IT and processes meant little disruption.

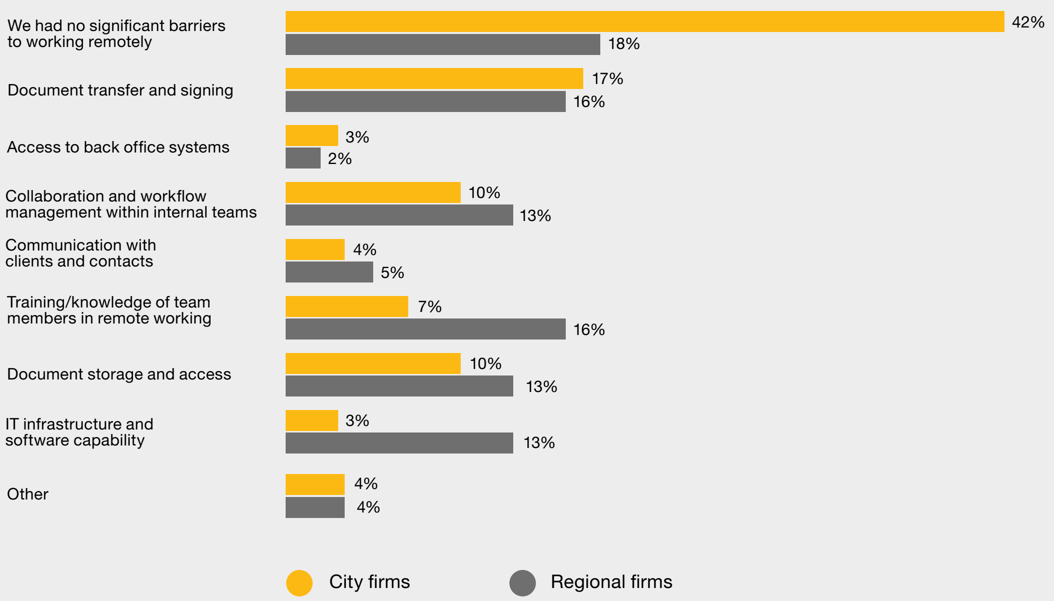
This proportion fell slightly to 69% for regional participants, where just over a quarter of respondents felt the transition process was acceptable; live plans, investment in IT and amending working practices in real-time only created minor challenges.

When it came to identifying the biggest barriers to working remotely, over 40% of City firms found no significant barriers at all. This should, perhaps, come as no surprise given the significant focus and investment in infrastructure and agile working that we identified in previous years' benchmarking. Barriers that were noted primarily related to document transfer, signing, storage and access.

More regional firms reported having to overcome challenges, with just over one-in-six participants highlighting training and knowledge in the use of remote working applications and tools being a barrier. Again, document management created issues and one-in-eight firms found their IT infrastructure and software capability slowed them down.

With City firm participants tending to be larger and having greater access to resources, it is understandable that they may have found this transition to be more straightforward. However, the pandemic has been a catalyst for many smaller firms to look at their technology spend and it is a good time for all firms to review their systems and infrastructure where new solutions can often be much more cost effective than they were just a few years ago.

What were your firm's biggest barriers to working remotely?



Remote working post-COVID

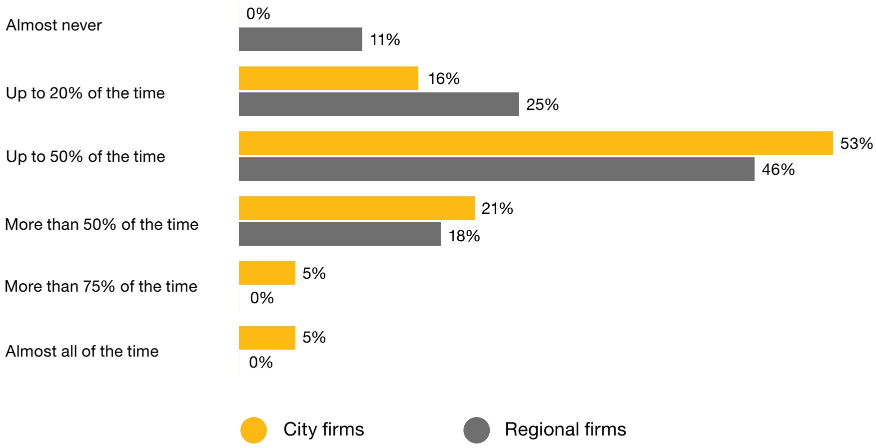
What now appears certain is that working practices will look very different in the post-pandemic world. Law firm leaders and management teams are shifting their focus from the immediate technology-dominated challenges of remote working to the wider implications on collaboration, training and development, client communication and impact on overall firm culture.

All City firm participants expect some form of remote working to continue for their teams once the COVID-19 restrictions are fully lifted. Just over half are anticipating that their people will be away from the office for up to 50% of their working week and one-in-ten are planning for individuals to be working remotely for more than 75% of their time.

The regional view is similar but is slightly skewed towards more time being spent in the office. A quarter of firms are expecting their teams to work remotely, but only for up to 20% of their time, and 11% of regional firms believe their people will only work remotely on rare occasions.

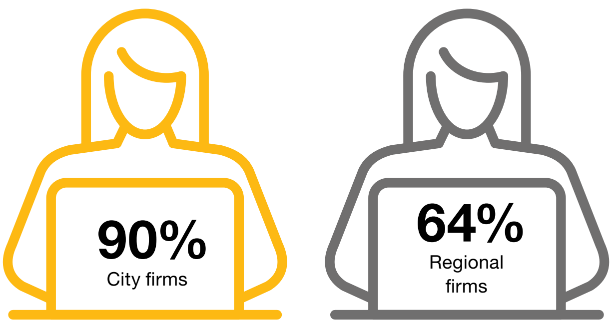
For the majority of participating firms, the pandemic has changed their view and approach to remote working and will significantly increase the amount of time their people spend away from the office.

After the COVID-19 lockdown restrictions are fully lifted, we expect most of our people to be working remotely...



Has this approach changed because of COVID-19?

Yes – remote working will **increase significantly**



Effect on property strategy

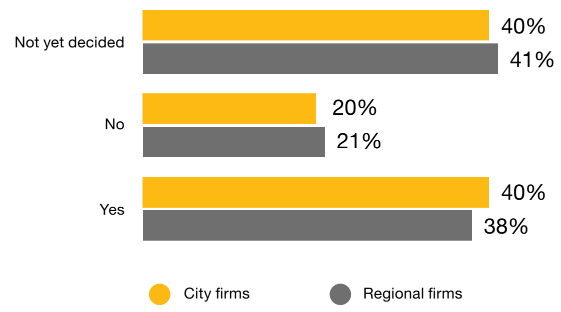
With most firms planning for a greater proportion of remote working, has this affected their property strategy?

For around a fifth of participating firms the answer is no; they plan to continue with their existing pre-COVID strategy. With around 40% of firms undecided and still assessing what changing working practices mean to them, we look to the remaining 40% who have decided to change strategy for an indicator of future plans.

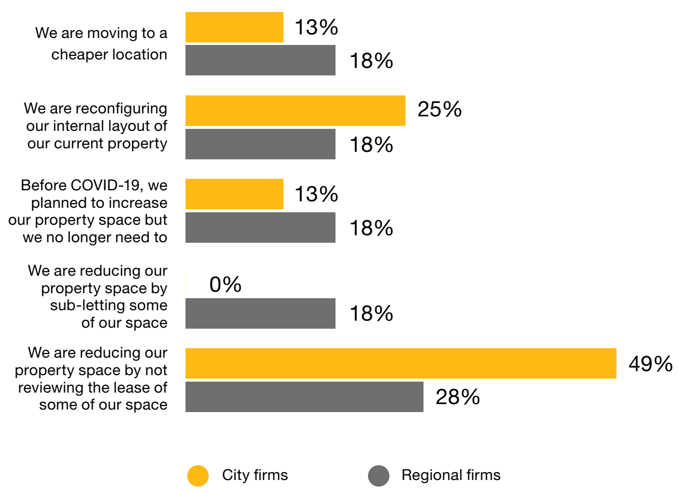
Not one participant reported that they now plan to increase their property space and just under half are considering reducing their footprint, either by non-renewal of leases or sub-letting. Around a fifth of respondents will reconfigure their existing internal property layout – presumably to provide a different kind of workspace based on fewer, more transient heads in the office – and one-in-six are looking at cheaper office locations.

The 'property' question' is a key point of discussion for many law firm boards and management committees, with many now debating how their real estate interacts with future strategy. This isn't something new, but COVID-19 has accelerated the debate and raises some challenging questions.

Has your property strategy changed as a result of COVID-19?



If yes, how?



Key property questions for management

- What are our properties for?
- Are they where work gets done?
- Are they a connection to our clients?
- Are they a part of our brand?
- Why are we located where we are?
- Are they providing value and how do we measure that?

City firms focus

With 7.4% average growth and over a third of participants enjoying an increase in top line in excess of 10%, City firms appeared to be in good shape as they entered the COVID-19 pandemic.

Growth in people, growth in revenue

Since our 2017 benchmarking, we have noted a steady increase in the proportion of City firm participants who reported a fall in revenue. This year, that trend was reversed as just 5% of firms reported shrinkage in their top line. It seems last year's confidence and investment in headcount was warranted and needed to create extra capacity for growth.

95%

of firms reported an increase in their top line

headcount increase.

6.6%

Staff costs as a percentage of revenue

35%

80%

of City firms cited the availability of people with the skills needed as a business-critical risk

In the coming 18 months,

42%

of firms are planning to increase partner numbers further

The average employment cost per head increased by

5%

The increase in headcount has continued into 2019/20 where we find a 6.6% increase in the average number of heads. The growth in both fee earning and support staff teams was similar, at around 6.75%, which preserved the ratio of fee earners to support staff at around 1.25 to 1 for these participants.

Given that the proportion of City firms citing “the availability of people with the skills we need" as a business-critical risk has increased from 30% in 2019 to over 80% in 2020, management teams appear to have concerns about meeting resource requirements in the immediate future.

For the 2020 year, this concern begins to be seen in wage inflation and the average cost per head grew by 4.9%. For this year's participants, staff costs as a percentage of revenue remained consistent at around 35%. It is difficult to forecast how the pandemic and the end of the Brexit transition period will affect the supply of quality people so next year’s results will make for interesting reading.

This year also saw investment in boosting partner numbers, particularly those at the junior level, although the number of top-tier senior equity partners also grew by 4%. This is likely to be a combination of the need to retain and reward key people, build additional team capacity and provide additional leadership for growth. The investment looks set to continue into 2020/21 with 42% of firms planning to increase partner numbers further.

“It is good to see the strength with which the City firms entered the pandemic, although they will not have been wanting to shout about it during the summer with all the uncertainty many of their clients will have been facing. Investment in technology, HR processes, electronic filing and knowledge management in previous years has paid off in spades with a seamless transition to home working for most City firms, enabling them to support their clients through the many challenges the pandemic has brought.”

Louis Baker, Partner,
Head of Professional Practices

Profitability and productivity

In terms of profitability, it has been a solid year for many City firms, with aggregate growth in the all-City participant profit pool of 7.2%. Over 80% of firms increased their profit pools this year and almost two-thirds of participants did so by more than 10%. The market still appeared resilient going into spring 2020.

Mean PEP grew by 9% but this headline figure masks some variation in individual firms where almost 30% saw a fall in PEP and 38% grew PEP by more than 10%.

A 2.7% increase in fees per fee earner and 2.5% in fees per partner will have contributed here and improves on last year's 2.2%. This suggests some increased output or an uplift in average billable hour rates – most likely a combination of both given that over three-quarters of firms considered price competitiveness a high priority business risk in 2019.

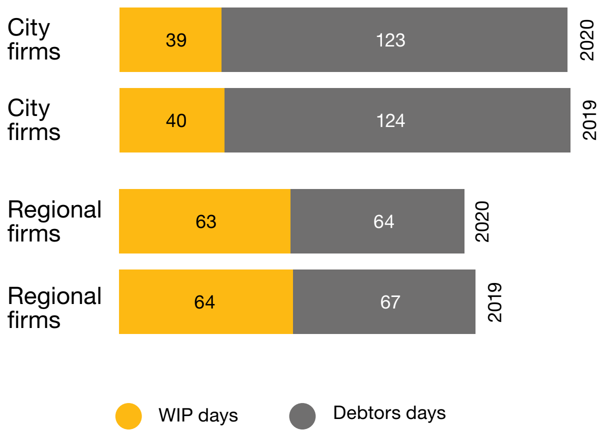
4 in 5

firms increased their profit pools this year

Credit risk

Lock-up remained consistent this year at 162 days, decreasing by one day each of WIP and billed debtors. There is no sign yet of payment terms being extended by clients.

Average lock-up days at year end



Mindful of the elevated risk created by the pandemic and general economic uncertainty, 57% of City firms identified credit risk in their client base as a high priority risk for the coming year. At the time of writing, we continue to see relatively healthy cash collections but firms will need to maintain credit control procedures, particularly where their client base operates in areas heavily impacted by the pandemic, such as retail, leisure and tourism.

Business confidence and looking forward

Reassuringly, most City firms have assessed the COVID-19 impact to be fairly neutral in over the longer period and to only have a moderately damaging effect on performance and results in the short term.

In terms of the coming year, real concerns about the UK economy exist as over 80% of respondents have a negative outlook for 2020/21 and believe that doing business in the UK will be challenging. However, they also see opportunity ahead and an ongoing need for legal services with only 40% having a similar negative outlook for the UK legal services market and half of firms having a positive outlook for their individual firm. With four-fifths of City firms anticipating client demand to hit 2019/20 levels as a minimum, the pandemic does not appear to have dented confidence.

Areas of focus

The availability and retention of individuals with the right skillset continues to feature highly and agile working policies, innovative people development strategies and clear progression pathways will no doubt be part of many firms' 'people plan'.

All City firm participants consider the continued battle against cybercrime and fraud to be a high priority business risk and the reported instances of reported fraud and attempted fraud continues to climb. Law firms remain an attractive target for the criminal world, both as a direct target and also a gateway to their clients. We expect the level of time and financial investment needed to build fraud resilience to continue to increase.

> "Overall, most City firms had a strong year in 2019/20 and, for many, activity levels have held up well over the last nine months or so as well. Many will now be thinking about what the 'new normal' looks like, especially in terms of office space and how that is used. Management must also make sure they keep the wellbeing of their people (partners and employees) at the top of the agenda. The past year has been extraordinary and it will have impacted people in all kinds of ways and many may be reappraising what they want from their work/home-life mix. Firms should make sure they take time to understand this and not just expect a return to pre-pandemic practices. The daily commute to the City may have become much less attractive."

Steve Gale, Partner, Professional Practices

Regional firm focus

Our 2020 results indicate a more challenging year for many firms. Average growth of 5.2% across all regional participants masks significant variation in individual firm performance and profit pools took a hit this year.

Was 2019 an anomaly?

Headline aggregate growth of 5.2% was derived from a very polarised set of individual firm results this year. While almost a quarter of firms produced a healthy increase in revenue, often well in excess of 10%, the proportion of firms which 'shrank' and reported a fall in top line grew to 40% of participants.

Last year, we reported that the 2019 results reversed a trend where we saw a year-on-year increase in the proportion of shrinking firms – peaking at 30% of participant firms in 2018. Concerningly, these 2020 results appear to return to that trend with 2019 now noticeable as the 'anomaly' year.

The inference that some firms are 'winning' and taking a growing market share from their competitors remains strong, although we must remain mindful of external factors and service line mix, such as the condition of the housing market and volume of corporate transactions.

"2019/20 proved to be a more challenging year for a good proportion of regional firms but we continue to see firms employing successful strategies to grow and take market share. Team structures appear quite volatile at the moment, with investment in headcount prior to the COVID-19 outbreak pivoting to a scale back during the pandemic, and a streamlining of back-office and support teams. Cost control and cash preservation will have been the focus for many management teams in recent months but firms must also focus on their business development strategies to win work and build a resilient profit pool."

Ross Prince, Partner, Professional Practices

59%

of firms experienced growth this year compared to 70% last year.

The regional all-firm aggregate profit pool fell by

2%

The average number of support staff reduced by

1%

The average cost per head increased by

4%

4%

headcount increase on average.

62%

of regional firms saw a reduction in PEP

Profit pools down but PEP maintained

If generating revenues in 2020 was challenging, maintaining profit levels has also proven to be the case.

The all-regional firm aggregate profit pool fell by 1.9% this year, with almost 60% of firms reporting a decrease in their distributable profits. The decrease was also more significant than we saw last year, with an average fall of 20% in all-partner profit pools.

This translates to a 6% average fall in PEP to £185,750 for this year's regional participants. With many firms reporting reduced revenues and bottom lines, we might have expected PEP to have fallen even further, so why do we see an unwelcome, but not so worrying, drop of 'just' 6%? The answer stems from two factors; a careful control of senior equity profit share – the number of top-tier partners fell by 1.8% this year – coupled with some strong performance in those firms who did grow their PEP.

People matters

This year's results highlight some interesting changes when we break down the 4% all-firm average growth in total heads into sub-categories. The headline is that 2020 was a year of growing the fee earner team while streamlining support and administrative functions.

The average number of support staff reduced by 1% this year. This may be indicative of more regional firms now employing technology and outsourcing solutions, where process changes most often lead to streamlining administrative and back-office functions.

The average number of non-partner fee earners increased by 7.5% across this year's regional firm participants. Last year, almost all firms stated that the availability of good quality people was a high priority risk and most also had a positive outlook for their firms and planned for growth. This suggests that going into the 2019/20 year, many firms felt there was little extra capacity available and recruitment was high on the agenda.

Changes in the partnership were also more significant this year. The number of junior/associate partners grew by 12.5%, perhaps a strategy of succession planning and a move to retain key people, but also to grow new and existing service lines. However, senior equity was kept under tight control with a 1.8% reduction in the average number of top-tier senior equity partners.

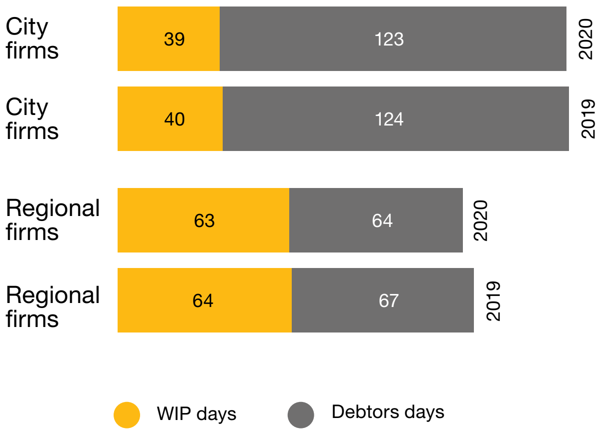
This growth in fee earner capacity has come at a price with the average cost per head increasing by 4% and total personnel costs across all participants rising by almost 9%. With many firms suffering a fall in revenue this year, the 2% drop in average fees per fee earner is expected. The big question for many firms is whether this means there is now excess capacity in the system. With almost half of firms telling us they plan to recruit more fee earners in the coming year, the answer would seem to be 'no'.

Credit risk

Pleasingly, regional firms managed to reduce their lockup by four days on average this year, taking total lockup to 127 days. The primary improvement was in unpaid debtors, which fell by three days. This may be indicative of those firms with March and April 2020 year ends reacting to the pandemic and tightening on credit control around this period.

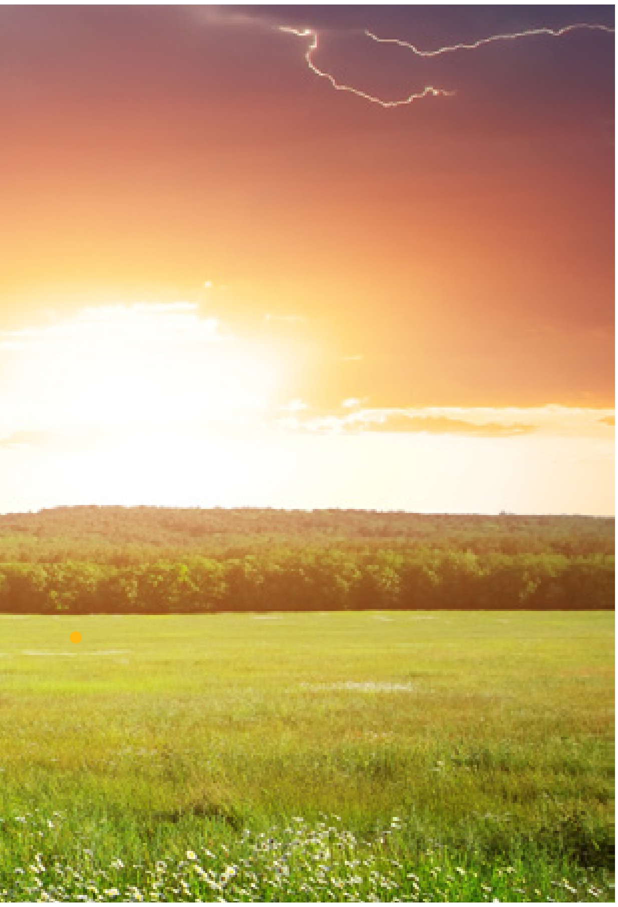
With only 41% of firms stating that client credit risk is a high priority for 2020/21, firms are either comfortable about their billing and credit control practices or confident in the outlook for their client base. Ideally, firms should be mapping where their clients operate in sectors most affected by the pandemic and robustly assessing credit risk at the outset, and throughout matter progression.

Average lock-up days at year end



What next?

Despite a challenging 2019/20 for some, business confidence still appears high. Firms told us that they generally managed to respond well to the COVID-19 situation and the move to remote working was relatively straightforward with some minor challenges. In fact, many are confident that opportunities will be identified from the pandemic and demand for services will slightly increase. This positive outlook for their firms is in spite of some real concerns that the UK will be a challenging place to do business in the coming year.



So, what are firms planning to focus on?

People matters continue to dominate, particularly the health and wellbeing of team members and creation of an environment and reward system, which helps to retain key individuals. Unsurprisingly, increasing the firm's level of agile, remote and virtual working is a priority action, with around 40% of firms also planning to update their people development strategies.

The current year's profitability and impact of the pandemic means almost half of firms will focus on cost control in 2020/21, with many also planning to invest in technology infrastructure and solutions.

It seems that building loyal service teams and promoting efficiency though technology will be key strategies for the coming year.

Looking forward

With the 2020/21 year being dominated by the ongoing pandemic, the end of the Brexit transition period and a global economy which remains highly unpredictable, are firms concerned for the future and what are their areas of focus for the coming 12 to 18 months?

Business confidence

We asked firms what their assessment of the impact of the pandemic on their firm will be over the longer term. Their responses show an interesting difference of opinion between the City and regions.

Almost all City participants believe the pandemic will either have no real effect on their performance (40% of participants) or that the impact will be only moderately damaging where performance and results will only be affected in the short term (55%).

However, while just over half of regional firms expect COVID-19 to be moderately damaging to their results and position in the short term, almost a third of regional respondents think that the pandemic also had a positive impact on them and opportunities have been, and will be, created.

So, do firms expect continued demand in the coming 2020/21 year?

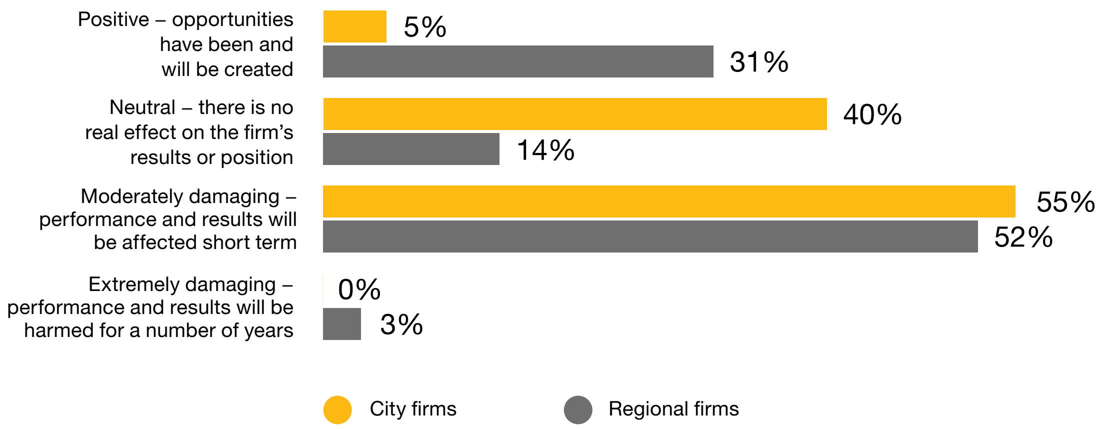
The answer is 'yes' and it is the regional firms who are slightly more optimistic, with around 85% of participants believing current demand levels will continue into 2020/21. More than half of those firms are anticipating that there will be a slight increase in the need for their services. City firms appear a little more guarded with one-in-five participants anticipating a slight decrease in client demand for legal work.

Not a single participant believes that there will be a significant drop in demand, despite the vast majority of firms having a negative or very negative outlook for the economy in the coming year. Indeed, this year's participants remain more positive about the outlook for the UK legal market than they do for the wider economy and almost half of those who responded have a positive, or very positive, outlook for their firm.

With regulatory change arising from Brexit and, undoubtedly, an emergence of legal implications unfolding from the COVID-19 situation, this optimism perhaps stems from the potential for new work streams.

However, it would be interesting to know whether this confidence is built on genuine, considered horizon scanning and scenario planning or, quite simply, a 'stay positive and it will all be ok' mindset.

We have assessed the longer term impact of the COVID-19 pandemic on the firm to be:



Business risks

People matters continue to be high on the risk register.

The availability of individuals with the right skillset remains a priority for all firms but it is notable that 81% of City firms elevated this risk to business critical this year, compared with 38% of regional firms and fewer than a third of City firms who answered the same question last year. It appears that competition for talent has increased in the City once again, and this seems particularly true for niche and emerging areas of expertise.

Intriguingly, this year, the impact of Brexit is considered a lower priority risk by the majority of firms, with a quarter of regional firm respondents assessing that it is not an issue for them.

This represents a relaxation in perceived risk impact compared with last year, where over half of participating firms had assessed Brexit to be a high priority risk.

Business risk	**Percentage of participants who considered this to be a high priority risk**		
	All	City firms	Regional firms
Retention of our key people	94%	100%	90%
Health and wellbeing of our people	94%	90%	97%
Availability of people and the skills we need	92%	100%	86%
Cybercrime and fraud resilience	90%	100%	83%
Leadership and management capability	86%	95%	79%
Data integrity and protection	86%	95%	79%
Training and developing our people	82%	86%	79%
SRA regulatory compliance	80%	100%	66%
IT infrastructure	78%	76%	79%
Succession planning	70%	76%	66%
Capability to effectively implement projects	66%	76%	59%
Credit risk in our client base	48%	57%	41%
Emergence of new pricing models	36%	33%	38%
Increased competition in the market	36%	43%	31%
Availability of funding	36%	38%	34%
The impact of Brexit	22%	33%	14%

Top three business critical risks

Retention of our key people

94%

Health and wellbeing of our people

94%

Availability of people with the skills we need

92%

"It is no surprise that firms have rated people and wellbeing as a key risk in their businesses, the same can definitely be said for their accountancy counterparts in professional services. The pandemic has undoubtedly focused all our minds on the people in our teams, some have responded better than others to working in lockdown. Whether that is home-schooling difficulties, the discipline needed to work effectively at times from home, technology pinch points or missing the social interaction with fellow colleagues over a sustained period of time – lockdown has been challenging for many businesses.

We often talk about providing excellent client service which is always underpinned by the principles of quality, responsiveness and creativity. Excellent client service is always provided by people and, if those people are not engaged, well managed and motivated to do a great job, there can be no excellent client service. Therefore your business is at risk.

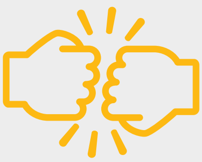
Much has been said recently about the light at the end of the tunnel and what will change when we come through this. My firm belief is that we have learnt so much in the previous 12 months that we can take this forward in our day to day working lives to be more efficient and more rewarding in future years. The office is far from a dead concept, but many firms have shown that workforce agility and flexibility can be as productive and rewarding as before and in many cases more so."

Tony White, National People Director

When it comes to regulation, all City firm participants maintain Solicitors Regulation Authority (SRA) regulatory compliance as a high priority. This proportion drops to two-thirds of regional firms, hopefully reflecting a confidence in their existing systems and processes rather than regulatory complacency. With increased Anti-Money Laundering responsibilities, the ongoing challenge of protecting client money and data, as well as staying compliant with the Transparency Rules, promoting a diverse and inclusive profession and ensuring financial stability of their firms, the 2020/21 year will have much to keep COLPs, COFAs and management teams busy.

What is a lower priority risk for firms?

Increased competition in the market

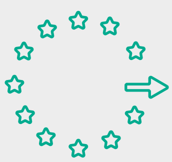


36%

Availability of funding

36%

Impact of Brexit



22%

Unsurprisingly, the ever-growing threat to the firm and its clients from fraud and cybercrime continues to feature as a high priority. The risk was recently demonstrated in late spring of 2020 where 193 law firms suffered a data breach related to an unsecured database at a common supplier. It was reported that the exposed database contained information related to the staff of legal firms and sensitive data relating to authentication on behalf of clients as well as usernames, IDs, hashed passwords, names of organisations, and details of platform administrators.

With the realisation that cyber security is a misnomer and cyber resilience is what is actually practically achievable, law firms will continue to need both ongoing financial investment and management energy to mitigate merging threats to acceptable levels.

For example, the ‘simple’ task of mapping the firm’s data – both how it flows and where it is held – can take significant planning and resource but is the critical foundation of all data and IT risk management.

Changes to working practices arising from remote working mean that many firms may need to revisit this vital area.

"Cybercrime has surged since COVID-19 with the latest official crime statistics showing a 92% increase in incidents of cybercrime for the 12 months ending September 2020, compared to the 12 months ending March 2020. Such an increase, in such a short period, is unprecedented for any type of crime. We should be clear that in many cases this has happened despite traditional 'IT security' measures being in place and because those measures have not kept pace with the latest rapidly evolving manifestations of the problem.

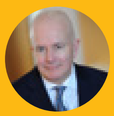
During the pandemic we have seen:

- exponential growth in the number of phishing and ransomware attacks
- a large increase in the number of fake websites being set up
- the advent of 'Cybercrime as a Service' where a cybercriminal can be hired to attack a particular organisation for specified tariffs according the seriousness required
- the markets and forums of the Dark Web (where much cybercrime is organised) full of stolen data and discussions about attacking particular organisations
- cybercriminal 'businesses' starting to use Artificial Intelligence to identify target organisations.

Key things law firms can do to protect themselves against the latest cybercrime techniques

1. Make sure that you have mapped your data and data flows, both internally and in respect of third party suppliers.
2. Obtain an External Vulnerability Assessment (this shows the view of a firm that a cybercriminal could have when assessing whether to attack it or another target – key vulnerabilities become apparent).
3. Obtain a Penetration Test or Internal Vulnerability Assessment.
4. Commission a check of the Dark Web for evidence of discussions about attacking the firm and for stolen data or emails and passwords belonging to it – one law firm Crowe did this for had 800 staff and over 600 compromised emails and passwords were found to be sale on the Dark Web.
5. Commission a check for fake websites (From 1st April 2020 to mid-February 2021 SRA's website shows that 42 UK law firms suffered from fake websites – or around four a month).
6. Ensure you have a clear plan to respond to a cybercrime attack and those tasked with implementing it have been trained in how to implement it."

Jim Gee, National Head of Forensic Services



Plans for the immediate future

So, what are firms' immediate plans for the coming 12 to 18 months?

Topping the list is the continued increase of remote, virtual and agile working practices, with around two-thirds of participants citing this as an action for the coming year. Although this also topped our 2019 benchmarking, it seems likely that the pandemic has re-emphasised how critical this is to future success.

46% of regional firm participants will focus on cost reduction – slightly down on last year which may reflect saving measures undertaken already – but only a quarter of City firms plan to do the same.

When it comes to people matters, around 40% of firms will update their people development strategies, a strategy consistent with the stated need to retain key people, adapt to new working practices and upskill team members who will be working remotely.

On headcount, there is a mixed message. City firms will be focusing on increasing partner numbers, with 42% of City participants citing this as a key action.

This is not the case for regional firms where, instead, just under half are planning for significant growth of their fee earner teams in the immediate future compared with just a fifth of City firms.

This year's increase in fee earner to support staff ratio in the regions could continue into 2020/21, with just over a third of regional firms planning to reduce support staff headcount. Technology projects may provide clues here as around 40% of regional firms plan to update their IT infrastructure and invest in new technologies, such as AI, document automation and data analytics.

Firms plans for the next 12 to 18 months	Percentage of participants who considered this to be a high priority risk Total	City firms	Regional firms
Increase our level of remote/virtual/agile working	66%	63%	68%
Update our people development strategy	38%	37%	39%
Invest in our foundation IT infrastructure	38%	32%	43%
Invest in advanced technology solutions	38%	37%	39%
Focus on cost reduction	38%	26%	46%
Significantly increase fee earner headcount	36%	21%	46%
Decrease our support staff headcount	28%	16%	36%
Increase partner numbers	28%	42%	18%
Change our partner/leadership remuneration model	28%	32%	25%
Change our practice management and/or finance system	19%	21%	18%
Move premises	13%	11%	14%
Change our capital/debt funding structure	13%	11%	14%
Increase our support staff headcount	11%	11%	11%
Change our employment remuneration and benefit structure	11%	11%	11%
Change our pricing model	11%	5%	14%
Change our ownership structure	11%	5%	14%
Other	11%	11%	11%
Focus on hiring 'non-legal' personnel	9%	11%	7%
Bring in a new specialist service line or team	9%	11%	7%
Decrease our fee earner headcount	6%	5%	7%
Decrease partner numbers	6%	5%	7%
Expand our operations overseas	4%	5%	4%

It is clear that 2020/21 is shaping up to be a year of real change for almost every firm. The pandemic has tested management, partners and team members by creating new, unforeseen challenges and obstacles to overcome. Despite (or, more likely, because of) this, positive outcomes have been plentiful already and the pandemic has been a major catalyst for change, whether that is simply in technology strategy, team structure or working practice.

The focus for law firm leaders and management teams will now surely turn towards a re-imagined mid-term vision for their firm. How will the expectations and needs of their clients and people change post-pandemic?

Many will view this period as the start of the next evolution of their business and we expect to see some innovative ideas and strategies emerging in the coming years.

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For more information on how we can help your firm please contact us at:

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