

Legal Insight Series 2020

Overview and introduction

Parts 1 & 2

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As Head of Legal Sector at Royal Bank of Scotland, I am delighted to share with you my latest report on the legal sector with my unique insights and perspectives on the profession. This is based on extensive research and analysis of the sector and combines with the vast depth of knowledge and experience we have built in banking in the legal sector for many years. Ours is a dedicated team of professionals focused exclusively on the legal profession.

The UK legal sector continues to be extremely important to Royal Bank of Scotland. We have a strong market presence in the sector and a long and proud history as bankers to the leading law firms in the UK market.

We continue to grow our business both domestically and outside the UK through our demonstrable and proven commitment to the sector, actively supporting the growth and development of the UK market and rapid globalisation of the legal sector.

I would like to thank you for the banking business we deliver your firms through our dedicated and focused legal sector team. As a measure of our commitment to our clients in this sector, it gives me great pleasure to provide you with the analysis and findings of this report.

Our focus on our clients and leadership in the sector is unwavering, and I commit to continuing to provide the legal profession with leading banking products and services in addition to cutting edge research and commentary on the profession. I hope you enjoy this report.

James Tsolakis



James is the Head of Legal Services within UK Commercial and Private Banking at NatWest. He has responsibility for NatWest's banking business with the legal profession and personally focuses broadly on the top 100 firms in the UK and global legal markets. James has been a banker to the legal profession for over 15 years, working with the sector in the UK, Europe and the US.

The Big Themes

Despite operating in a trading environment hit by deep political and economic uncertainty the legal sector remains one of the most confident performers of any UK industry group. And with good reason. The Top 100 firms averaged revenue growth of 9% this year posting collective revenues of £26.35bn of which almost a third, £8.28bn, was profit. (Source: *Legal Business*.) These are impressive numbers in any market let alone one dogged by persistently low sterling exchange rates, high staff salaries, choppy deal markets and fears of major Brexit chaos.

The UK's legal and accountancy firms contributed a total of £19.1bn in tax in 2018, up 6.8% since 2016. They also employed 743,000 people, a significant 2.4% of the entire UK workforce and a staggering quarter (23.5%) of all legal and accountancy professionals in the entire EU (Source: *TheCityUK*) UK Law plc is currently operating with a swagger not seen since its high-water mark over a decade ago. Even the battered pound has created a new kind of value in the market as foreign investors, buoyed by the strength of their domestic currencies, seek out UK corporate and real estate deals with increasing relish. Brexit uncertainty now appears to be so priced into the market that lack of clarity has become a fact of life and no longer the commercial deal-breaker it was even six months ago.

But scratch beneath the surface and evidence of a highly fragmented market emerges. The Top 25 is now generating 79% of the entire Top 100 revenues, doubling its income over the past decade. The second 50, in contrast, grew just 26% over the same period. (Source: *Legal Business*.) Firms in this grouping without a meaningful value proposition and few stand-out practice areas will continue to be tested as the client flight to specialism continues. General Counsel are using their sophisticated market knowledge and buying power to hire only those firms that are absolutely right for the mandate. Communicating to the market what you wish to be known for has never been more important.

The more enlightened firms are turning to a new model – the development of non-legal consultancy and advisory services – as they seek to broaden their sell to clients and tackle underlying profitability issues. Such 'non-reserved' business activity can be run by non-lawyers at a markedly lower cost yet are also attractive to outside investors, thus enabling quicker growth. Many of the pace setters in this area are publicly quoted law firms which are using their vast war chests to snap up consultancy businesses and gain a competitive advantage. Those firms not investing heavily in technology and new business lines will struggle to drive innovation and productivity at a time when clients are actively insisting on the provision of non-legal advisory services. Continuing the technology theme, the growing cyber security threat has become a related business-critical issue with significant investment required at all levels of the profession to prevent client data and financial breaches.

Leading clients continue to demand greater diversity amongst their external legal advisors, with firms still struggling to increase gender and BAME representation at senior levels. A big theme this year has been the gender and ethnicity pay gap which has been given a boost by the large number of top law firms that are now reporting their figures in this area.

The Big Themes

The savvier firms know that the communication of a brand message that transcends profit can help them recruit the most talented people and win the best clients, relative to their less progressive rivals. This messaging can also be seen in the response to the numerous #MeToo allegations that law firms are currently being confronted with. Firms are actively addressing their behaviour and culture programmes in an attempt to deal with the significant brand damage that such cases can bring.

For the top UK players in London the greatest market threat is coming from the powerful US firms who continue to use the weak pound as a means of heightening the associate salary war and enticing some of the best talent away from their rivals. Armed with superior profitability, a highly focused practice mix, a booming US economy and the increasing dominance of US regulators globally, they are routinely outperforming their increasingly homogeneous UK rivals at the top end of the market. The fact that many elite US firms now have senior management based in London shows their level of confidence in the UK legal sector.

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(Source: Smith & Williamson.)

Nonetheless, firms at all levels of the market continue to struggle with cash collection, making only cursory progress with their year-end lock-up performance. With four months now considered a normal period of time for clients to settle bills, firms are missing out on massive capital opportunities to fund their businesses. Data shows that the top 50 UK law firms had a massive £5.6bn owed from clients at year-end 2017/18. *(Source: Smith & Williamson.)* This was an increase of 9% on the previous year, statistics that law firms simply need to get to grips with as a matter of urgency.

Going forward, the smart firms know that the economic climate will deteriorate at some point and that, if Brexit goes as badly as predicted by many analysts, the pain could be deep and long-lasting. That the UK economy has already contracted in the second quarter of 2019 could prove to be an ominous warning sign. On the upside, the majority of firms have far greater control over their costs than at the time of the financial crisis ten years ago and the cheap debt climate that has prevailed since then has allowed many to make critical investment decisions ahead of the next downturn.

Yet surging associate salaries and demands for greater value from clients continue to hit the bottom line. These will quickly become significant issues for many firms in the event of a sustained downturn. Yet for now at least, the overwhelming feeling is one of cautious optimism, a mindset backed up by the seemingly unstoppable financial resilience of the UK legal sector.

Contact us

If you have any comments on the contents of this report or would like to have a discussion on any aspect of the legal profession more generally, please contact:

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