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State of the UK Legal Market 2016

A Thomson Reuters research report: Buy-side and sell-side decision-makers in the legal industry give their views on growth, innovation, technology use, alternative legal service providers and attitudes towards winning, retaining and outsourcing work.

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Introduction





What is motivating today's buyers of legal services and how are law firms positioning themselves to take advantage of the opportunities coming their way?

Law firms face more competition than ever before and while most would expect the threat to come from other firms or new market entrants, they may have underestimated the threat posed by their own clients, who, our research suggests, are building up their own in-house teams and planning to keep more work in-house over the course of the next year.

In order to stay competitive, many firms have already started getting to grips with their cost base, taking advantage of lower cost regions, using contract lawyers and embracing new technologies and processes to help them deliver legal services differently. In the aftermath of the EU referendum and the prevailing economic uncertainty, embracing efficiency will be as important as ever for firms.

But do these changes mark a new chapter in law firm/client relations? Were they exactly what clients had been searching for from their lawyers or were law firms running the risk of losing what makes them stand out from the crowd in the first place?

These were some of the questions we asked to more than 200 decision-makers from in-house legal departments and the top 100 UK law firms in Spring/Summer 2016. This report summarises our findings; we hope you find it insightful.

Lucinda J Case

Lucinda Case

VP, Customer Segments & Strategy, Legal UK & Ireland, Thomson Reuters

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Executive summary

This research was conducted in May 2016, with 110 senior legal decision makers in large and medium UK law firms and 104 senior legal decision makers in UK corporate organisations. Here is a summary of key findings.

Law firms are exhibiting a lack of confidence

The increasingly competitive environment for legal services in the UK appears to be weighing heavily on the minds of private practice law firms. When asked how they thought they compared to alternative service providers, law firm respondents consistently exhibited a lack of confidence:

The majority (**71%**) agreed that the traditional law firm model and culture does not meet the needs of legal services buyers

71% agreed that alternative legal services providers were a threat to the law firm model

But have law firms underestimated the strength of their relationship with clients?

71% of law firm respondents believed that accountancy firms had overtaken them in their relationships with corporates, whereas only 31% of corporate respondents agreed.

In-house respondents also identified law firms as the preferred provider of legal work in most areas. Only in tax were accountancy firms ranked ahead; and in the area of general company & commercial, clients ranked their own in-house teams ahead of law firms.

Competition is increasing for law firms, particularly from clients' own in-house capabilities

Competition appears to be increasing with 69% of law firm decision-makers saying they have lost more work in the last year than in the previous year. Interestingly this competition is not just from other law firms:

45% said they had lost work to accounting firms

43% said they had lost work to in-house legal teams

27% said they had lost work to legal processing outsourcing organisations

Looking to the next 12 months, 69% of senior legal buyers in large corporates said that the biggest threat to law firms was companies keeping more work in-house. They also told us that the biggest motivators for doing so were reducing costs and the fact that their own in-house teams had a greater understanding of the business and matter context.

The growth of the in-house team could come as a shock to law firms. Only 17% believed this to be a threat in the next 12 months. When asked why clients might keep work in house, law firm respondents did not pick up on the reasons clients gave (mentioned above), instead most thought it was due to technological capabilities or a bad experience working with one firm.

The use of alternative legal services providers remains low, but the threat is increasing

15% or fewer in-house decision makers in our survey said they have used non-law firm providers in the last 12 months (including accountancy firms, consultancy firms and legal process outsourcing firms). Still, our respondents felt the competition from these providers was increasing, with more than half of law firm decision-makers agreeing that they need to do more to counter the threat.

Interestingly, we found that the threat posed by alternative providers doesn't just relate to cost. When asked why a client might opt for a non-law firm provider, in-house respondents were most likely to mention the speed/time for the work to be completed (63%). Only 29% of respondents mentioned reduced cost.

A law firm brand alone is not enough to win work in the future – true business insight and value for money are key to success in the eyes of clients

One area both buyers and sellers of legal services agreed on is that a brand alone, even a significant one, will not be enough to guarantee a steady flow of work for a law firm in the future: 67% of clients and 73% of law firms agreed that the power of the brand will not be enough to guarantee work in future.

With new entrants as well as waves of consolidation giving rise to new brands, the tradition of big brands dominating clients' decisions may have come to an end.

When asked what they wanted to see from their chosen suppliers, in-house counsel stressed the importance of business acumen and value for money. Both of these points also featured heavily among the reasons clients kept legal work in-house.

Law firms plan to invest in technology and non-lawyer talent

With competition – not least from their own clients – snapping at their heels, law firms are investing in new talent, new infrastructure and new ways of working.

Three quarters of all law firm decision-makers said they were planning to hire a project management professional in the next 12 months; and 82% said they were planning to hire strategy professionals.

Over half of all law firm respondents agreed they were either looking to buy or build their own technology capabilities, including: knowledge management, document automation, matter management, client collaboration and data analytics systems.

Firms need to invest in the right areas

As we have seen, law firms and their in-house clients are not totally in synch with regards to what corporates are looking for in their chosen legal services providers.

When we look at the desired changes or innovations that clients are looking for from their law firms, there is a similar discrepancy. Here clients cited as important innovations, fixed fee pricing or other pricing arrangements and understanding the business and its needs better. Again only a minority of law firm respondents picked these traits, instead going with strategic partnership as the most innovative “value add-on” they could provide, followed by improving communication and collaboration.


Use of technology in legal departments is low, with few planning to invest

While the use of online information tools such as Practical Law was high among our in-house respondents (85%), the same cannot be said for other technology tools. 25% or fewer respondents used matter and document management solutions, drafting tools, eBilling, eDisclosure or contract lifecycle management.

When asked whether they had immediate plans to invest in these areas; the majority did not, with the exception of document management – where around 60% of in-house respondents were planning to either purchase or develop a solution in the next 12 months.

If corporate teams do bring more work in-house over the next 12 months, as this research suggests they might, then the lack of technological infrastructure to help them deal with that work efficiently is set to become a more pressing issue.

Attitudes to legal services suppliers

A vertical decorative element consisting of a solid white circle at the top, followed by a series of smaller, dashed white circles, and ending with a small cluster of four dots at the bottom.

The competitive environment for legal services in the UK appears to be weighing heavily on the minds of private practice law firms, but have law firms underestimated the strength of their relationship with clients?

UK law firms face more competition than ever – from other international firms, as well as other organisations including accountancy firms moving into the sector through Alternative Business Structures. Firms have also had to contend with the arrival of a number of companies offering contract lawyers such as Lawyers on Demand, who have disrupted the traditional supplier model. In this context, when asked how they thought they compared to alternative service providers, law firm respondents in our survey consistently exhibited a lack of confidence, ranking themselves behind accountancy and consultancy firms in most areas, from UK M&A to regulatory and beyond.

For example, for providing advice around UK M&A, 40% of law firm respondents said accountancy firms were the better providers and only 12% said law firms; and for general company work, 28% said accountancy firms and only 17% said law firms.

With results such as these, it seems that law firms are exhibiting a crisis of confidence which many who come into contact with lawyers on a regular basis may not recognise. However, it seems these fears stem from a general feeling of uncertainty and change within the market.

In an industry not known for uncertainty, change and risk taking, lawyers are certainly aware the market is changing.

71% of law firm respondents agreed with the view that accountancy firms had overtaken law firms in their relationships with corporates

71% of senior decision-makers in large law firms in the UK agree the traditional law firm model and culture do not meet the needs of legal services buyers

71% also agreed that alternative legal services providers were a threat to the law firm model

77% were concerned about the impact of in-house legal teams keeping work in-house

Lawyers' nervousness about the relationships accountants have with companies may be justified. One General Counsel from a major corporate said to us:

“Lawyers don’t think through the advice they give to in-house counsel and how easily this will convert to something I can take to the Board of my company.”

Another said:

“Law firms have lost out to accountants in terms of offering consultancy services. We pay a lot of money to accountancy firms for additional services that law firms simply don’t offer. They have been shown up to be comparatively uncommercial.”

But while competition has stepped up, clients are still overwhelmingly choosing law firms as their preferred suppliers. When asked whether they had outsourced legal work in the last 12 months and if so, to whom:

99% of decision-makers in corporate legal departments said they had and that it had been to law firms

1 in 10 said they had outsourced to accountancy and consultancy firms

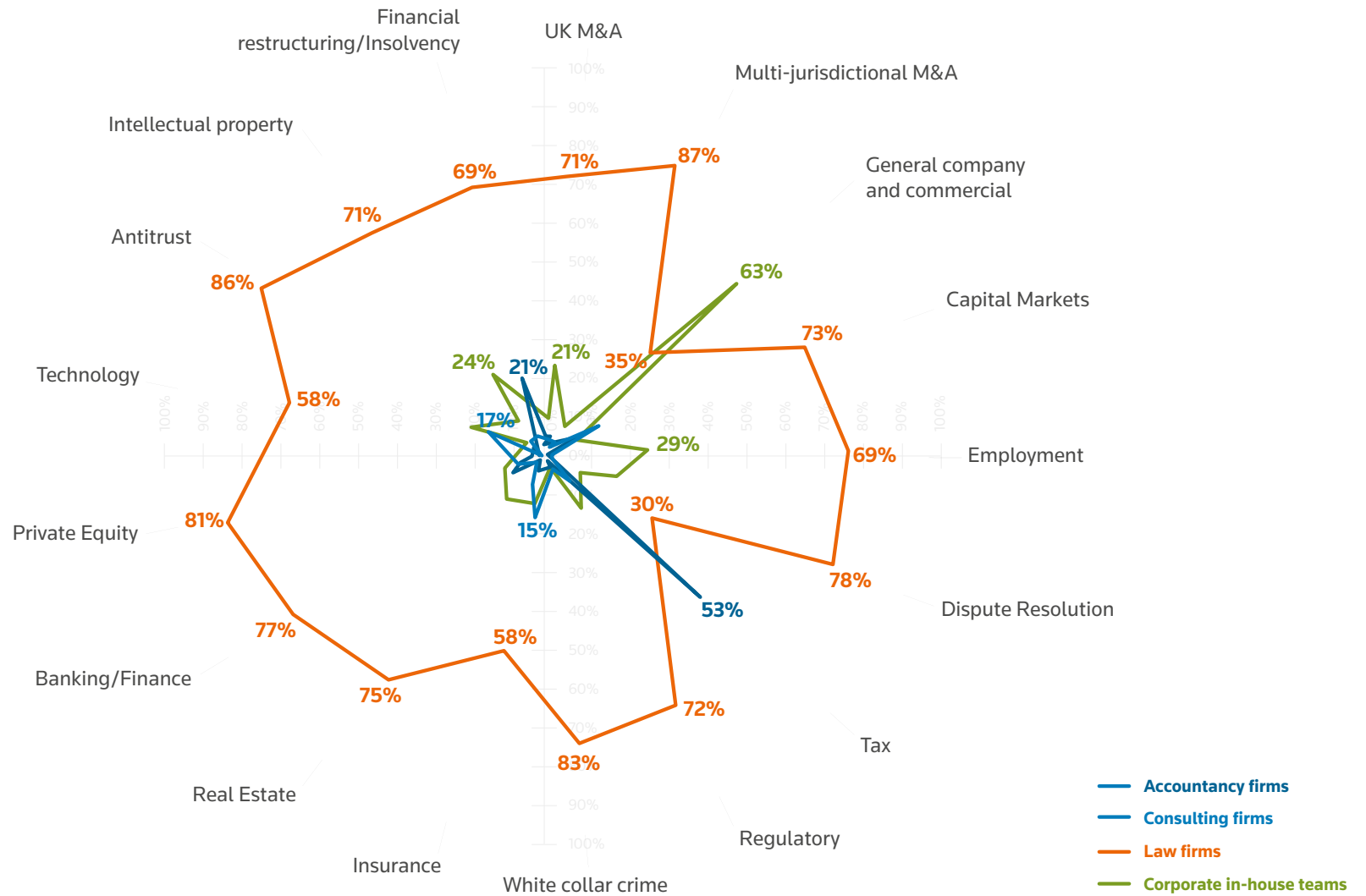
11% said they had used legal staffing companies or employment placement agents. Only 10% cited other alternative legal service providers

When we probed further and asked which kind of suppliers clients perceived to be the best across specific types of law such as: UK M&A; white collar crime and dispute resolution among others, again, law firms came top in nearly every area. And this was generally by some margin – for example, for white collar crime, 83% of company respondents chose lawyers as opposed to 4% who chose accountancy firms.

Only in two areas did law firms rank lower than first: in tax, in-house counsel showed a preference for accountancy firms, while in general company & commercial, they preferred their own in-house legal teams.

While these two choices are reasonably obvious given the strength of accountancy firms in the provision of tax advice and the naturally more commercial edge of in-house teams, what was interesting was the rather muted response to other non-law firm suppliers. While much has been written about the threat posed by other alternative legal suppliers, our findings support a number of more recent industry reports that usage of these suppliers remains low: at least right now.

Which of the following do you perceive to be the better supplier of the following legal services?



Base: Senior legal decision makers in UK corporate organisations (n=104)

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Competition is gathering pace for law firms, particularly from clients' own in-house capabilities.

Competition from the client

As well as perceiving threats in the future, law firms are feeling the pressure here and now. 69% of decision makers in law firms said they have lost more work in the previous 12 months than in the year before that.

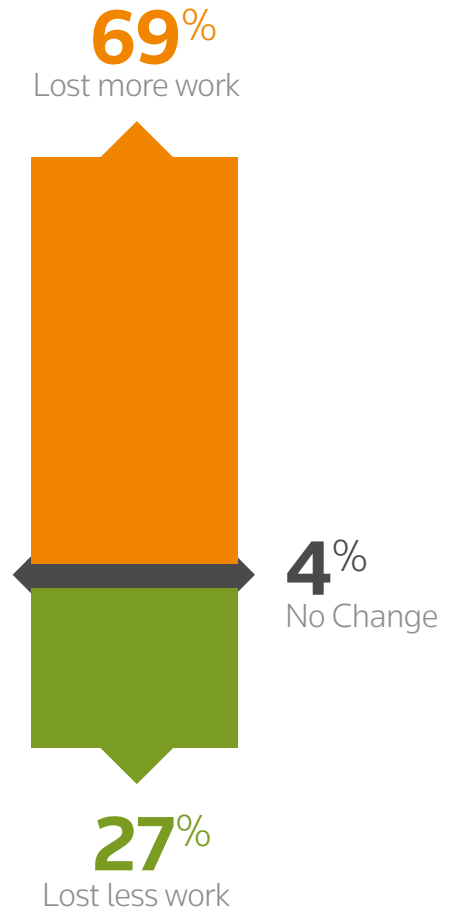
Our study shows that non-traditional legal service providers are beginning to have some impact in the market over the last 12 months.

45% of law firms said they had lost work to accountants

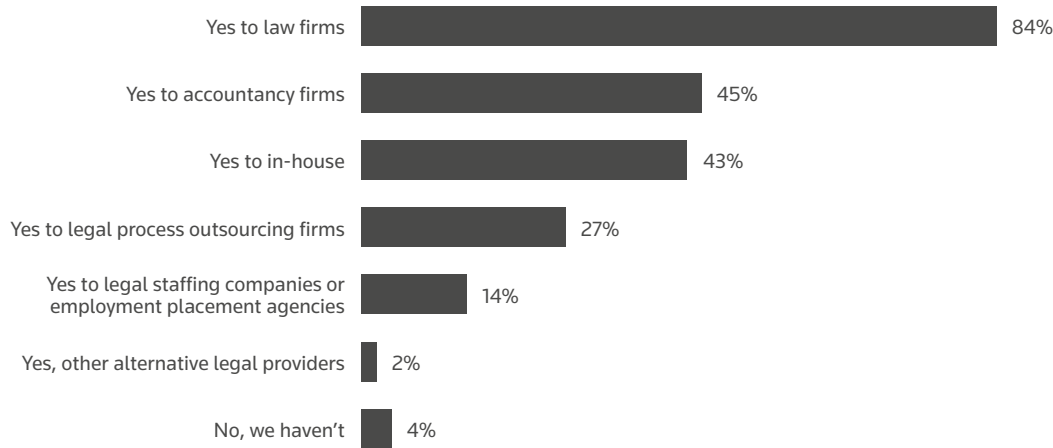
27% said they had lost work to legal process outsourcing organisations

At the same time firms are facing a threat from their own clients. **43%** have lost work to in-house teams.

Approximately how has the amount of legal work you have lost changed in the last 12 months?

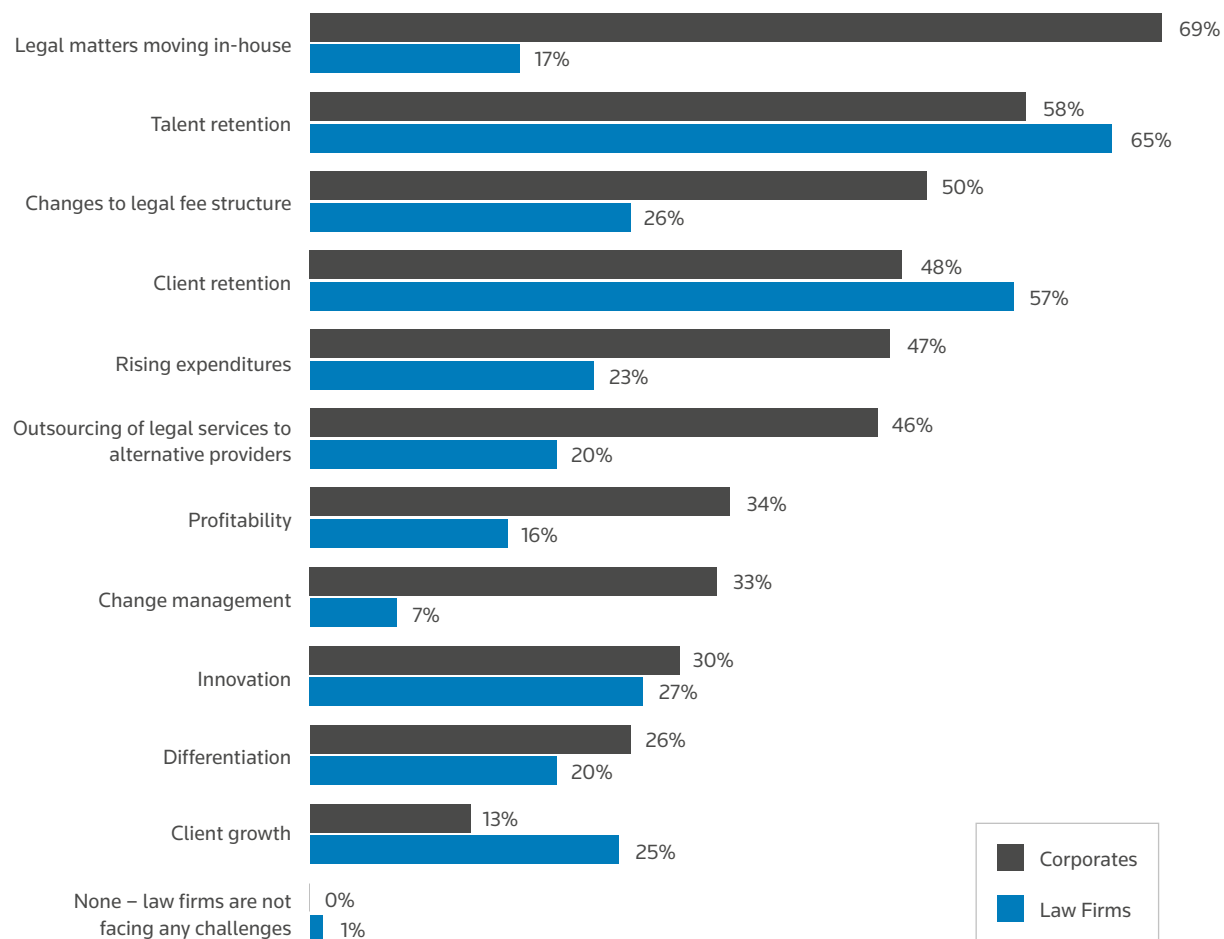


Has your law firm lost legal work in the last 12 months?



Base: Senior decision makers in medium and large UK Law Firms (n=110)

Which of the following challenges do you believe law firms are facing in the next 12 months?

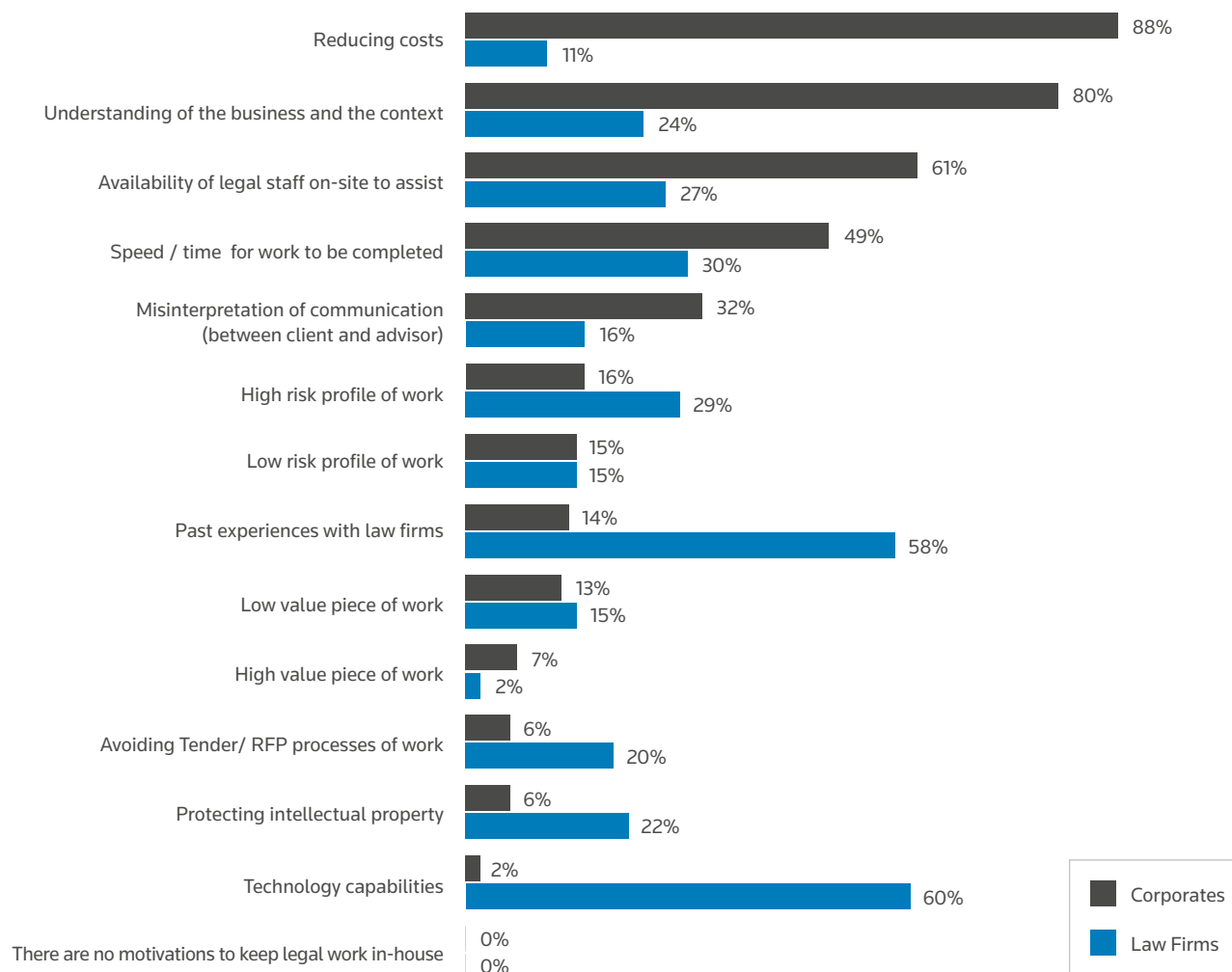


Our research also suggests that law firms may not be sufficiently prepared or aware of the immediate threat posed by growing in-house functions. When in-house respondents were asked what the biggest challenge facing law firms over the next year would be, 69% said legal matters moving in-house, while only 17% of law firms thought this to be the case. Instead, law firms see the major threats as talent retention and client retention.

When we delved a bit deeper into the motivations for clients to keep work in-house, 88% of corporate respondents identified reducing costs as the number one issue, closely followed by 80% who cited understanding of the business and context.

What we also found was that the shift is already, if subtly, taking place. When we asked clients if they had or had not increased the amount of spending to undertake work in-house over the last 12 months 38% agreed they had. Indeed, a small number – 5% of respondents – confirmed they had more than doubled the amount of spending on their in-house legal teams during the period. In comparison, only 13% of corporate respondents had reduced spending on their in-house legal teams.

What do you feel are particularly motivating drivers for corporate organisations to keep legal work in-house?



Continuing on the same theme, when law firms were asked why a client would keep work in-house, only a minority identified with the answers given by clients – 11% cited reducing costs and 24% cited understanding of the business and context.

By far the most common factors chosen by law firms were past experiences with law firms (58%) and technology capabilities (60%). And to reinforce the apparent misalignment between the two sides, when asked about the most innovative value add-on they could provide to clients, 63% of law firm respondents said strategic partnering, followed by improving communication and collaboration (60%); while clients chose fixed fee pricing and understanding the business better.

In fact, when corporates were asked outright whether the growth of in-house was threatening the traditional legal model in the UK, 44% said yes and 52% no (the remainder being 'don't knows').

So the message from corporates came across loud and clear. They still rate law firms highly but the costs associated with that advice is too high and it does not always carry the same commercial edge that they can find from their own teams or from accountants and/or consultants.

While it is perhaps not surprising that in-house respondents can point to more business-relevant advice from their own teams, the ramifications are important – law firms will lose more work to accountants and/or consultants and more work will be retained in-house, unless they make the changes that their in-house clients want them to make.

Alternative legal service providers

The use of alternative legal services providers remains low, but the threat is increasing.

Our research shows the beginnings of non-law firms as credible suppliers of legal work, presenting a challenge to law firms. It is not surprising that 99% of corporate legal teams have outsourced legal work to law firms in the past year. However, non-law firms are making some in-roads.

Of the in-house decision-makers in our research:

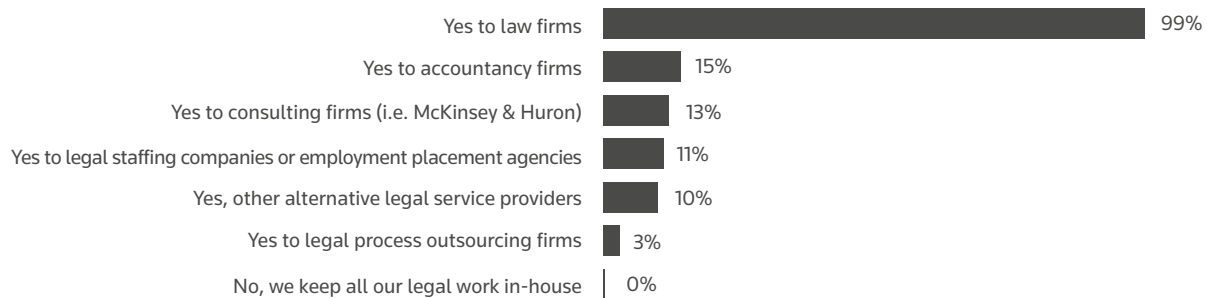
13% have used consultants

15% have used accountants

10% other alternative legal service providers

Interestingly not one respondent said they had kept all their legal work in-house. Despite the move to increase the in-house teams, it seems that there are still opportunities, although perhaps fewer and different, for external suppliers.

Have you outsourced any legal work in the last 12 months?



Base: Senior legal decision makers in UK corporate organisations (n=104)

Nonetheless corporates are clear of the direction of travel, with 46% naming outsourcing of legal services to alternative providers as a key challenge for law firms in the coming year.

Far fewer – 20% – of law firms agree this is an immediate threat. Both agree that alternative providers will pose a threat to the law firm model in the longer term however – 71% of law firms and 66% of in-house buyers. And this was despite the fact that 35% said they did not know whether they were better value for money than law firms (only 37% agreed that they were).

The threat of alternative providers is growing, but some buyers are unsure of the value. One GC told us:

“The new providers are like emperors with no clothes. It sounds great but there are basically selling the same service the lawyers sell, but it’s often more expensive and no good.”

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Choosing a legal service provider

Law firm brands cannot be relied upon to win work in the future – true business insight and value for money will be the key to success in the eyes of clients.

In order to more fully understand the attitudes of buyers of legal services, we asked some more detailed questions about how clients decided which legal service provider to use.

We started with the law firm brand itself. Interestingly, when asked about the power of the law firm brand, both sides were in complete agreement that law firms can no longer rely on their brands alone to win work.

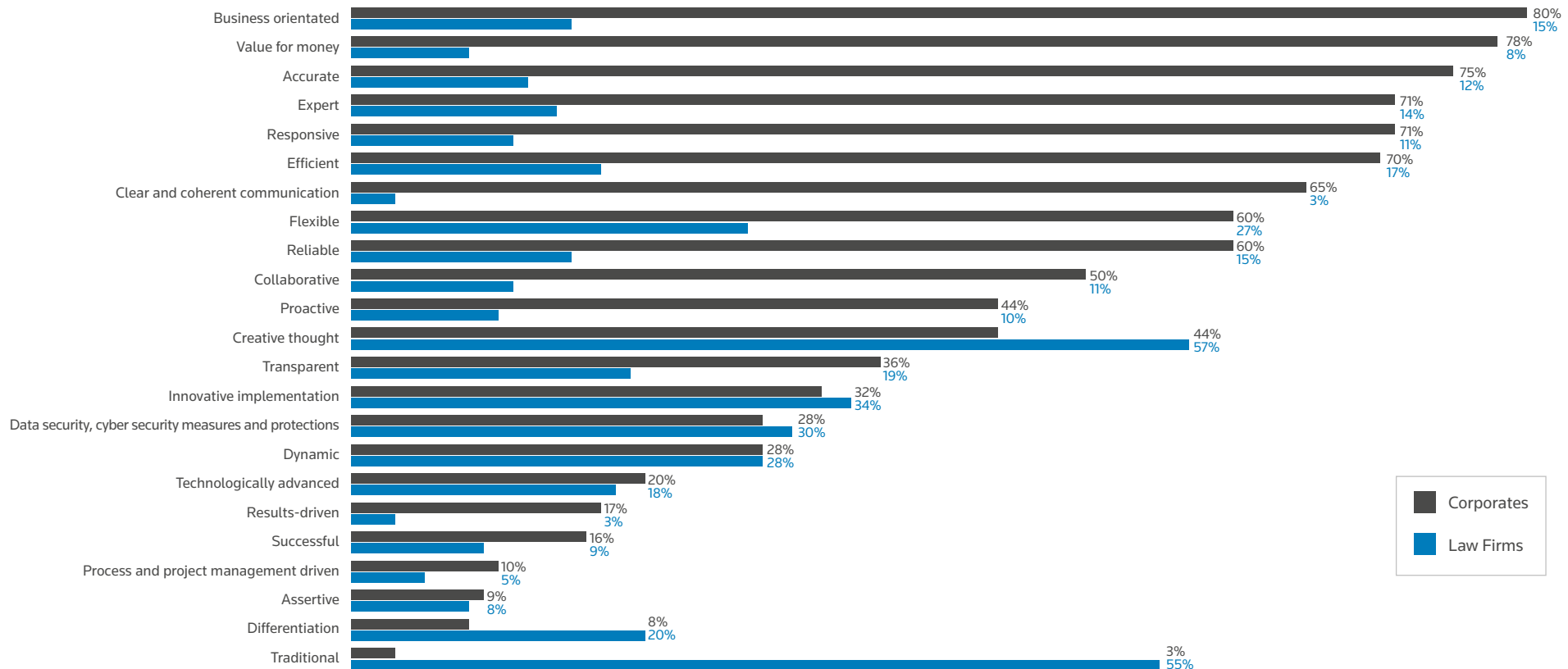
While it is likely that a major global law brand will continue to carry weight with international clients, the levels of competition are such that clients can afford to move around rather than sticking with one particular firm – which has been a preference for some to date. 67% of clients and 73% of law firms agreed that the power of the brand will not be enough to guarantee work in future.

Instead, our survey found a consistent theme emerging, in that clients are looking for commercial and value-for-money advice. When they were asked for the key attributes they looked for in a legal services provider the number one theme at 80% was business-orientated advice, with value for money coming in a close second at 78%.

Further, when asked which value add-on would have a positive impact on the client-law firm relationship if provided by a law firm, 74% of in-house buyers of legal services responded with “understanding the business and its needs better” followed closely by “fixed-fee pricing or other pricing arrangements”.

Putting these answers together with the reasons why a client would choose to keep work in-house, one can see what appears to be a growing dissatisfaction with the status quo. But have law firms got the message?

Which of the following characteristics do you consider particularly important to buyers of legal services?



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Law firms are planning significant investment in technology and non-lawyer talent.

Investing in innovation

Whether or not they are fully aware of the threat posed by the growth of in-house teams, law firms have realised that they need to change in response to the broader competitive landscape. 71% agreed that the traditional law firm model and culture does not meet the needs of legal buyers in the UK and 72% said their firm is innovating when it comes to how it provides legal services to clients.

We then asked what kind of changes and innovations law firms were making in the next 12 months.

In the area of talent recruitment:

73% said that they are looking to recruit transformation/innovation and process improvement professionals

76% confirmed they are looking to hire project management professionals

82% said they were looking to recruit strategy professionals

Beyond investing in people, firms are also looking to technology to streamline their processes. When we asked respondents about whether their firms were considering investing in technology systems, over half of all law firm respondents agreed they were either looking to buy or build their own capabilities, including: knowledge management, document automation, matter management, client collaboration and data analytics systems.

In addition, we asked about general process, structural and operational improvement – particularly around pricing.

73% of lawyers agreed they have or expect to re-evaluate their pricing methods in the next 12 months

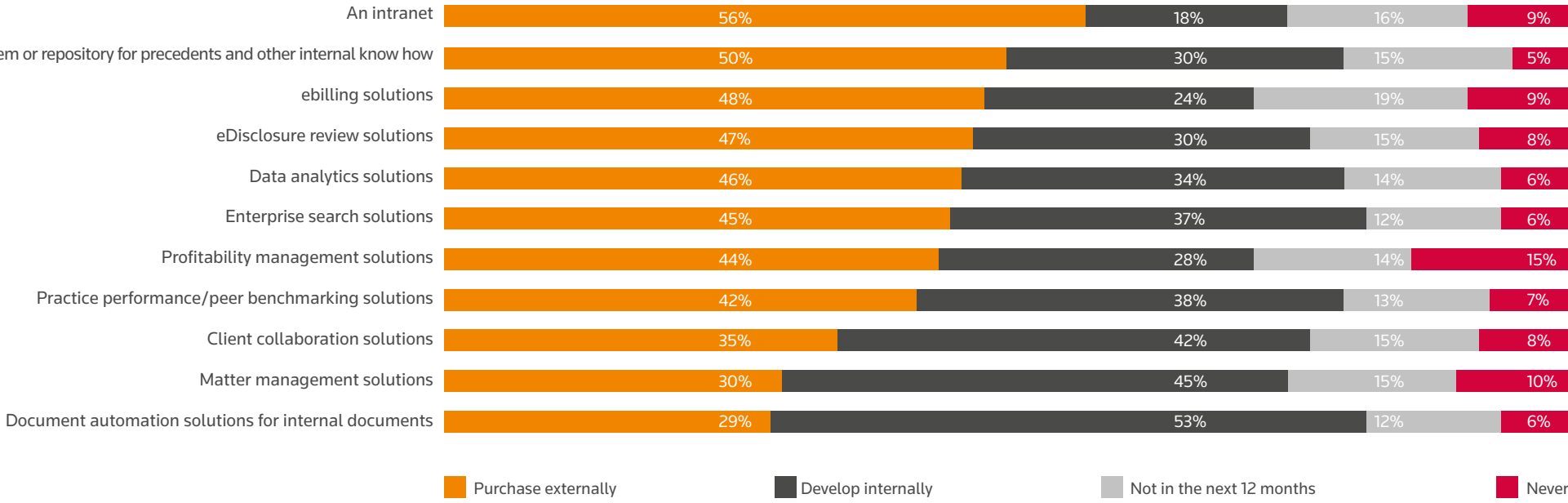
73% agreed they have or expect to introduce process mapping during the same time period

7 in 10 agreed they were looking at making process improvements across the board including: better matter management; legal project management; introducing low-cost centres

67% of respondents said that their firm would likely be applying for an ABS license in the next 12 months

It's clear that law firms realise that staying as they are is not an option. The key question is what are the right investments to make in an increasingly crowded marketplace?

Which of the following solutions would your law firm consider to purchase externally or develop internally within the next 12 months?



Base: Senior decision makers in UK law firms (n=110)

Firms need to ensure they are investing in the right areas

Innovation has been a watchword for the legal industry for the last few years as firms began to look beyond consolidation in order to gain market share. But while trying to do things differently should be welcomed, have clients started to view law firms as innovative? Also, and more importantly, are the changes law firms have been making in the right places and are they making the impact they were looking for: better and more lucrative relationships with clients?

Let's start with the first of those questions: Have clients started to view law firms as innovative?

When we asked in-house counsel to rank their own teams for innovation against the likes of other suppliers (accountancy firms, consultancy firms, law firms, alternative legal service providers), only 8% of clients put law firms in the category of 'very innovative'. This compared to 33% for consulting firms, 30% for corporate in-house teams, 21% for other alternative legal service providers, and 20% for accountancy firms. In addition, only 24% described their own organisations as very innovative.

On first glance it would appear that law firms had thus far, at least, failed to convince clients they were agents of change. But actually the picture is more nuanced.

Anecdotally we hear that while in-house buyers are open to innovation, clients have some other more straightforward requests of their law firms.

"Innovation is all very well but rather hopeless when law firms can't even get the basics right. I can't phone up the global law firm that advises me and find out quickly and easily what the WIP is and what the cost is likely to be."

"Couldn't someone launch a client portal allowing me to see all of the fee narratives open on my file? I'm not aware of anyone that offers practical innovation like that."

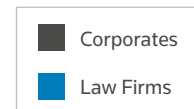
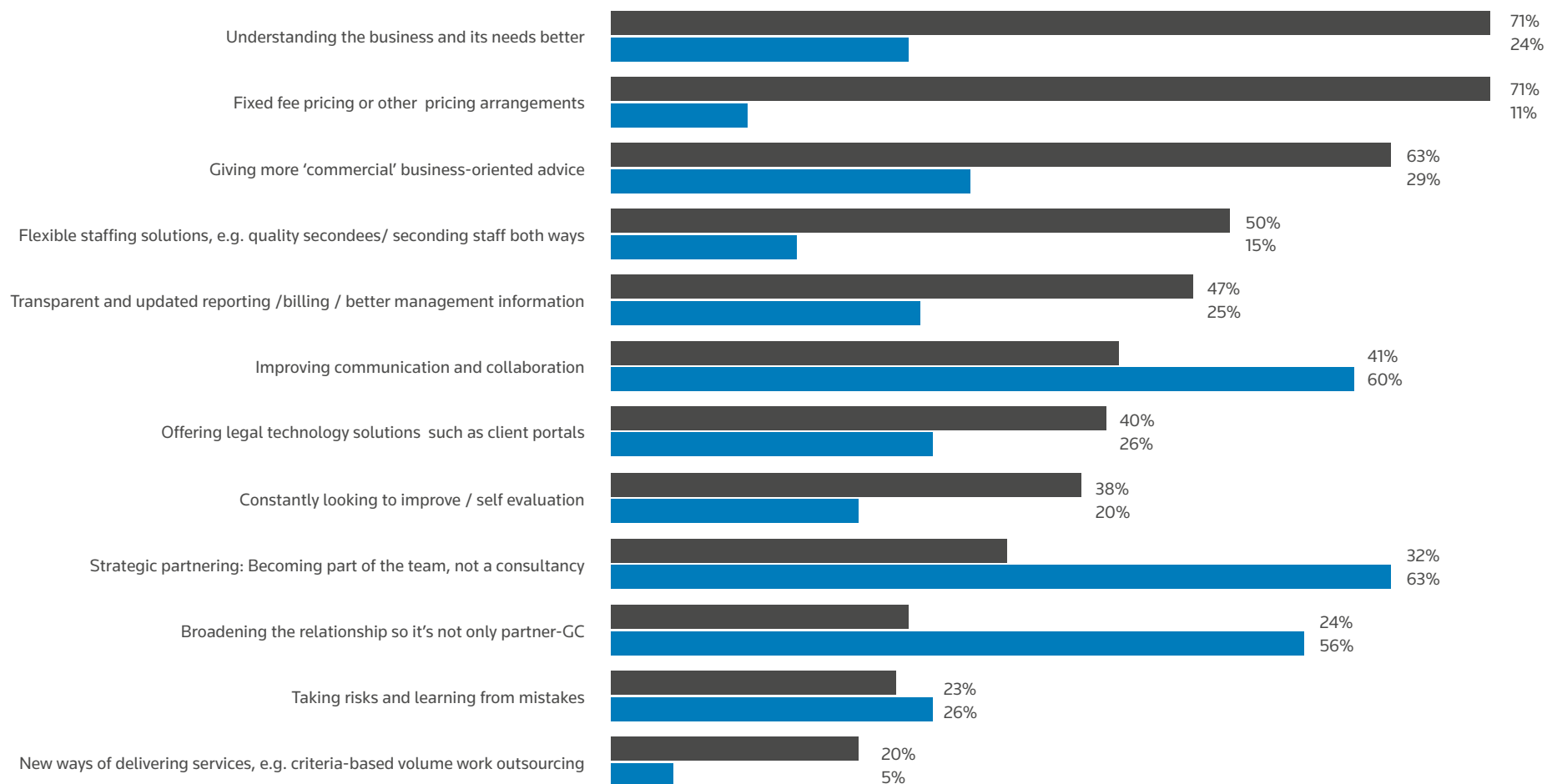
"I want to see a law firm that can bill properly. So often I get a call on a matter where the time charged is way in excess of what we agreed and I'm simply not prepared to pay for this time."

As we know, commercial advice and value for money are the top two attributes clients look for in a law firm, so where does innovation really rank in their list of wants? In reality it appeared, but much further down the list than one might have expected – ‘technologically advanced’ scored only 20% and ‘innovative implementation’ only 32% .


In addition, when asked about the challenges law firms face over the next 12 months, only 30% of buyers of legal services thought innovation was one of the key challenges law firms needed to address. Many other factors ranked ahead of this.

Further, when asked about which innovation clients thought would have a particularly positive impact if provided by a law firm, 71% cited fixed-fee pricing or other pricing arrangements and 71% answered understanding the business and its needs better. Once again, those same two issues of commerciality and cost came to the fore.

Which of the following innovations or 'value add-ons' do you think law firms could provide that would have a particularly positive impact for clients?



Technology use in corporate legal departments



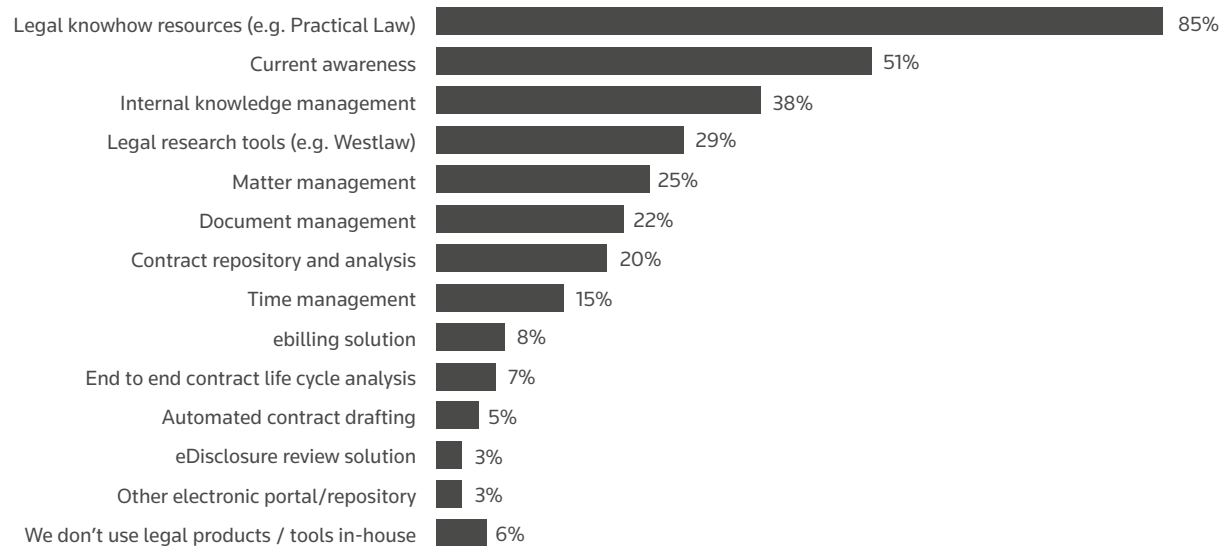
Use of technology
in legal departments
is low, with few
planning to invest.

Our research has highlighted the trend towards growing in-house teams and we have looked at that from the perspective of the threat to law firms. But how are in-house departments preparing to build what could essentially be a law firm within a major company?

This issue was not the main focus of our report, but a number of warning signs were raised about the technological infrastructure of in-house teams.

The vast majority of respondents (85%) use legal know-how tools, such as Practical Law to help with the day-to-day management of work. However, beneath the surface in-house teams lack many of the tools a private practice lawyer takes for granted and would say are necessary to fully serve clients. Just 25% currently use matter management tools, 22% document management, 20% contract repositories and analysis, 15% time management tools and 5% automated contract drafting.

What tools do you use to help carry out legal work in-house?



Base: Senior legal decision makers in UK corporate organisations (n=104)

Furthermore, the appetite for investment in technology infrastructure does not appear to meet the appetite to increase headcount within in-house departments:

40% of in-house departments say they are not looking to invest in automated contract drafting in the next 12 months and **31%** say it is not on the cards at all

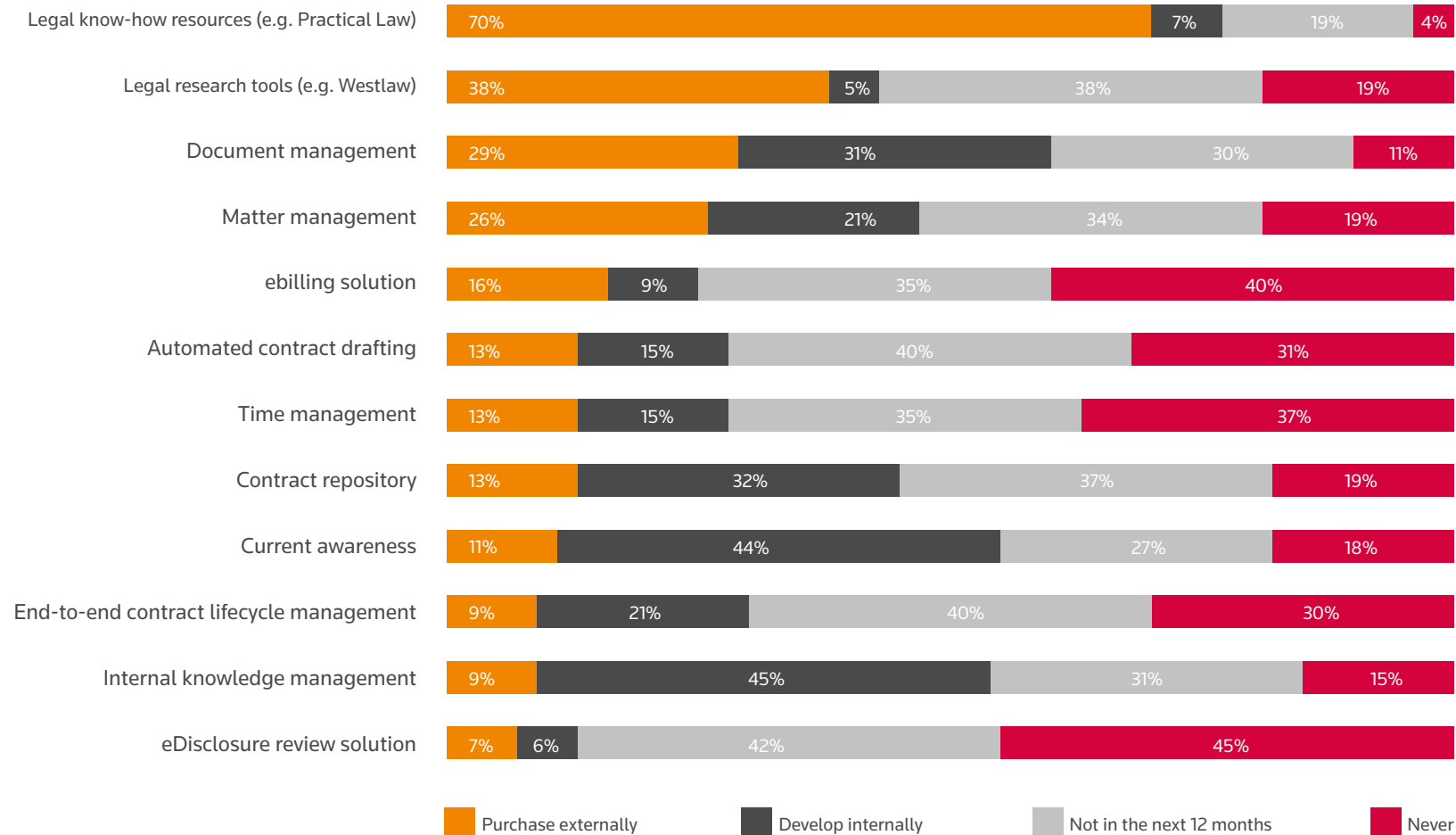
30% say that there will be no investment into document management over the next 12 months; **11%** say it is something they will never consider

40% are not looking at end-to-end contract lifecycle management in the next 12 months and 30% are not at all

These findings suggest that in-house departments may lack the technological infrastructure in the future to properly serve their 'internal' client.

This is unsurprising given the comparative sizes of their legal departments and the major investment needed to buy or build some of these products, but what are the long-term implications? Perhaps the pace of growth of in-house departments will slow to ensure the right infrastructure is in place. Or maybe there is an opportunity for law firms and alternative providers to focus on how they can monetise this technological know-how for the benefit of clients?

Which of the following tools would your organisation/legal department consider to purchase externally or develop internally within the next 12 months?



Base: Senior legal decision makers in UK corporate organisations (n=104)

Conclusion

We know that the demand for legal services in the UK is as great as ever. For many law firms, the business of servicing clients and providing innovative solutions to complex problems has not changed. And the industry is full of well-run, profitable law firms with strong brands.

Certainly in the aftermath of the EU referendum and the prevailing uncertainty, top class, specialist advice is more important than ever. But a period of tremendous change brought on by the referendum decision will see clients ask more of their lawyers than ever before and lawyers must be well prepared and proactive in order to deliver.

There is a sense of concern among law firms about other alternative providers offering legal services, but no real clear sense of where the threat lies. While focused on what accountants and law firms are doing, firms appear to be missing the potential threat of companies moving more work in-house and, more importantly, their motivations to do so.

At the same time, if in-house departments are planning to grow their teams, as our research suggests, they may need to consider developing a better infrastructure to manage such work effectively and provide their business the quality and efficiency they have come to enjoy from established law firms.

Many firms are alive to the changes. Some are restructuring internally, most are offering different billing structures and we are seeing the first announcements of partnership with alternative providers. Law firms are clearly attempting to innovate across the board, but in doing so they are potentially missing the real key to improving their client relationships – getting back to basics and doing what they do best – top class advice but with more of a focus on value for money with an understanding of the commercial context.

Methodology

This research was conducted by FTI Consulting's Strategy Consulting & Research team in May 2016, with 110 senior legal decision makers in medium and large UK law firms and 104 senior legal decision makers in UK corporate organisations.

Please note that the standard convention for rounding has been applied and consequently some totals do not add up to 100%.

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