HSBC

Peer group analysis

FINANCING INVESTMENTS IN LEGAL TECH

THE LAWYER
Research Service

Introduction

Welcome to HSBC's report on law firms' investment in legal technology, produced in collaboration with The Lawyer.

Technology is the current buzzword in the legal industry. From predictive coding and artificial intelligence to client facing portals and advanced cyber security protection tools, firms are significantly ramping up investment in a wide range of solutions to boost productivity and improve client service delivery.

But what are the implications of these investments on law firm business models and pricing structures? And is law firms' traditional approach to financing and investment sufficient to facilitate potentially large investments in innovative technology? More fundamentally, how much are firms really investing in truly innovative technology as opposed to updating existing systems?

To answer these questions, HSBC and The Lawyer surveyed the UK's 50 largest law firms, 46 per cent of which responded.

The results are presented in detail in this report.

We hope you enjoy reading this report, and if you have any questions please don't hesitate to contact me.

Simon Adcock
Head of Professional Services
UK Corporate Banking
HSBC

Spending on innovative tech is rising

Almost two thirds (65 per cent) of surveyed law firms ramped up investment in technology last year. Some 35 per cent increased tech spend by up to ten per cent, 24 per cent boosted tech spend by between ten and 20 per cent and six per cent increased spend by more than 50 per cent. Just over a third (35 per cent) of firms didn't change their level of tech spend while no firms reduced investment.

According to the survey data, the majority (56 per cent) of firms spent between two and five per cent of their revenues on technology last year. The remainder (44 per cent) spent between five and eight per cent of their revenues on tech. Of course, technology is a broad term that encompasses a variety of hardware and software, much of which is used by lawyers for routine tasks. To understand firms' true level of investment in innovative technology, we asked them to divide their technology spend between business-as-usual / replacement technology and new innovative technology.

Interestingly, surveyed firms stated that an average of 25 per cent of their total tech spend was allocated to what they considered to be new innovative technology last year. In the next three years, firms anticipate that an average of 33 per cent of tech spend will be on innovative projects.

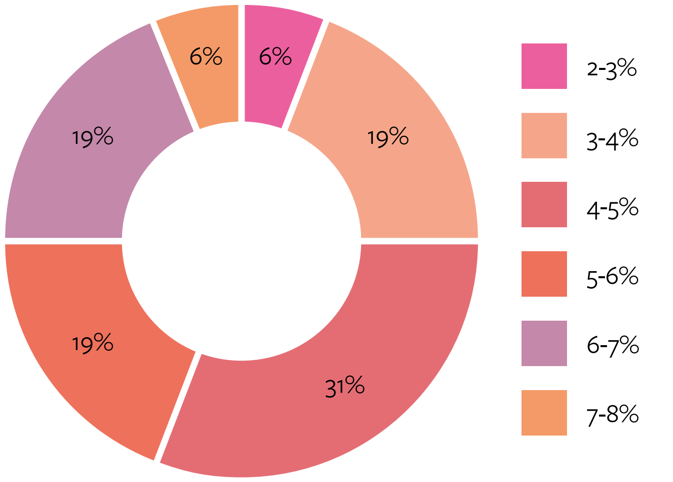
HSBC Comment

These statistics paint a vivid picture regarding how critical technology and the digital agenda has become to the provision of legal services. With 65 per cent of firms increasing their spend vs the previous year, and 44 per cent of firms now investing between five and eight per cent of their revenues, the level of investment across the industry goes well beyond sustaining firms' current infrastructure.

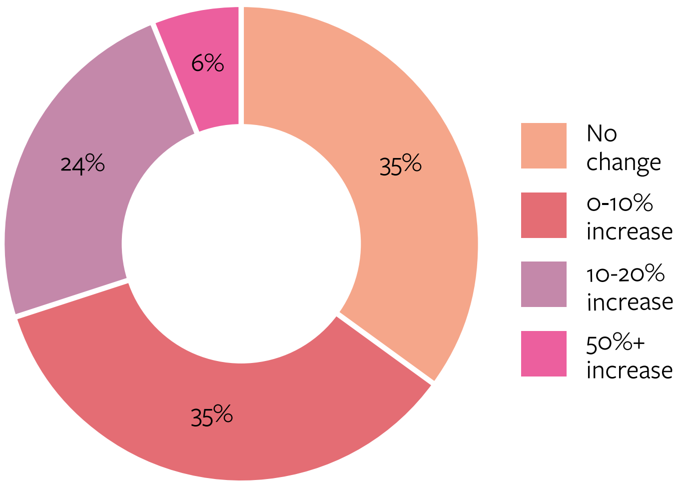
Clearly firms need to track their spend across a few years, rather than a single year in isolation, however, for the 25 per cent of firms investing less than four per cent, management need to consider whether this is sustainable over the medium term to remain competitive.

HSBC is a significant lender to the legal sector, and the frequency with which we are discussing platform investment with firms has increased materially in the last two years. We see this continuing well beyond 2020.

Roughly speaking, how much did the firm spend last year on technology as a percentage of revenues?



How did this compare with the previous year?

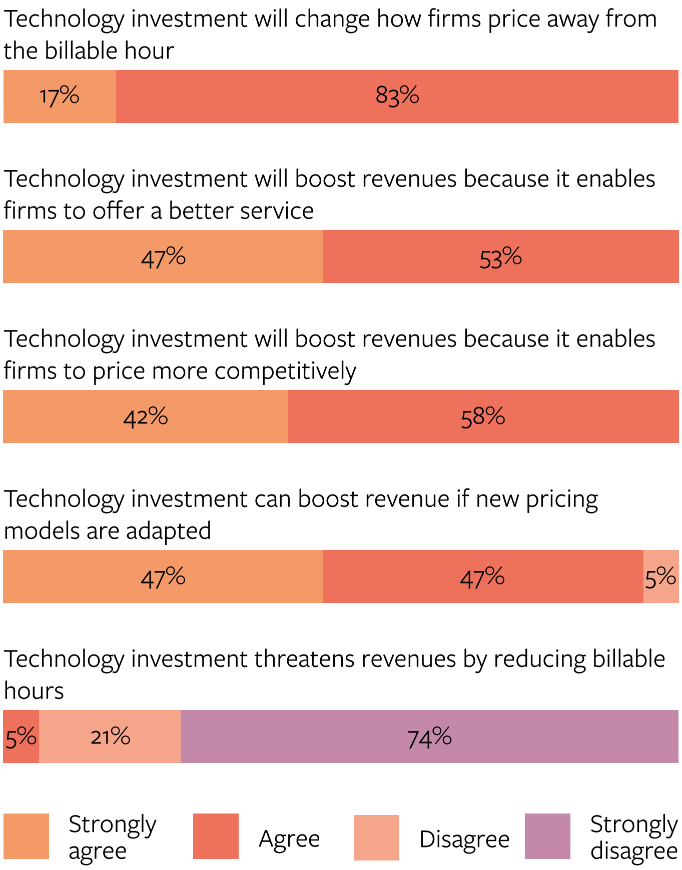


Technology now viewed as a key business enabler

Investment in technology is rising because it is now viewed as a key business enabler and a competitive differentiator. Gone are the days when firms were concerned that the main consequence of improved efficiency might be a reduction in billable hours. Indeed, 95 per cent of respondents disagreed with the statement that ‘technology investment threatens revenues by reducing billable hours’.

Instead, all surveyed firms believe that technology will boost revenues because it enables them to offer a better service to clients, price more competitively and shift away from hourly rates.

To what extent do you agree with the following statements regarding the relationship between investment in technology that improves efficiency and billable hours?



Jason Haines, Finance and Operations Director at Allen & Overy, provides some examples of how the firm’s investments in technology have changed the way it works with clients and charges for work.

“Our online legal risk management service aosphere is provided to clients via a subscription to a website, which is delivering legal services in a completely different way to the traditional method of lawyers spending a certain number of hours on a task,” he says. “Our Margin Matrix product, which repapers derivatives contracts based on legislative changes, is another example. It’s a really interesting tech investment because it fundamentally changes the way legal services are delivered and priced. It’s a fixed price for a service.”

Even for matters still conduced on an hourly-fee basis, technology investments that improve efficiency won’t necessarily jeopardise billable hours. This is because it can improve recoverability, the percentage of hours spent on a matter that a firm actually charges for.

Nick West, Chief Strategy Officer at Mishcon de Reya, explains why. “Lawyers don’t try to gouge clients on price, they just don’t think like that,” he says. “Firms accept that not everything is chargeable and typically think they can recover 80-90 per cent of hours worked. The grunt, process orientated work is more likely to be written off, so there’s an incentive to reduce time spent on this work through automation and use of technology.”

Clients are also starting to notice a difference between firms that do and don’t embrace technology. According to Neal Livingston, Global CFO at Dentons, demonstrating a commitment to technology and innovation can sometimes be the difference between winning and losing work.

“We keep a track record of all the client proposals we’ve done where innovative investments have been included,” he says. “There are currently multiple cases of panel retentions and new panel appointments where we include this. So demonstrating a commitment to technology and innovation can be a real differentiator. We’ve been told by many clients that this was the key factor that caused them to retain our services. Many other aspects of law are commoditised and clients know this. They know they can get similar services from other law firms but access to innovation and technology is not something they can get from everyone.”

HSBC Comment

In a highly competitive marketplace, pricing and transparency for clients have long been a key challenge for firms. Whilst we are still a long way from the end of the billable hour, technology is clearly a key enabler for firms to price services with a high degree of confidence, and critically, operate more efficiently and improve recovery rates.

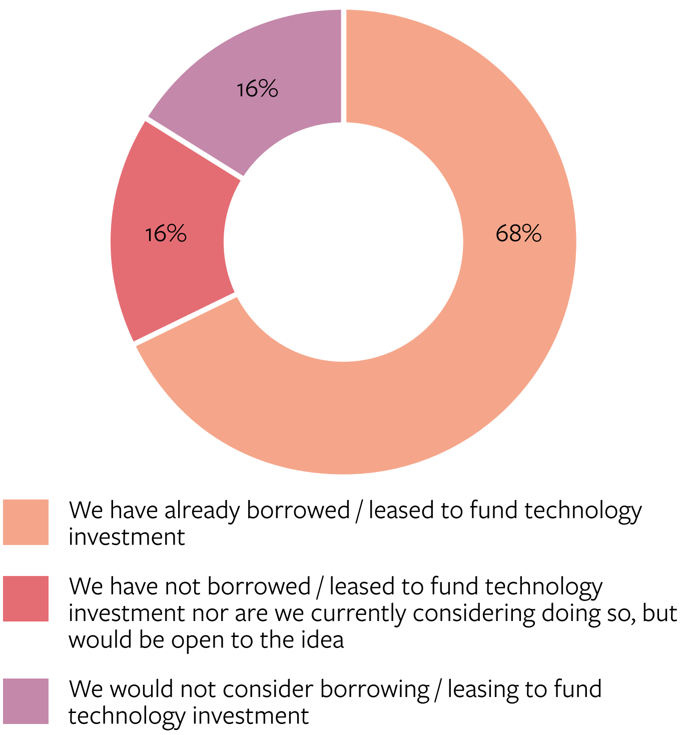
Given the digital transformation underway in many other industries, there is a significant opportunity for firms to differentiate themselves and attract clients through innovative service propositions.

Funding tech investments – should you borrow?

Traditionally law firms have been reluctant to borrow. Jason Haines, Finance and Operations Director at A&O, explains why. "We, like many other firms, are very conservative financially," he says. "Law firms are very highly operationally geared, meaning they have a very high ratio of fixed costs to total costs, which means that in a good market you can do very well but in a bad market you can do very badly very quickly. It makes no sense to mix high operational gearing with high financial gearing."

However, when it comes to technology, our survey data demonstrates that many firms have borrowed or leased to finance expenditure. Some 68 per cent have already borrowed or leased to fund technology investment. A further 16 per cent said they would be open to the idea and only 16 per cent said they would not consider borrowing or leasing.

To what extent would the firm consider borrowing to fund technology investment?



Firms consistently fed back that they would not be able to make the transformational investments in technology they want to without borrowing.

"The financing and capitalisation of a typical law firm is set up to finance working capital and investments in operating technology, such as upgrading software platforms," explained Neal Livingston, Global CFO at Dentons. "It is not geared to investing in new innovative technologies or operating models where the risk reward relationship is different to investing in a new practice management platform, for example."

"It's challenging to correlate this risk reward profile of innovative investments to the traditional performance metrics that a law firm uses. Real innovation calls for a different approach to performance management and financing. Our approach today has been to finance with partnership funds. But this is only tenable to a point and will put a limit on firms' ability to support investment in real innovation. All law firms that are serious about true innovation are going to have to solve this issue, including the extent to which debt and financial gearing has a place in the funding mix."

HSBC Comment

We have seen a material increase in the number of firms who are willing to explore financing options for platform investments. These have tended to be replacement of practice management systems, licences, new devices, hardware etc as opposed to "R&D" or new tech innovations.

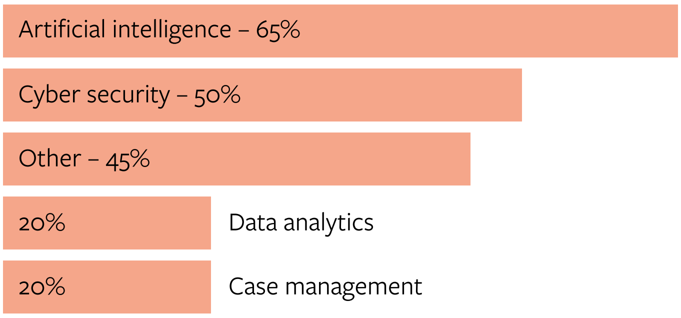
For firms who have grown through merger, either domestically or internationally, it is critical that these are integrated on to the same platform as quickly as possible. This reduces operating risk and ensures the firm's service delivery meets the client's brand expectations.

Given the ongoing interest rate environment, financing can be a very effective tool to deploy a large investment quickly and minimise the short term cash impact on Partners.

Which tech investments are firms prioritising?

Our survey data reveals that law firms are investing in a wide range of technologies. That said artificial intelligence and cyber security solutions appear to be being prioritised above others. Indeed 65 per cent of survey respondents stated they are prioritising investment in artificial intelligence technologies while 50 per cent are investing in cyber security solutions. In parallel 20 per cent are investing in case management and data analytics solutions.

Which technologies is your firm prioritising for investment? (Top five answers)



The survey data also reveals that these technologies are being applied across multiple practice area and sector teams. In particular, respondents frequently mentioned they are investing in technologies that streamline the pre-trial eDiscovery process.

“One of our recent investments was the creation of Mishcon Discover, our own in-house eDisclosure facility,” says West. “The traditional model of going to a range of eDisclosure suppliers and asking for quotes is completely suboptimal for a number of reasons. First, you end up working with lots of different suppliers and different technology stacks and the lawyers have to familiarise themselves with new technology all the time.”

“Second, you are effectively paying for these suppliers to mark up the costs of the underlying technology licence and hosting charges, on top of which you are charged every time you want to use some analytics tools. So we decided to strip this all back and think about what assets we need to own and have in-house to offer the best services to our clients. We re-did it all and can now offer much more joined up eDisclosure services to clients, using the most cutting edge technology at a competitive cost.”

Many law firms are also investing in technology that enables staff to work remotely, flexibly and collaboratively with colleagues and clients. One of these is Allen & Overy. “We are currently replacing our document management system and the core infrastructure behind this and are using this opportunity to bring in more mobile devices because we think younger lawyers want to work more flexibly and in different ways,” says Haines.

“We are experimenting with different workspaces. Someone might come in in the morning and want a private quiet room to review a big legal document. Then they might want to work with a team, then they might need to do a video conference. So we are trying to give people different types of workspaces and different types of activity and the flexibility to work from home. We are investing in more mobile devices and other technologies to make this easier and improve connectivity.”

HSBC Comment

Technology is enabling firms to radically rethink their real estate strategies, reducing expensive city centre offices and access talent pools in a diverse range of locations.

We have assisted a number of firms to establish legal and business services functions in regional and offshore locations. Reflecting client demands, we expect this trend to accelerate over the coming few years, with firms effectively reallocating real estate spend to technology.

Given the quicker rate at which technology, including devices, becomes obsolete, firms are increasingly viewing leasing as an effective means to keep control of their IT estate, ensuring the hardware is regularly refreshed and securely disposed.

Conclusion

The majority of law firms now realise that technology is critical to ensuring they remain competitive. From artificial intelligence to client facing portals, technology enables firms to provide a better service to clients and move away from the antiquated hourly rate model. The pace of technology change and the investment requirements mean that firms may need to borrow to finance these investments. Most are already doing so. Indeed 68 per cent of respondents stated that they have already borrowed or leased to fund a technology investment.

If you have any questions about the themes raised in this report or would like to explore financing options for your firm, please contact Simon Adcock at: simonadcock@hsbc.com.

Simon Adcock
Head of Professional Services
UK Corporate Banking
HSBC