Thomson Reuters Institute Insights.
A podcast for tax, legal and compliance professionals around the globe.

Episode title: The possibility of an economic downturn may complicate strategic planning as we enter 2023

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Gregg Wirth: Hello and welcome to the Thomson Reuters Institute Insights podcast. I'm Gregg Wirth, the content manager for the Thomson Reuters Institute and today we're going to be talking about 2023 and what the new year may hold for the legal, corporate, and tax and accounting sectors, as well as the impact of ESG, environmental, social and governance initiatives. And of technology and innovation across all sectors. With me are several of our professional experts at Thomson Reuters Institute. Bill Josten, who heads up our legal content, Rabihah Butler, who heads up our risk fraud and compliance and government relations content, and Nadya Britton, who handles our tax and accounting content. We also have with us Natalie Runyon, who manages our ESG content, and Zach Warren, who manages our technology and innovation content. First, let's start off with you, Rabihah. What are corporate leaders, especially those involved in compliance and risk, seeing as their top priorities in 2023?

Rabihah Butler: So, considering everything that's gone on in 2022, the biggest areas that the compliance professionals and corporate entities are thinking of are the Beneficial Ownership Act, the Enablers Act, Crypto regulation and ESG compliance. So, the Beneficial Ownership Act is the new ruling from FinCEN where they're trying to make sure we understand the ultimate owners of all these companies and that that information is reported directly to the, sorry, and to the government and because that just came out, the more the new FinCEN ruling and it goes into effect in 2024. A lot of what we're concerned about is one, what those unforeseen circumstances are, two, how do we use our human capital to properly resolve these issues, three, who the compliance burden falls in falls into and how overall regulations will happen. And these are all similar issues the regulation of crypto. We want to know where the burden is going to fall, how much burden is going to be there, and how to maximize our human capital.

Gregg Wirth: You also cover sort of the government area too. What are the leaders of government agencies seeing as our top priorities the next year, especially in regards to courts?

Rabihah Butler: So, in the government sector, especially given the courts, there are two major things we're concerned about. The first is the access to justice and the second is systemic reform. So, what we want to do is to be able to more easily access the services that the government is able to provide, including the court system and the actual municipalities and the system of reform will allow people to more effectively use those things and this is everything from technology to, again, our human capital and the ESG impact.

Gregg Wirth? OK, and again I know no one has a crystal ball, but if we've learned anything from the past few years, it's that economic realities and outside events can kind of come crashing in on people's plans and priorities. How do you think any kind of the economic realities might impact these priorities?

Rabihah Butler: So, in the corporate world where we're talking about compliance risk and fraud, it's somewhat insulated from a lot of the economic downturn, because these are regulatory concerns we have to address. However, depending on how bad economic downturns might be, we have to lean into the determination of how or who bears the burden of the compliance risk and how to better staff or prepare our staff to handle these things. Essentially, we have to learn to do less with more and the same thing goes with the courts. As those budgets are shrinking as well as government agency budget shrinking, we have to learn to do less with more, and that's what our what our what our government agencies tend to be looking for.

Gregg Wirth: Well, it's certainly it's something definitely to keep an eye on going forward. Looking at your area, Natalie, on ESG what are leaders kind of across the spectrum, seeing as their top priorities in 2023 in regard to ESG?

Natalie Runyon: So, I think they are laser-focused on meeting ESG requirements, but in 2023 it's going to be a painful year because of multifaceted operational challenges and also other headwinds. So, let me explain what I mean. Some drivers of why I made this statement and perhaps some implications for lawyers and accountants and people managers in the legal and accounting sectors, which you know as we all know are human capital-intensive industries. Let me first by saying that ESG has staying power with ongoing regulatory action that will continue in 2023 and beyond. In addition to long term support by shareholders, investors and employees who also happen to be consumers, investors and customers that are buying legal and accounting services. To elaborate on the regulatory action, the SEC in the US is likely to finalize rules on greenhouse gas emissions late in Q1 in 2023. In addition, the EU recently passed comprehensive reporting requirements through its Corporate Sustainability Reporting Directive, which will come into law in 2024. And this basically requires companies of a certain size, in terms of revenue or people, to legally report on a range of issues across the E, the S and the G. To illustrate that the “E” is they are required to report on Environmental Protection policies and actions from an “S” perspective, they are required to report on things like quote-unquote treatment of employees, and respect for human rights. And on the “G” they are companies are required to report on anti-corruption and bribery and board diversity. The other aspect to the EU regulation is that it requires third party assurance. Which of course is a business opportunity for tax and accounting firms because they provide these services already. This rulemaking and regulatory action will also impact and increase work for lawyers and accountants who in particular happen to work in-house within corporations in regards to execution of a corporate ESG strategy. So, for example, accountants and employees they have the skill to conduct rigor analysis and reporting of financial data, and this is something that they've been doing for decades, right? In addition, so now with this regulatory reporting around ESG that skillset, their skillset, will be in higher demand, and so there's going to be increased work, likely, for them. For in-house lawyers there they have a huge role to play in understanding how the new regulations apply to their particular organization. And of course, they also are key to reviewing and approving disclosure statements of the new regulations so they will be seeing additional responsibilities coming down. Now, so that kind of describes what are some of the implications and drivers for lawyers and accountants. But now I kind of want to hone in on the accountability for people managers specifically within the legal and accounting industries. Earlier, I mentioned that the EU regulation will require companies to report on pieces of the “S”, particularly those quote-unquote treatment of employees as an area to comply with, and this in particular converges with some other human capital trends that I think are important to highlight because the markets that TR serves, that we serve, are human capital-intensive industries. So, if we think about the quote-unquote treatment of employees that is an indication of or an indicator of organizational well-being and we all know that well-being has been a popular topic for employers for a while, but what this means really is that well-being of people is a, is stronger, is going to be a stronger performance indicator for organizational health. And this is all happening in the backdrop of an ongoing tight labor market that is likely to continue for the next few years at least, and it's also happening in the backdrop of an emerging trend that boards of directors are more interested in workforce issues, particularly around attrition because they're recognizing as our executives and shareholders that the value of the human side of leadership, meaning the capability to connect with others, show empathy and compassion, be inclusive and resilient and excel even in and uncertainty are important to quote a recent Deloitte report. So, these factors are all mutually reinforcing, so the regulation is begetting the importance of organizational health, which is begetting the importance of employee health in a tight labor market. Thus, reinforcing board level interest in these topics.

Gregg Wirth: You can see that is just a lot going on in the ESG area, and I think it's the focus of a lot of people's attention now. But again, like I asked previously, you know, the economic realities come in, how will these priorities be impacted by that?

Natalie Runyon: Yeah, and I think in short, it's going to slow progress on ESG in 2023, but not kill the momentum around ESG, because like I said ESG has staying power for reasons I mentioned a few moments ago and I think it's institutional at this point. But the realities are both economic and also operational, so one of the key operational challenges is around manual processing of data and then small teams are actually performing this analysis and so that is one challenge that is going to be impacted because they're in a different economic environment, requests might have been made to increase headcount. Or requests might have been made to invest in technology. And yes, technology can drive efficiency, but right now the high cost of capital will require very targeted investments that are going to be absolutely necessary to beat regulatory requirements and so that regulatory requirement is going to be the reason why technology investments are made. But they will need to have absolutely a high return on investment. Alongside, in addition to meeting the regulatory requirement.

Gregg Wirth: Oh, that makes sense. That makes sense. It seems like a good segue into your area, Zach. In regard to technology and innovation what are leaders seeing there as their top priorities in the coming year?

Zach Warren: Yeah, yeah, thank you Gregg. And I think Natalie's point about targeted investments is very well taken. I mean, just think back over the past couple of years with technology, obviously 2020 and 2021, it was very much everything is on fire. What can we do to make sure our operations are actually stable right now? Because that was priority number one, making sure the business could operate with everybody remotely. Then in 2022 you started to see a little bit of a shift away from that. You started to see more of those targeted investments exactly like Natalie was talking about, but in that you didn't necessarily see a lot of R&D a lot of I guess you call it outside the box thinking with technology. It was much more business-oriented targeted technology. So, for example, in our State of Small Law 2022 we saw that there were fewer firms increasing their overall investment in technology. Only 15% of those firms in 2022 said there was an increase compared to 20% in 2021, but when they did invest, it was heavily focused on business development and marketing. Maybe it wasn't the quote-unquote sexy technology, but say small law firms rose 14% in how they invested in their websites last year. They were investing in things like customer relationship management systems, in financial systems and business systems, and I think that's something we're going to see continue on into 2023. Taking an example from a different industry in our global trade report, we asked supply chain managers and others what are your top areas for tech investment over the next year? The top areas for investment, again very practical, it's security and data protection and insurance, ensuring compliance for transactions. The last three places where they were investing, at least in the US, blockchain technology automating product classification using AI and predictive analytics. Things that I think we'll see definitely, progressively more adoption in the future, but especially as we're talking within the next 12 months, this may be segueing into your next question, but if we are seeing priorities impacted by the economy, I think a lot of the talk about AI, the blockchain, and especially something like chat GPT recently, I think it may remain just talk. I'm not sure there are many practical applications and particularly within the next year, the practical, the now is what I really think businesses are going to be focused on.

Gregg Wirth: Well, you did predict my next question and how are these priorities going to be impacted by what could be going on economically and elsewhere in the in 2023?

Zach Warren: Yeah, I think I will echo Natalie once again and slow the progress, but not kill the momentum. I think is a very good way of putting it. I think you are going to see a large-scale spending pushback it definitely a decrease. So, if we look at the last time, obviously there was a major recession 08-09. We saw a very large dip in technology spending before it bounced back very much to those critical systems of what's absolutely needed. So, Rabihah was talking a little bit about who's bearing the burden of compliance risk and how exactly are people going to be tackling compliance within this new paradigm. So, in our FinTech Regtech report, that's coming out in 2023 among all firms there's still some growth in financial and regulatory technology, 42% anticipated fintech budgets to grow over the next 12 months and 38% anticipated RegTech budgets to grow over the same time period. But if we're looking at a subset of that, looking specifically at global, systematically important banks, who usually we see as more of an indicator of the future as compared to the wider mark 20% of those banks actually anticipated budgets decreasing for FinTech and 40% anticipated budgets decreasing for RegTech, which especially given the compliance risks that both Rabihah and Natalie talked about I thought was kind of interesting, but it also could be an indicator of OK, we have these systems in place already, obviously if you're a globally systematic important bank, you're going to have some sort of FinTech RegTech there. So, focus shifts a little bit more not to adopting new technology, but making sure that technology that is already there is sound in place is being used across the wider organization. One note to that though that I will say you do see some technology that's countercyclical to economic recession. So, for instance, something like in legal, legal operations was sometimes seen as an outgrowth of the 08-09 recession because corporate legal departments needed to actually work a little bit more efficiently to use technology a little bit more efficiently because they had those budget restraints and sometimes not the headcount that they used to, so it's something definitely to watch out for over the next year, but I think in total it's going to be a very heavy focus on how do we use what we already have in the most efficient and productive manner.

Gregg Wirth: It does seem like a smart approach given the uncertainty of economic future. Let's look shift gears a bit and look at some of the industries that we follow closely. Starting with the legal industry, Bill, what are the leaders of law firms and corporate law departments seeing as their top priorities in 2023?

Bill Josten: Certainly a lot of the things that have been talked about already are on the priority list and that they're with addressing, but unfortunately I think the reality is that those aren't necessarily “top of-top of mind” for some of these leaders, for both corporate law departments and law firm leaders really kind of top of mind right now is matter, volumes and costs. Those are really, a top of minds, but perhaps at cross purposes, for the two segments, and so what do I mean by that? Well, for corporations, they're seeing increasing matter volumes, probably flat staffing, because very few of them are hiring. Some of them are even preparing to potentially go through layoffs, which is unfortunate. They're seeing flat budgets, and they're having pressure to control costs, so if you can't step up, you can't spend more money, but you have an increasing workload, what do you do? They're also looking at potentially, then increasing external trend, but how do they balance more work going outside with increasing with the increasing pressure to lower cost? So, they're looking a lot at tiering of work, you know, moving work from higher cost firms to lower cost firms, or you know even tiering in the sense of breaking matters down more discretely into component parts and utilizing ALSP's more heavily in a beginning part of 2023, here we've got our ALSP report that's going to be coming out, and that's one of the big findings from that report is that corporations are taking on a more active role in in managing their ALSP's more directly, whereas in the past they've been more reliant on law firms to manage it for them as part of a portfolio of work. So, that I think is going to be part of it is how are clients tiering work as a way to manage costs, because then they may be spending a little bit more, but they're getting a lot more work done for it because each matter is being done, you know, at a nominally cheaper rate because of the way the work is being tiered. For law firms, that obviously then becomes a concern. What they're worried about in terms of matter volume is really they're worried about matter volume in the sense of potential decline in demand, and in particular transactional practice demand if we look back over really the last decade transactional practice demand has been the key driver of demand growth for law firms, and yet we can track a pretty clear path of transactional demand slowdown really from Q1 of 2022 on through the present and it's a global phenomenon. You know, it's happening everywhere, so that's something law firms are really concerned about. Keys for them in the coming year are going to be holding on to market share so that they personally their firm doesn't see a demand decline even if a segment of law firms is growing their rates effectively. That's a huge point of discussion right now given the impact of inflation and how that can impact long term revenues, so they want to make sure that they're growing rates effectively and then holding the line on realization. One of the things we saw in the pandemic was realization against their rates for law firms had really improved. We're starting to see it sort of backslide a little bit. We're not back to pre-pandemic realization levels, but seeing it start to drop, there's a potential there that it's declining because clients are pushing back more on invoices. There's also a potential that it's declining because firms are potentially losing some of the billing discipline that they put in place as part of their pandemic efforts, so that's something to really to be keeping a close eye on. Biggest story though is going to be likely to be clients shifting work on market already talked about this a little bit, but research from the Thomson Reuters Institute shows that roughly 50% of clients have shifted at least some of their work to lower cost firms in the last six months. And we recently published an article that shows that even as little as a 5% shift in matter hours can mean massive overall savings for the client just by tiering that work down a little bit. So all of that, and we haven't even talked about talent challenges around topics like retention and the increasing costs of talent. I mean that that's an entire we could spend an hour just on that, but that's all keying up to make for a pretty challenging start to 2023.

Gregg Wirth: Well, clearly the legal industry is very impacted by economic shifts. As you mentioned, transactional demand things like that what, you know, with firms being dependent a lot on their corporate clients and what their corporate clients are willing to do and to pay for how will these priorities be challenged by any economic realities coming in?

Bill Josten: Yeah, that's a really interesting and difficult question because they're almost conflicting priorities, right? In a certain sense, and there's only so much attention span to go around. And I don't mean that to be at all pejorative, but we only have the ability to do so many things at a certain time. And at some point, the tactical day-to-day starts to interfere with the long term strategic. So, the concern, I think is that, you know, for both corporations and law firms, they're saying a lot of the right things around key topics like tech and innovation, tech, adoption, diversity, and ESG priorities there's a lot of talk around the right priorities there, but the concern is that those topics may give way to the economic realities that the burden of maintaining day-to-day profitability just sucks up so much oxygen out of the room that those priorities start to sort of fall to the back burner. That's going to be a really challenging thing because you continue to see, you know, we've, we've heard from my colleagues here about increasing ESG focuses and regulatory regimes and all these other things. So, there's going to be a key focus on some of these things and in the tech and innovation area, you know, you look at states that are looking at adopting rules of professional responsibility around technological competence and technological capability well, that's all excellent stuff to be focusing on and yet law firms also have to focus on their day-to-day business operations and how can they serve their clients today. So, there's going to be that that challenge, and hopefully the long-term work of digitizing the legal services, injury or industry, improving access to justice, enhancing the meaningful distribution of career advancing work. Hopefully all of that will continue. And I think the smart way to do that, rather than letting those priorities slip as we focus on managing day-to-day. I think the key to that is going to be focusing on keeping those priorities at a strategic top of mind incorporating those into the management steps that that firms and corporate law departments are taking to manage the twists and turns of 2023. So, as we're looking to tier work to lower cost providers is there a way to do that while also deploying a meaningful diversity initiative within the way that the corporate work is distributed or law firms, as we're looking to enhance our service deliveries, can we use that as a way to drive adoption of the innovative tech through our innovation teams or whoever is deploying that. So, we're combining priorities rather than focusing myopically on this is the one thing we have to solve. I think that's going to be key where we do run the risk of some of these things slipping.

Gregg Wirth: Certainly, certainly. Another area we kind of keep tabs on to a great deal is tax and accounting. So, I would ask Nadya, what are you seeing from the leaders of both tax and accounting firms and corporate tax departments as to their priorities in the coming year?

Nadya Britton: Sure, thanks Gregg. So, I'll start with tax firms. For them it will continue to be about expanding advisory services. Now, for the larger firms that had been part of their traditional model, but for the small and mid that shift was starting to happen prior to 2020, but really kicked into gear as, you know, helping their clients navigate all that needed to navigate. Kind of move them into this position of understanding their role as just being tax providers. So, understanding that they can give tax and accounting advice to help their clients run their businesses better, why that will continue to be a trend A, it's just smart business but B, compliance work is being deprioritized, right? Imagine that we have technology that can get a tax return done within seconds, so the need to sustain yourself as a small and mid-sized tax firm have to have you shift away anyway. Because again, if you can do the taxes which took you two or three hours, and now you can probably whittle it down to all in 45 minutes, well, you know, that's a lot of clients, and is that really the best use of your time and skills? So, many firms had already started shifting, that trend will continue. What that then means then is firms are now looking at well, how do I make this happen? Because yes, it sounds great I can offer business advice to everyone but A, it's having them look at their customers a lot closer. Are these the right customers? Having them be more strategic so what started last year, and I've heard will continue, is firms looking at calling right their clients saying that OK, A, we're going to raise our rates because historically we've just had bare minimum rates, so we're completely out of whack, so that's the first thing that's going to happen. So, that might cause some of the shift, but for there's some customers that the business they get isn't sustainable for that customer might be difficult, whether it's sending in tax returns later, huge pain, they're all I think taking a better, closer look at the business of how they're running their business as a tax firm, so that's super interesting. Along those lines, it's now looking closely at their workflow. What software's do we have or don't have. As Bill mentioned we haven't even touched talent, but that drives them further, thinking about their efficiencies and what workflows will work best and how again they're trying to move to this new world of servicing their customers or the ideal. On the large tax firms from size, like I said, they've already been in the advisory space, so for them the evolution and focus is around specialization, right? I think similar to what law firms do in terms of many are saying, OK, we're going to have a person that's dedicated to this particular industry. So, imagine oil and gas, we're going to have specialists. And that's all they do. That's their wheelhouse. So, that's becoming quite a trend for larger tax firms, and how some of them are going about doing it again, right? We've talked about or not talked about talent, but many of them are looking at opportunities, whether it's merging with other firms that already have those practices, right? So, now it's about scaling up. You're getting talent and you're already getting the expertise, so this is how they're looking at growing their businesses and establishing themselves to meet their customer demands. On the corporate side, it's interesting. I would say for them it's all about data data data. And that's around, you know, much of what Natalie has covered in terms of the regulatory changes that they will face, including all of the ESG and not just in the US but across the globe. And they're now having to figure out in addition to, mind you, all the work that they previously had and to do, but now there are additional pieces to their work. Much hasn't changed in terms of staff, so thinking through how you're going to gather information from throughout the business, quite often I've heard is that everyone is kind of on their own platform within a company and so you have to think through. Who do you go to get what? How are they delivering the data to you? How can you verify that the data might be in the best shape is what I would say and then where do you store it? Because again in some cases where some of these regulations have not come down yet, you're having to start to plan to get ready for you've got to think through how you store it. And what you store so you can readily grab it when the time comes. So I would say for them that's a big priority. The other piece which is driving even going back to the data collection, is that seeing themselves as a business advisor. They're one of the unique departments that sit across the business, right? They can kind of see into everything they see, sales, they see operations. And so, they're looking at themselves as being more proactive, not just saying, OK, let's talk through tax planning, but also thinking through, you know, using technology, for example, if heard to model different scenarios. So, even if for the company let's say merge or acquire another company providing that kind of input, like here are the tax implications, the implications this year or what this might look like if we did this then and again adding back to pieces to Natalie's point around ESG. We're saying we're committed to this, but what might that look like? Or how might we be impacted if we did this? And how best to use it? So, the role of the corporate tax department has shifted. It has been shifting I, I think for them with being concerned about the regs, but also understanding that their role has really significantly changed within the corporatization, within the corporation.

Gregg Wirth: Right, right. And like taxes are inevitable so are economic changes. So, what do you see economic realities in the coming year impacting how tax and accounting leaders are going to address these priorities?

Nadya Britton: I'll start again with the tax firm, and you know what does it say, two things are certain death and taxes? So, I think that for the tax firm, they're not going to be as impacted as some other industries in terms of, you know, the work they will still have the work some might actually become even more busy based on what their customers and the businesses they're in in terms of helping them figure out how they will navigate and how best to run their business through an economic downturn. So, I think for them they're probably in an interesting place. I mean many that I've talked to, you know, they're still looking at this as the year that they're going to acquire technology to do some of the things they need to, and honestly doesn't think the they'll be impacted because they believe their customers are going to pay. They need the services and it still provides them the opportunity to do what they. On for the corporate tax department, I feel like that's not the case because obviously their budgets, you know, come from an organization and how the business is doing impacts what they will have? It's worth noting already that you know, I think it's according to our State of the Corporate Tax Department Survey that a tax department spend is about .3% no .03% of revenue. That's what their budget typically is, and that the average technology spend that they get is 117,000. Now, that's not a lot, and that's in normal times, so to speak. So, I think for them that they will face the challenge of, you know, wanting to acquire additional technology will they'll probably face a significant challenge and trying to get resources to make that happen, which makes their job a lot more challenging.

Gregg Wirth: Certainly, certainly. Well, thank you, Nadya, for sharing your insight on that. And thank you also to our other guests, Bill, Rabihah, Zach, and Natalie. And thank you for listening to the Thomson Reuters Institute Insights Podcast.

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