HSBC UK

Peer group analysis

INVESTMENT TRENDS IN LEGAL TECHNOLOGY

THE LAWYER
Research Service

Introduction

Welcome to HSBC's report on law firms' investment strategies into legal technology, produced in collaboration with The Lawyer. This report builds upon a survey of 52 UK headquartered law firms, of which 50 per cent of the UK Top 50 responded.

Following on from last year's analysis, our survey sought to identify trends and changes of direction in technology investment across UK law firms. The rise of machine learning and artificial intelligence (AI) has rightly generated a lot of interest in the last two years, but are firms continuing to invest in these technologies or are they being pulled in different directions?

The survey data revealed that some 54 per cent of UK Top 50 firms in this year's survey focussed their technology investment efforts on new innovative technology as opposed to business as usual (BAU) systems in the last year.

Interestingly, the data also revealed that when considering their technology investment strategies for the next three years, firms are seeking to shift their outlook and focus investment on BAU systems rather than new innovative technology. This is in a clear attempt to pursue firm-wide integration of their existing technologies, such as AI-driven document review systems, upgraded practice management systems and more advanced CRM systems.

Another ubiquitous theme across this year's survey is the emergence of cybersecurity as a priority for technology investment, with respondents becoming increasingly sensitive to the prevalence of cyber threats in the legal sector.

The survey also sought to understand the repercussions of increased technology investment. Would more investment generate greater revenue gains and shift firms away from the billable hour to new pricing models? The data suggests so.

This report also touches on the increasing representation of senior IT executives on firms' management boards. After all, their expertise will be of vital importance as firms look towards a new future with legal technology as a fundamental pillar of law firm strategy.

Finally, this report looks to analyse the ways in which firms will finance this new level of technology investment. How keen are firms to use borrowing as a method to finance investment? And for the firms that haven't already done so, what appetite is there for a shift towards borrowing as a means of financing investment in the future?

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
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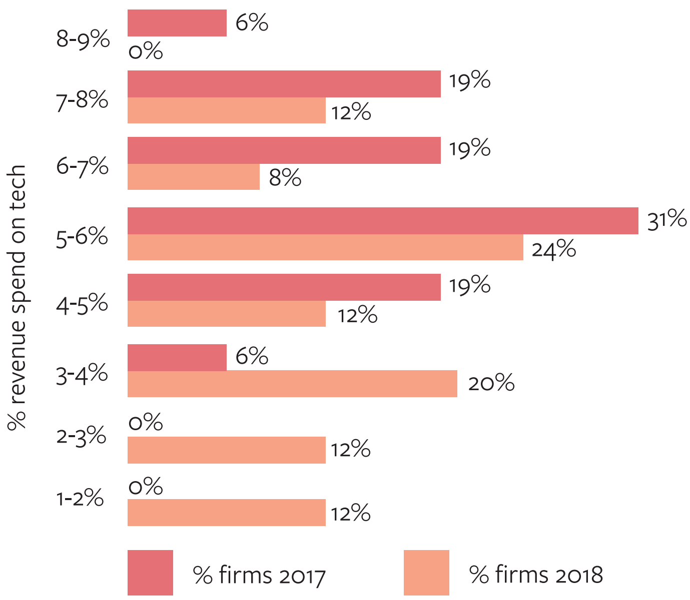
Has spending on innovative tech peaked?

Last year, 65 per cent of the law firms surveyed reported they expected investment in technology to increase in the coming years with 56 per cent of firms planning to invest between two and five percent of firm revenue. Furthermore, these firms anticipated that a quarter of this investment would be on innovative technology and that this figure would rise to around a third over the next few years.

Top 50 Firms: Approximately how much is your firm planning to spend this year on technology as a percentage



One year on and the picture being painted by the same group of law firms is quite different. The anticipated levels of investment in technology remain broadly the same as 54 per cent of all UK law firms surveyed and 56 per cent of the UK top 50 are still investing between two and five per cent of their revenue on technology.

However, the allocation of spend towards innovative technologies was in fact much higher than anticipated with the top 50 firms allotting 54 per cent of their tech investment in this area compared to just 25 per cent in the previous year. These figures outline a shift in thinking suggesting the area of innovative technology has proved it can deliver results.

Despite this change, the data shows there has been a marked shift in opinion when looking at firms allocating less than 5 per cent of revenue to technology spend. This year, 58 per cent of the Top 50 firms have stated they are planning to allocate less than 5 per cent of revenue to tech spend, as opposed to 25 per cent of firms last year.

The assertion here is that despite some large-scale firms committing a higher percentage of revenue to technology spend, with a majority of this geared towards more innovative tech, some other similar-sized firms have at the same time also had to cut back on tech spend as a percentage of revenue. Where early adopters of these technologies have shown the way, other firms have quickly followed and are now making the decision further down the line to focus on consolidating what existing technology they already have in order to create firmwide specialisation allowing them to keep up with the flourishing levels of competition.

When asked how law firms expect their tech investment proportions to change over the next three years, responses showed that firms are anticipating a reduction to around 40 per cent allocated to new innovative tech. This indicates that for at least the next three years firms' attention is being drawn back to BAU investment areas. These trends are mirrored across the wider UK legal sector suggesting there is no difference in the technology strategies of the top 50 UK firms and the remainder of the surveyed UK firms.
In speaking to *The Lawyer* on Freshfields' tech strategies, Chief Legal Innovation Officer, Adam Ryan spoke enthusiastically about the firm's innovation-focused in-house hub and its ability to build its tech offering. "We have invested heavily in our global center offering based in Manchester, which has fantastic capabilities in legal tech operations, dev ops, architecture, change management and security."

What does this anticipated reduction in innovative technology investment tell us? The most plausible reason for the decrease in investment would be that many firms have purchased and implemented the systems they wanted and are now working on maximising the capability of those systems.

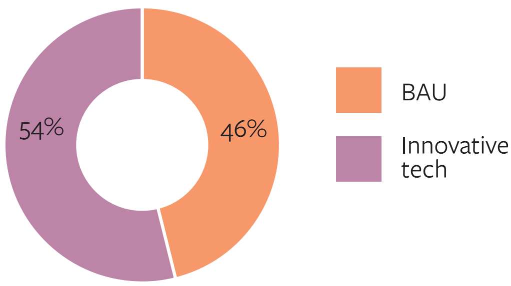
Alternatively, another reason why firms might be cutting back on their investment in innovative tech in the future could be because they are waiting to see some genuine return on their investment. After all, this new innovative technology comes at a great cost, with firms having to purchase, implement and learn about this new tech, all as a part of the strenuous adaption period post-investment.

Abby Ewen, IT Director at BLM says "I think people are wanting to invest but they are probably being quite cautious, simply because it's difficult to see where the returns are going to come from. I suspect when the returns do start to come they will grow exponentially, as people will really start beginning to understand how they can apply some of these new technologies to their particular businesses."

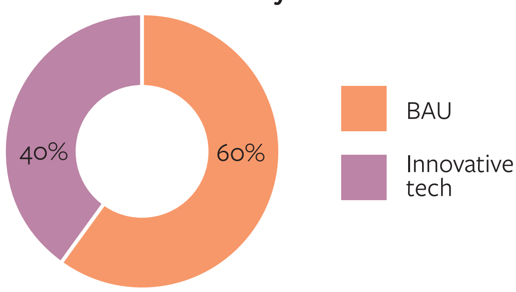
It is clear that specialist technology such as contract analysis tools and other document analysis applications take time to develop as firms must learn to use them, which requires input from legal specialists.

Furthermore, firms that invested in these technologies for one application have come to find there are many more applications for the same technology, creating the potential for new service offerings for clients. Consequently, firms are concentrating on making the most out of their investment before working on new ideas.

Top 50 Firms: Broadly speaking, how did your technology spend last year break down between business as usual / replacement technology versus new innovative technology?



Top 50 Firms: How do you expect your technology spend to break down over the next three years?

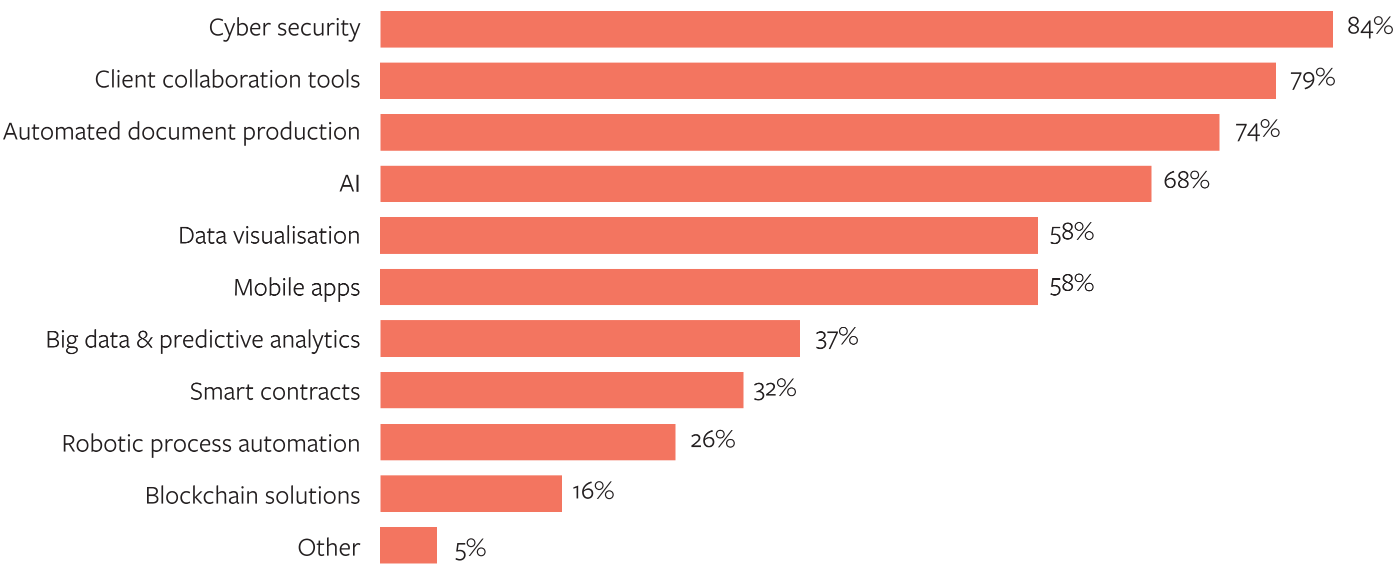


A shift in priorities for tech investment

With a predicted shift back to spending on BAU, respondents were also asked to outline where their key areas of investment would lie over the next three years. Last year's survey results showed that 65 per cent of respondents chose AI technologies as their key investment focus.

Whilst AI remains high on the agenda this year with 68 per cent of respondents indicating they would be investing in these technologies, cybersecurity has risen to the top of the priority list, with 84 per cent of firms selecting this as their main technology investment focus.

Top 50 firms: In which of the following areas is your firm prioritizing its investment in technology?



Although 30 per cent of surveyed law firms reported that they have never experienced a cybersecurity incident, the remaining firms admit they have, with 25 per cent reporting they have experienced an incident within the last twelve to twenty-four months. With such a high proportion of firms experiencing problems in this area, it is no surprise that measures to improve cybersecurity are now of paramount importance.

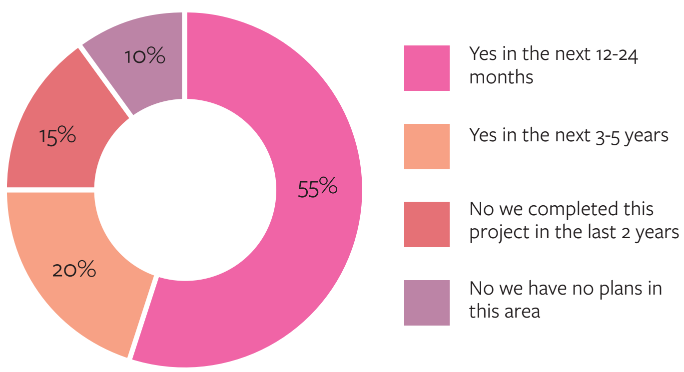
"A breach could be catastrophic for the business, reputationally as well as operationally," says Nathan Hayes, International IT Director at Osborne Clarke. "Reputation is more important on the basis that our clients trust us to provide them with a service and hold their information securely. If we lose that trust then that's a significant issue so that's why cybersecurity is a priority."

Clearly, firms are becoming increasingly concerned when it comes to data protection and the unfortunate events suffered by a large global law firm, which last year saw the firm 'go dark' for two weeks due to a security breach, only serve to underline the importance of sustained investment in this area.

Abby Ewen, IT Director at BLM says "The firm has various certifications like most people. We've got Cyber Essentials, Cyber Essentials Plus and also ISO 27001 that brings its own kind of auditing functions, because it means that every office is audited on a rolling basis by a British Standards Institute auditor who will come in and check that everyone understands the policies."

In addition to investment in cybersecurity and AI, many firms are looking to invest in or upgrade their practice management, HR and CRM systems in the next three years. Only 13 per cent of all respondents and 10 per cent of top 50 firms said they would not be upgrading their practice management systems whilst 55 per cent said they would be upgrading within the next twelve to twenty-four months. The investment picture for HR and CRM systems was similar with 47 per cent of firms planning an upgrade to one of these systems in the next twelve to twenty-four months. This figure rises to 58 per cent for the top 50 firms.
Indeed, Eric Belli-Bivar, Partner at DLA Piper says "I know that for us the next big investment will likely be to enhance our CRM system through greater use of AI and data analytics; we will continue to look at investing in practice management and HR systems as well."

Top 50 firms: Are you planning to invest in a new or significant upgrade to your Practice Management System in the next 3 years?

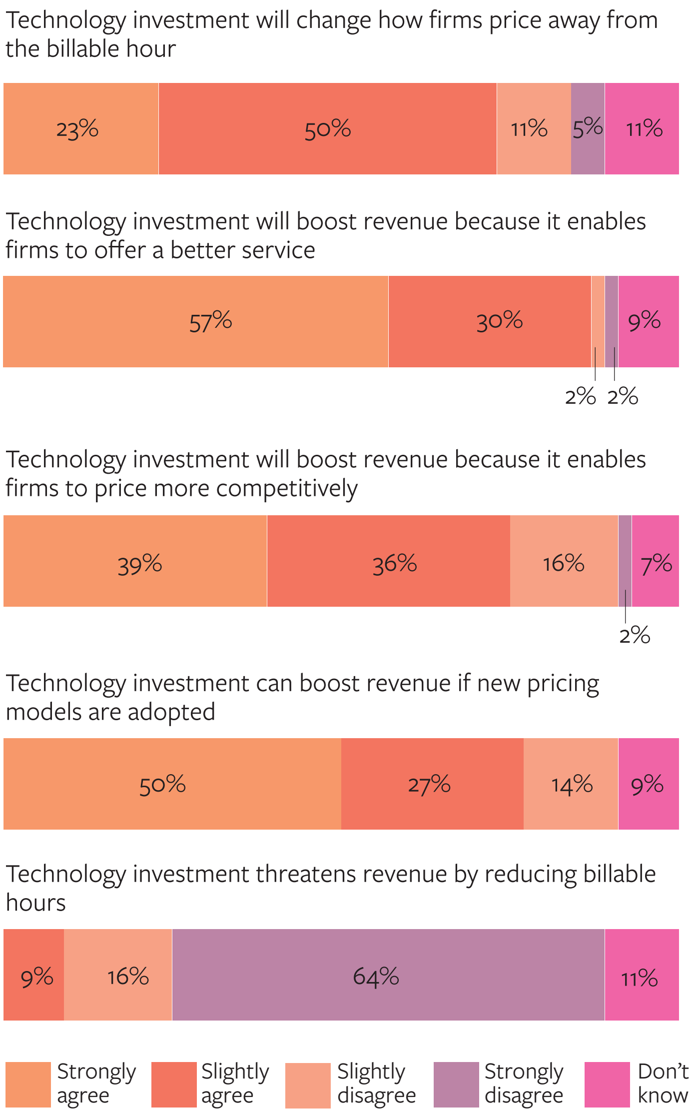


Altogether, the results suggest that law firms are taking a very close look at their back-office systems and the data they contain to make sure they are fit for purpose in the long-term and can support the innovative technologies of the future. Over the coming years we are sure to see a sustained level of investment in technology in firms' back-office capabilities to ensure that workflow efficiency remains at a satisfactorily high level.

Technology still viewed as a key business enabler

Investment in technology continues to rise in consideration as a key business enabler, with 87 per cent of firms believing their investment in technology will help to boost revenue by enabling enhanced service offerings to their clients.

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



Furthermore, there is a strong belief among firms that investment in technology will continue to facilitate a move away from a reliance on the billable hour, with 73 per cent of respondents strongly or slightly agreeing with this statement, supporting the belief that the billable hour will one day be replaced by alternative pricing structures. This is backed up by the fact that 64 per cent of respondents strongly disagree with the statement that technology would threaten to reduce revenues by reducing billable hours. Elsewhere, 75 per cent of firms believe that further investment in technology will simply enable them to price more competitively.

"Ultimately if you are driving efficiency into your business which is what technology should be about, it should also be about improving service," says Nathan Hayes, International IT Director at Osborne Clarke. "If you are going to reduce the amount of time it's going to take you to complete work obviously this will enable that. If you stick with the billable hour then you risk reducing your revenue."

"At the same time all firms have to look at new pricing mechanisms," he adds. "It simply makes no financial sense to invest in technology which improves efficiency for your lawyers without doing that."

So what alternative pricing mechanisms are there?

Eric Belli-Bivar, Partner at DLA Piper says "The global nature of the business that we run at DLA Piper is such that we have real time access to literally thousands of touchpoints from comparable transactions from our global footprints.

"We are able to draw on a data base that is so exhaustive and comprehensive that it allows you to streamline other processes which, if they had to be bespoke or performed on a one-off basis, would be inefficient, costly and time-consuming."

Technology headcount and a seat at the board

A consequence of the growing strategic importance of technology to law firms is the increased number of firms including a senior IT executive on their management board. Last year some 45 per cent of firms said they had at least one senior IT executive on the board whereas this year the figure has risen by almost 20 per cent. Now just under two thirds (63 per cent) of firms have at least one senior IT executive on their management board.

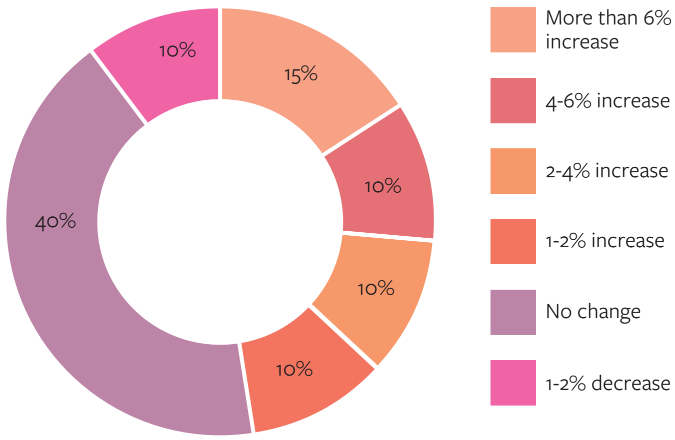
According to Nathan Hayes, International IT Director at Osborne Clarke "Having a senior IT executive has the benefit of providing board insights to opportunities that tech can afford. It also enables management to be informed about what technologies are being explored."

"It just makes everything clear to the board and provides insight that they otherwise wouldn't get if somebody wasn't there explaining it to them," he says. "You need somebody with the expertise who understands tech."

Investment in technology begs the question, will there be an increase in headcount in the IT department? Interestingly, 40 per cent of the Top 50 UK firms have said there will be no change in headcount in the next 12 months. Despite this, 15 per cent say there will likely be more than a 6 per cent increase in technology staff in the same time period, with another 20 per cent of firms saying that they expect to see an increase in IT department headcount of between 2 and 6 per cent.

Although firms are reporting an expected increase in IT staff, the nature of their roles is beginning to change. As more services become cloud-based fewer server technicians are required. Whilst these roles may dwindle, specialists in cybersecurity, innovation, process improvement and experts in the new technologies, such as document review software, will become increasingly deployed by firms. Staff will also need to be more consultative as clients begin to ask for involvement in the direct implementation of technology solutions into their legal workflow processes.

Top 50 Firms: In the next 12 months are you planning to increase or decrease permanent headcount in your IT department and if so, by what amount?



Funding tech investment – should you borrow?

Sustained levels of technology investment require some sort of funding. The survey data shows that just under a quarter (23 per cent) of all firms have already used borrowing as a method of financing investment in technology. A further 16 per cent are actively considering using borrowing to finance their IT spend, with another 25 per cent of firms being open to the idea. Only 18 per cent of firms said they would not consider borrowing as a method of financing technology spend.

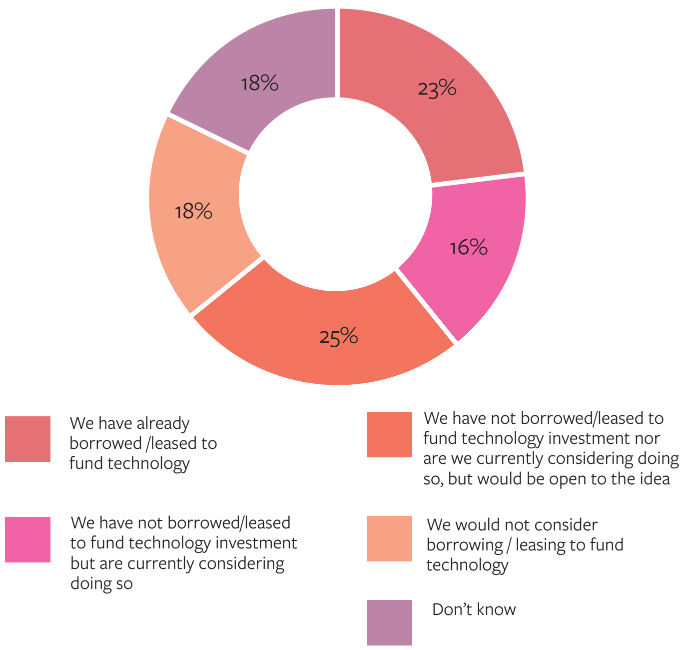
Breaking out responses from the top 50 law firms painted a broadly similar picture with 21 per cent saying they had already borrowed to fund technology investment, with a further 53 per cent either considering or being open to the idea of borrowing.

Abby Ewen, IT Director at BLM says "People are starting to see borrowing to fund tech investment as a potential springboard to really overtake the competition.

"Every single day there is a new news story about technology and as a result technology has been driven up the strategic agenda for every firm.

"People are now thinking of investing in technology because of the strategic advantage it gives them, whereas before it was just a necessary evil. Why would you go out and borrow money to invest in keeping the lights on? You wouldn't do that, but with some of the more transformational technology available now, it's a different ball game."

All firms: To what extent would the firm consider borrowing to fund technology spend?



Conclusion

The survey has shown that firms' technology investment over the past year has been weighted more towards innovative tech than BAU spending, however, it is of vital importance to consider these numbers in the context of the last few years. Whilst the industry has arguably underinvested in this area for some time versus other sectors, it is possible we have now reached a saturation point where firm's short-term capacity to digest and implement new tech has been met.

Looking forward, it is clear that firms will have a focus on infrastructure with a very significant proportion needing to upgrade their PMS, CRM, HR systems; this reflects some legacy platforms becoming obsolete, but also integrating recent mergers and supporting service centre projects. In terms of overall investment levels, the survey has consistently shown that the average run rate of spend is 2-5% of revenues; this number is a useful guide and firms should track how they spend through a period of years. For those spending less than 2%, they need to consider whether this is sustainable in a highly competitive market.

Cybersecurity is now the top priority for firms' and is also a board level matter across all industries, reflecting the increasing frequency and sophistication of attacks and the potential operational and reputational risks of a breach. We expect it to remain in the top 3 for the next few years, and is influencing the much-needed appointments of senior IT personnel reporting directly to CEOs.

It is also interesting to note that client collaboration tools rank in a close second place – this aligns with the trends of corporates slimming legal panels and demanding greater value from the firms they work with. Mobile apps stand out too; the agile working agenda is really influencing the form of technology spend, particularly greater use of laptops and devices.

The results continue to demonstrate a high degree of confidence regarding the role technology plays to improve the delivery of services to clients and ultimately growing revenues for firms. As the stats indicate, we are far from the end of the billable hour, however, technology is clearly helping firms to price more accurately, offer greater flexibility to clients, and should result in improved recovery rates.

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 for the replacement of infrastructure and proven applications, as opposed to new tech innovations where the return is less clear. 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.
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.

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