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How Change is Driving Opportunity: Market Trends Shaping the Legal Landscape

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INTRODUCTION

In today's legal landscape, it is common to perceive corporate law departments and law firms as competing forces. But in reality, the relationship between the two is not so dissimilar. Though there are fundamental structural and incentive differences, the big-picture challenges they face – and the solutions available to them – are very much alike.

The legal vertical is experiencing a fundamental shift, with law departments and firms challenged to deliver and justify value to internal and external clients. The push for efficiency across the legal market is palpable, raising new questions around how to effectively manage talent, technology and overhead in a way that is cost effective, yet supportive of established value propositions. Furthermore, the industry is in the midst of a generational shift, with the face of legal professionals morphing as millennials flood the workforce and senior leadership prepares for retirement.

These combined forces have and will continue to create new, transformative opportunities across the legal vertical. This paper explores the distinct market trends impacting law departments and law firms today, and illuminates the actions we believe industry leaders must take in order to stay competitive, sustain profits and continuously drive value for clients and shareholders.

CORPORATE LAW DEPARTMENTS: GREATER WORKLOAD BRINGS ADDED RESPONSIBILITY

The role law departments play within their organizations is expanding due to internal and external pressures. The responsibilities of general counsel have grown beyond dispensing risk and compliance advice to acting as a trusted advisor helping to shape the overall business strategy for the organization. In response, general counsel are bringing in experienced legal operations leaders to focus on accelerating legal team productivity and identifying creative approaches to help law departments accomplish more with less.

Rising in-house legal spending underscores the need for greater efficiency

From 2014 to 2015, law departments' outside counsel spending was flat, but in-house legal spending rose three percent, driven by a focus on internalizing legal work.[1] In response to the rising cost of outside counsel support, corporate law departments have been transitioning work previously assigned to law firms back in-house – and investing in the internal resources and technology needed to support this trend. However, as law department teams and responsibilities grow, they are finding themselves under additional scrutiny to be more efficient. Rather than bring in additional legal administrators or paralegals to free up attorneys' time, law department leaders are investigating alternative staffing models and service providers for support in areas such as project management, invoice review and spend analytics.

Specifically, they are finding success in recruiting professionals with strong business and consulting expertise – regardless of whether or not they have a legal background – to serve as instrumental process and project managers so that attorneys can focus on strategic legal matters. Internal resource alignment is, and will continue to be, a key focus area for law departments and is a trend that law firms should be cognizant of as it will have a profound impact on law departments' outside counsel search and selection process.

A collaborative partnership: general counsel and legal operations leaders

The role of general counsel has evolved significantly over the last decade. More than ever before, general counsel are expected to act as business advisors to c-level executives within organizations.

As a result, GCs are strategically hiring legal operations professionals to implement and manage initiatives that drive change and efficiency across internal department structures, practices, technology and staffing – in addition to taking on responsibilities around cost containment and vendor and contract management.[2]

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1 "2015 Law Department Survey," HBR Consulting. October 2015. http://www.hbrconsulting.com/lawdepartmentsurvey.html
2 "The Rise of In-House Legal Operations," Hansen, Susan. Bloomberg Big Law Business. February 24, 2015. https://bol.bna.com/the-rise-of-in-house-legal-ops/

Outside of their respective organizations, legal operations professionals are joining forces through movements such as the Corporate Legal Operations Consortium (CLOC) and ACC Legal Operations to share knowledge, collaborate on policy, and ultimately accelerate innovation across the legal vertical. In the near future, these individuals will likely spearhead the most significant transformation in law department operations through initiatives such as the integration of artificial intelligence solutions, law firm RFP optimization, guidelines for firm performance evaluations and scorecards, and the expansion of value-based billing.

Technology priorities shift to a trifecta of transparency, predictability and security

Historically, law departments have been underserved when it comes to technology adoption – be it document management tools, matter management platforms or e-billing solutions. This trend is changing, however, as the most recent HBR Law Department Survey showed that 44 percent of organizations reported an increase in their systems and technologies budgets.[3] Through our work with law department clients, we are finding that executives are strategically investing in technologies to support their drive towards internal efficiencies.

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Law departments are also placing a greater emphasis on tools that leverage historical data, provide robust reporting capabilities for executives and enhance visibility into the metrics needed to make smarter business decisions. There is a growing market for software solutions that provide law departments with greater transparency into outside counsel activities, some of which are striving to provide real-time monitoring.

An increased reliance on technology also means more exposure to cybersecurity and privacy concerns. Research conducted by the Association of Corporate Counsel shows that almost one in three law department employees stated that their organization had experienced a data breach.[4] While GCs and chief legal officers are largely aware of looming IT security threats, leadership often lacks clarity around what investments to make, or policies to draft, in order to mitigate these issues. As breaches and deliberate IT attacks become more prevalent and diverse, law departments are being held accountable for not only strengthening their own organizations' defenses, but also ensuring that any sensitive data shared with law firms is safeguarded against risk.

Channeling data for more strategic decision-making

The cornerstone of a modern law department operations team's business strategy is to increase efficiencies through the support of data-driven metrics. Making strides toward operational transparency through e-billing and contract management tools is only the first part of this journey. The next phase involves harnessing the data these platforms capture to predict future needs and outcomes inclusive of staffing and cost forecasting.

3 "2015 Law Department Survey," HBR Consulting. October 2015. http://www.hbrconsulting.com/lawdepartmentsurvey.html#

4 "The State of Cybersecurity Report: An In-House Perspective," ACC Foundation. December 9, 2015. http://www.acc.com/legalresources/resource.cfm?show=1416928

Already, many law departments are applying analytics to guide strategic outside counsel vetting processes and to aid in assembling project teams faster. Approximately 20 percent of corporate law departments have initiated employee time recording initiatives (either periodic or ongoing) to supplement e-billing data from law firms.[5] From this data, law departments are identifying trends and opportunities to improve internal resource utilization, eliminate workflow redundancies and identify cumbersome, low-level tasks ripe for automation or outsourcing. Direct access to this data can also elevate law departments' role in larger corporate decisions, such as M&A and divestiture activity.[6]

Through the use of new technology, law departments are working to use analytics tailored specifically to their organization, matter history and outside counsel to set budgets and establish pricing structures for new matters. Getting there, however, requires identifying and recruiting the right resources to not only implement well-vetted systems, but own and manage business intelligence gathering and reporting processes.

LAW FIRMS: NEW COMPETITOR, CLIENT + CAPABILITY DEMANDS

The sea of change occurring in corporate law departments has triggered a ripple effect across law firms. As law departments' emphasis on efficiency and value has increased, law firm conversations have pivoted to "How can we best convey to our clients the high-quality work we are doing?"

New competition continues to saturate the legal market with innovative tools and alternative service models aimed at taking market share from traditional law firms. In response to client pressures and emerging competition, almost every decision law firms make today is rooted in improving service delivery and demonstrating increased value for clients.

A diverse competitor landscape

As the increase in law departments' internal spending suggests, some of law firms' biggest competitors today are their in-house counterparts. This dynamic is especially prevalent among firms that serve Fortune 500 organizations, which have large, established law departments with extensive legal resources of their own.

Law firm competition is not strictly limited to in-house counsel. The last few years marked the rise of what industry critics often refer to as "New Law" organizations – particularly managed service providers and software vendors that stray from the traditional "Big Law" paradigm.[7] With specializations in everything from contracts and M&A to discovery and document assembly, these alternative businesses provide a viable route for corporate clients seeking innovative, cost-effective business partners.

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5 "2015 Law Department Survey," HBR Consulting. October 2015. http://www.hbrconsulting.com/lawdepartmentsurvey.html#

6 "In Xerox Split, Legal Department Leads the Way," Reisinger, Sue. Corporate Counsel. February 4, 2016. http://www.corpcounsel.com/id=1202748889631/In-Xerox-Split-Legal-Department-Leads-the-Way?mcode=0&curindex=0&curpage=ALL

7 "Law Firms' Grueling Hours Are Turning Defectors into Competitors," Williams, Joan C. Harvard Business Review. August 25, 2015. https://hbr.org/2015/08/law-firms-grueling-hours-are-turning-defectors-into-competitors

Simultaneously, the "Big Four" echelon of accounting and consulting firms are trying, not for the first time, to stake a claim in the international legal market. In 2013 – in an effort to meet its goal for doubling or tripling the size of its legal practice by 2020 – Ernst & Young hired more than 200 attorneys globally and launched legal services in almost 30 countries. The following year, PwC formed its "PwC Legal" practice in the United Kingdom; Deloitte and KPMG have made similar attorney hiring pushes around the world.[8]

Such fluctuating competitor rosters put the onus on law firms to be creative in how they price and provide their services, as well as how they demonstrate their value proposition to clients. In many cases, law firms may be innovative in terms of service delivery, but are not effectively communicating initiatives to clients. As a result, there is a major disconnect between what law firms are doing and what corporate clients are experiencing.

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Prioritizing profitability to stay competitive

Given the ultra-competitive landscape law firms face today, healthy revenues with a greater focus on profitability are vital to long-term success. Aside from reinvestment opportunities to support new service offerings or technology, sustained profitability can provide law firms with a key advantage in talent acquisition. Today almost two-thirds of lawyers believe it is challenging for their firms to find skilled legal professionals – an understandable pain point, knowing that U.S. law school enrollment dropped almost 30 percent between 2010 and 2015.[9,10] As millennials continue to supplant baby boomers in the U.S. workforce, law firms' ability to attract high performing law school graduates is as important as their ability to bring in new clients.

To remain competitive, law firms are working to protect and augment profitability by identifying cost-saving opportunities in operations and IT functions. Law firm COOs and CIOs have realized there is no need to shoulder the burden of developing new operational platforms in-house. With the help of law firm procurement leaders, whom are playing a growing role in strategic business planning and budgeting, law firms are pursuing opportunities to transition non-legal activities to managed service providers and contractors.[11] Today, vendors and external business partners are playing critical roles in streamlining law firm capital expenditures and providing a higher degree of predictability to future spend forecasting.

The mounting importance of risk mitigation and vendor governance

With the increased use of third-party vendors and external business partners comes an increased need for governance strategies and risk mitigation policies at law firms.

Many vendor and firm relationships necessitate that vendors have access to privileged and sensitive employee and client

8 "2015 Report on the State of the Legal Market," Georgetown Law Peer Monitor. January 7, 2015. http://www.law.georgetown.edu/academics/centers-institutes/legal-profession/upload/FINAL-Report-1-7-15.pdf

9 "2016 Salary Guide for the Legal Field," Robert Half Legal. https://www.roberthalf.com/sites/default/files/Media_Root/images/rhl-pdfs/robert_half_legal_2016_salary_guide.pdf

10 "Law School Enrollment Slumps 5 Percent," Sacks, Mike. The National Law Journal. December 17, 2015. http://www.nationallawjournal.com/id=1202745205074/Law-School-Enrollment-Slumps-5-Percent?slreturn=20160509115610

11 "2015 Law Firm Procurement Roundtable," HBR Consulting. October 8, 2015. http://www.hbrconsulting.com/LFPR/summaryreport.html

information – not to mention provide direct access to a law firm's networks, systems or physical spaces.

As a firm's community of vendors increases or faces turnover, data and infrastructure vulnerability increases. BakerHostetler research finds that vendors are the fourth most common causes of enterprise data security incidents.[12] Some of the highest-profile data breaches from the last few years, including incidents involving Target and The Home Depot, can be traced back to third-party vendors. Acutely aware of these risks, corporate clients are requiring law firms to undergo complex, detailed audits to demonstrate that there are robust and well documented vendor governance policies in place – including vendor selection, relationship management and offboarding procedures.

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Under increasing pressure to protect client data, law firms are examining how best to standardize, streamline and enforce vendor processes and policies. These efforts can range from nominal process changes – such as writing clearer language into vendor RFPs – to broader process and policies shifts, like conducting regular IT security audits across existing vendor networks. Firms that are not able to readily demonstrate the breadth and structure of their vendor governance policies are at risk of losing current clients' trust, as well as prospective client business.

Putting an end to obsolete billing practices

Each year since the 2008 recession, large law firm rates have steadily increased by 3 to 4 percent.[13] Given the increasing demand for transparency and predictability by corporate clients, there is pressure on law firms to justify these price hikes by creating more predictable pricing structures and effectively illustrating the quality of their work to clients. Getting to this point begins with the establishment of accurate and transparent billing practices – an area that continues to be a pain point for both law firms and clients alike.

According to HBR's law firm billing study, 90 percent of law firms ranked billing process improvement as a high or essential priority for 2016, and it's no surprise why. With 64 percent of firms claiming to have experienced an instance where invoices were significantly delayed because the bill distribution responsibility fell to attorneys rather than support staff; a comparable amount, 65 percent, have sent late invoices due to late time entry from employees.[14] Haphazard billing practices and manual reviews – something around half of firms still perform – is no longer being accepted by corporate clients. Law firms that do not work to rectify inefficient and inaccurate billing practices will continue to face increased write-offs and loss of revenue as more corporate clients are refusing to process invoices that lack transparency, accuracy or timeliness.

12 "Is Your Organization Compromise Ready? 2016 Data Security Incident Response Report," BakerHostetler. March 30, 2016. http://bakerlaw.com/files/uploads/Documents/Privacy/2016-Data-Security-Incident-Response-Report.pdf 6 "In Xerox Split, Legal Department Leads the Way," Reisinger, Sue. Corporate Counsel. February 4, 2016. http://www.corpcounsel.com/id=1202748889631/In-Xerox-Split-Legal-Department-Leads-the-Way?mcode=0&curindex=0&curpage=ALL

13 "Legal Fees Cross New Mark: $1,500 an Hour," Randazzo, Sarah, and Palank, Jacqueline. Wall Street Journal. February 9, 2016. http://www.wsj.com/articles/legal-fees-reach-new-pinnacle-1-500-an-hour-1454960708

14 "2016 Billing Survey," HBR Consulting. 2016.

KEY TAKEAWAYS

In light of mounting pressures for legal industry leaders to address such diverse, expansive challenges, we believe the following shared opportunities exist for corporate law departments and law firms.

- **Efficiency requires new tools and talent.** Law departments and law firms must continue to pursue advanced technologies aimed at boosting individual productivity while streamlining operational processes. The key to effective technology, however, is having a thoughtful staffing strategy to support it. Organizations that focus on aligning technology tools with experienced business professionals will benefit from increased profitability.

- **Technology adoption and security are not mutually exclusive.** Any newly implemented software solution or third-party business partner is only as successful as the IT security and governance policies that support them. Organizations that establish comprehensive data compliance, privacy and vendor policies will have a clear advantage over competitors that are not investing in the necessary tools and resources dedicated to securing digital and physical environments.

- **The race to innovate is on.** In terms of services, tools, technology and processes, there is no shortage of opportunities for law departments and law firms to pursue competitive differentiation. The key to success is pursuing innovative alternatives and supporting those efforts with the right level of capital, as well as a well-developed internal and external communication strategy.

At HBR, we have spent years honing our legal consulting services, partnering with law firms and corporations to increase productivity, improve profitability and navigate strategic change. With expertise that spans across the legal vertical, our team is uniquely positioned to support clients with technology strategy, planning and implementation, process optimization and benchmarking. We continue to invest in our business, people and solutions to enable our clients to succeed in this dynamic industry.

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HBR Consulting delivers advisory, managed services and software solutions that increase productivity and profitability for corporations, professional services and law firms. Thought leaders with decades of experience, we deliver value to our clients. HBR has long-term relationships working with 90% of Am Law 200 law firms and 35% of the Fortune 500 corporate law departments.

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