THE MOVE INTO PARTNERSHIP
WHAT DOES THIS
MEAN FOR LAWYERS?

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Strategic Partner
The Law Society

Making partner is recognition of the service you have given to the firm; delivering good customer outcomes, satisfying client demands and making a solid financial contribution. It's also a personal reward for the hours you've invested, and sacrifices you've made, to gain your professional qualifications.

The partnership business model continues to be the bedrock of the legal profession and with the significant growth of new partners seems to have assured its position for many years.

Existing partners are unlikely to dilute their equity by admitting new partners without the prospect of business growth and rising profits.

Specialist legal recruitment firm Edwards Gibson reported a total of 510 new partner moves in 2023*, which is the highest number ever recorded in a single year. The number of hires last year broke the previous record of 501 set in 2017; a year which was itself disproportionately elevated due to the collapse of King & Wood Mallesons Europe.

New partners are an important part of growing a law firm, which is reflected in PwC's Annual Law Firms' 2023 Survey** results. Despite another year of uncertainty, it reported a 8-10% average increase in fee income growth across UK law firms.

*Law Firm Partner Moves in London - Issue 78
https://www.edwardsgibson.com/uploads/202401050343-Law%20Firm%20Partner%20Moves%20in%20London%20Issue%2078.pdf

**Annual Law Firms' Survey 2023: Bold steps to sustainable transformation
https://www.pwc.co.uk/industries/legal-professional-business-support-services/law-firms-survey.html

KNOW THE STRUCTURE

Each firm adopts a partnership model that meets its business needs and reflect its ethos and culture. It also remains the way to retain great talent.

Some firms maintain different levels of partner to ease the move from salaried employee to equity owning partner while others are more fluid with no intermediary step between associate level and partner.

The most common partner structures are:

- Salaried partner – you remain as a salaried employee and are unlikely to need to invest capital in the firm. You will have extra responsibilities but will have no part in the decision making. Negotiating the right deal.

- Fixed-share equity partner – likely to be self-employed with a small amount of capital invested in the firm,gaining limited voting rights. You will also receive a pre-determined share of the profits generated by the firm.

- Full-equity partner – this means being fully self-employed with a higher level of investment in the firm. Your income comes from receiving a percentage of profits generated by the firm and you have full voting rights.

The reality is that in a multi-tiered partnership the differences are predominately internal and whatever level you attain, the outside world acknowledges you as a partner in the business. What will be different is your legal, financial and practical liabilities.

A partnership offer is dependent on a firm's approach which is based on length of service and period since attaining full qualification. Others are less rigid and consider an individual's track record in delivering consistently good work for clients, winning new business and a demonstration of all-round commercial abilities rather than time served.

There is usually an agreed 'lock-step' programme in place to help the move from being a salaried employee to a full-equity partner. Each step will see responsibilities change and probably see the introduction of pre-agreed targets. Significantly, it will also mean there is a set time to make a capital contribution to acquire your equity in the partnership and gain rights in key decisions about the business and the firm.

TRANSITION TO PARTNERSHIP

Reaching any level of equity partnership is a career defining moment. It also involves taking important personal decisions. Without doubt it needs you to be committed and be able to demonstrate flexibility and resilience to meet the personal and professional challenges it brings.

The transition to partner has risks and rewards but for you, and those closest to you, it means there may be sacrifices. One of the biggest is the move to becoming self-employed and away from the security and benefits of being a salaried employee. There is also likely to be a financial impact in making the capital contribution. Unless you have access through personal or family funds, the likelihood is that the capital contribution will come from taking out an equity loan with a specialist provider.

A benchmarking database from business advisory firm Armstrong Watson*** found that the average partner capital account is £273,000. The contribution for smaller firms may range from £50,000 to £150,000 whilst the lowest entry point for a large firm may be £100,000 rising to around £350,000, but could be much higher.

Like any agreement it is important that the full details of the offer laid out in writing to include:

- Full terms and conditions of the offer
- Outline of the capital contribution required and how it is to be paid
- Structure and payments of rewards and any other benefits
- Role and responsibilities that you are required to carry out

Take the time to consider the pros and cons of accepting a partnership and ask for clarification if you feel there are any gaps or you have questions. Also carry out your own due diligence to get a true picture of the business. You should:

- Ask for at least the last three years accounts to see what profit the business makes and identify your likely drawings as part of the profit share.

- Request the monthly management accounts for the current financial year and to see any forecasts that have been prepared for the next 12, 24 and 36 months.

- Understand the return on capital employed and the total salary costs. Ask what proportion of revenues and fees these represent and be aware of non-salary overheads such as loans, lease and rental agreements. According to the Law Society's benchmarking annual survey this should be just under 30% of overall fee income.

- Review the partnership agreement or deed to understand more about the relationship between partners and matters including duties, responsibilities and dispute resolution; decision making processes and dispute settlement; holiday and sick pay entitlements for partners.

- Check profit share allocations and what it means for your drawings. This can be compared with past performance to gauge the accuracy of the figures presented.

- Have one-to-ones with partners, both those you know and those you don't, to ensure the personal and professional dynamics fit with your own.

- Be clear about the management structure of the firm and whether all partners are involved in key business decisions. If certain roles are delegated, either to management boards or groupings of partners, who takes responsibility and do they report to an all-partner board?

- Investigate what additional responsibilities you will be expected to undertake.

- Understand the policy on the resignation, retirement or the expulsion of a partner.

- Ascertain what the pension arrangements are as you will no longer be eligible for the employee scheme. Does the firm have a partners' pension scheme or are you responsible for your own?

- Discover how capital contributions are structured. Does it all have to paid on entry; does a sum have to paid and then capital increased by reduced drawings; and do contributions required increase with seniority?

- Know the firm's and personal responsibilities for indemnity insurance and ensure you are covered in the case of claims against you or the firm.

***Legal Sector Benchmarking Annual Report
https://www.armstrongwatson.co.uk/sites/armstrongwatson.co.uk/files/legal-downloads/bro_legal_sector_benchamarking_report.pdf

RISK AND REWARD

It is also important to understand the personal risks you are taking on. With a traditional partnership, as a full member you are responsible should it became insolvent or if a claim exceeds funds. This could put your personal assets at risk.

Some firms have moved to be a limited liability partnership or limited company which reduces the exposure to the amount you have invested in the firm. Even in this structure there could be added responsibilities if, for example, you had made a personal guarantee or taken funds from the business when you knew it was in difficulty.

When you have all this information consider engaging with advisers who understand professional services partnerships, their agreements, finance and accounts. Their advice will help guide you around any pitfalls which can catch out the unwary and be a good barometer as to whether the suggested capital contribution represents good value and is commensurate with the size of the firm and the needs of the business.

NEW ROLES

As a partner you become part of the senior management team and are expected to be active in key areas of the business. Remember as a fee earner you will be expected to fit these duties around your 'day job' as you still have billing targets to meet.

The roles could include:

- Building new and existing client relationships
- Seeking out and winning new work
- Developing business strategy
- Mentoring and developing staff

There might also be additional roles which are seen to fit your skill sets or interests and could mean taking on responsibility for key business functions such as marketing, IT or personnel.

These responsibilities will inevitably lead to longer hours and potential difficulties in maintaining a reasonable work/life balance, particularly in the early years as a partner when the pressures can be greatest.

It's important to also think about your own development and ask what support you receive as a new partner; whether you will have a mentor to ease the transition; and what training opportunities you'll have particularly if you are tasked with roles where you may not have had much practical experience.

Even with extra responsibilities the reality is that in the first years as a partner you will probably earn less than when you were an employee. The drawings schedule and structure impacts most on a new partner and can be a strain for some particularly if there is a mortgage and growing family to support.

CHANGING PERSONAL FINANCES

There is the personal challenge of having to adjust to not receiving a monthly salary. Instead you're likely to be able to make drawings from the partnership on account until the set date when the cash distribution of the profit share allocation is made.

These payments are without tax or national insurance deducted so you need to make allowances to meet these obligations. Seek specialist advice to ensure that you are fully tax compliant.

It's not uncommon for a new equity partner to be given various targets to meet to build up points which will entitle them to an increasing share of the profits. This system may mean drawing less than more senior partners.

After a couple of years, you should reach the full earning potential which will be in excess of your earnings as an employee. According to the latest report of accountancy firm Hazlewoods****, the average pay for law firm partners increased by 8.5% last year, reaching a new record high average of £241,000 a year.

The level of drawings can also be less than expected if the firm has a challenging year or there are cash flow issues. Several high-profile failures in recent years have been caused by firms allowing partners drawings to exceed profits.

This has made the regulatory authorities more alert to potential issues and they are not afraid to impose financial or legal sanctions against firms and individual partners. It's important to be mindful of this because any wrongdoing, however innocent, can have implications for your reputation and license to practice.

****Legal update: Average pay for law firm partners increases by 8.5% in a year
https://www.hazlewoods.co.uk/news/legal-update-average-pay-for-law-firm-partners-increases

MAKING THE FINANCIAL MOVE

Having received a formal offer letter, weighed up the pros and cons and decided partnership is for you then you need to be ready to make your capital contribution.

Each firm has its own approach however it is likely you will need to make an immediate lump sum payment on becoming a fixed-share or full partner. Depending upon the firm's approach it may be one payment or, for larger amounts, phased over a couple of years.

For many, a partner equity loan is the most efficient way of doing this There are specialist finance companies who can tailor loans to suit your needs.

Shire Professional Funding is widely experienced in working with professionals. Each customer has a dedicated account manager who understands the issues and challenges you face and can support you at every step to achieve your career goals. Loans from £25,000 to circa £500,000 are available with flexible payment terms with costs spread over up to 7 years. The loan can even be repaid earlier if business is good.

Once you have the financial issues sorted out then you can look forward to embarking on the next stage of your career and to play a part in developing and growing a business in which you are part-owner.

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