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A STUDY OF SMALL & MEDIUM LAW FIRMS

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Welcome to the Thomson Reuters report looking at the state of the small & medium law firm market.

Small & medium law firms are facing many of the same pressures as their larger counterparts. While the demand for legal services remains high, the pressures to compete in this market while building profitability are growing. With new entrants to the market, the move to fixed fees and more transparent pricing, alongside technological advances, firms need to think strategically about where to invest in order to remain competitive and relevant.

We surveyed senior decision makers in small and medium sized law firms in the Summer of 2016, immediately following the UK's Brexit vote. The response to the referendum has been well-covered elsewhere and our survey did not seek to add to this. But with the outcome of the vote likely to create greater economic uncertainty in the short to medium term, it is an interesting time to pause and see if small and medium law firms are fit to tackle changes in the market.

We found firms in an upbeat mood – a majority pointed not just to revenue growth from the previous 12 months, but were expecting this to continue over the next year.

Yet beneath the surface we detected doubts, ones which could threaten small and medium law firms' ability to weather greater economic storms.

Most law firms are aware they will need to adapt, but many lack certainty about where they need to focus efforts amongst the competing priorities. Firms recognise that the market is getting tougher, but don't seem to have a clear plan for how they will differentiate and increase market share. Instead we saw a tendency towards their 'comfort zone' when tackling some of the more difficult issues. Others admit that the priorities they identified are more aspiration than reality.

As a result, they feel under-prepared, and perhaps more exposed than they would prepare to admit.

This report builds on our findings from previous research published in October 2016, '[Small & Medium Law Firms confront operational efficiency?](#)' We hope it provides some food for thought as firms grapple with what success looks like in the future.

Chris Jeffery

Director, Small & Medium Law Firms
Legal UK & Ireland, Thomson Reuters

Executive Summary



Small and medium law firms confident of revenue growth

- **79%** of small and medium law firms claim their revenue has grown over the past 12 months
- Firms tend to believe they have performed better than their competitors and the market as a whole

Firms focused on clients above revenue and profit

- **54%** of law firms put client satisfaction as a key measurement for success, scoring higher than revenue and profitability
- Clearly client satisfaction is an important element, however, prioritising this within a shifting market over more traditional business performance measures could make it difficult to tackle increasing pressures on the sector



Small and medium law firms struggling to perform against their own key areas of success

- Law firms identify a myriad of areas for focus to achieve success, but more than half admit they have yet to achieve against these
- **88%** of law firms think they are more efficient than their peers, but the research shows there are gaps in the implementation of specific solutions



Revenue growth in small and medium law firms expected to continue...

- **76%** of small and medium law firms are expecting revenue to grow in the coming 12 months
- Private client, residential and commercial property and dispute resolution expected to be the biggest growth practice areas in the coming 12 months
- **59%** of law firms expect existing clients to be a particularly effective source for generating new business opportunities

...but many find it hard to prioritise areas for sustained future growth

- **82%** of law firms say market conditions are tougher now than they were 12 months ago
- Law firms are struggling to prioritise where to focus efforts in order to achieve success
- The research shows there are gaps in the importance given to an area and how well the firm is prepared to meet this, with the most striking gaps in profitability and talent retention
- **46%** of law firms are looking to grow through acquisition, although only **27%** and **25%** respectively believe they will merge or be acquired
- In naming appealing ways to grow and develop their businesses, law firms seem reluctant to move out of their comfort zone

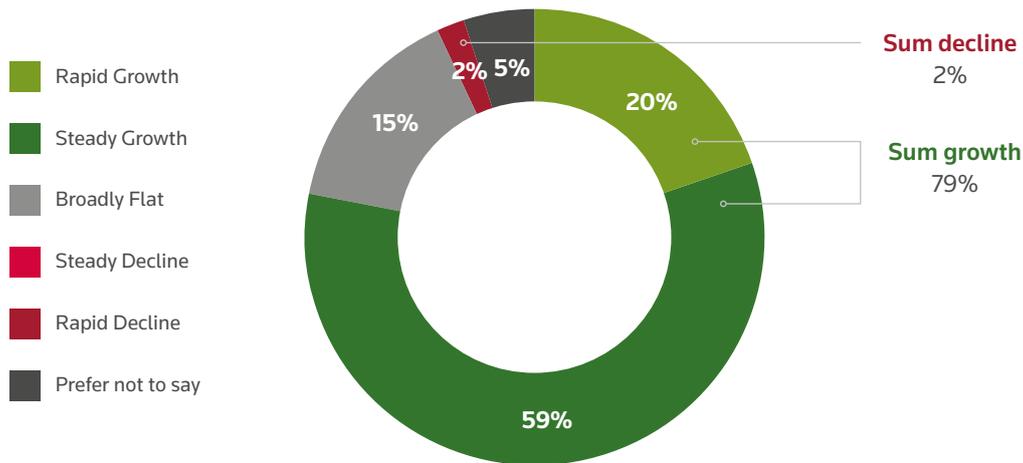




Small and medium law firms confident of revenue growth

This Thomson Reuters research looks at the views of senior leaders in law firms ranging from 2 to 80 fee earners. The vast majority of law firms in this income bracket say they have experienced some revenue growth over the past year, with a significant number saying this was 'rapid'.

Q. How does this compare to your revenue 12 months ago?

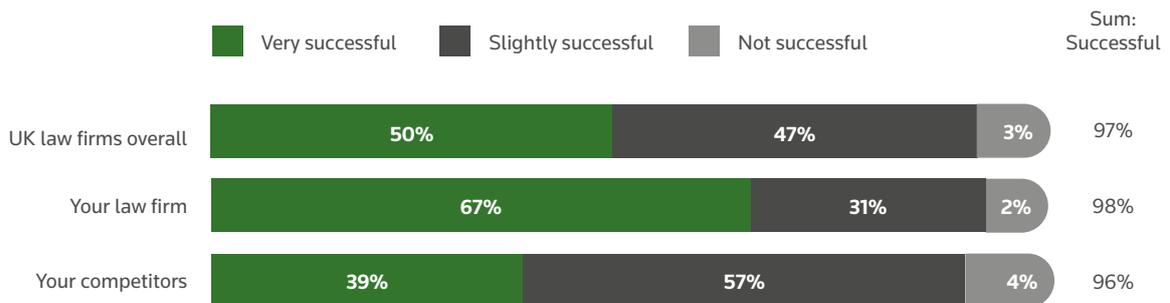


These figures will no doubt indicate to law firms they are doing something right and there is enough demand from the SMEs and individuals to maintain instructions and therefore fee income. Anecdotally we often hear of firms who are happy enough to experience income growth that they don't look too deeply into the drivers or the source of that growth.

In this context, it is interesting to see that almost all of our firms believe they will outperform the market over the coming year – a statistical impossibility! Perhaps this more than anything gives us an insight into the lack of rigour some firms apply to their revenue growth predictions. It suggests to us that many are likely to be unprepared to adapt and change to thrive in an increasingly competitive market space.

Throughout this report, we will delve deeper into this contradiction looking at areas where firms may start to implement real change.

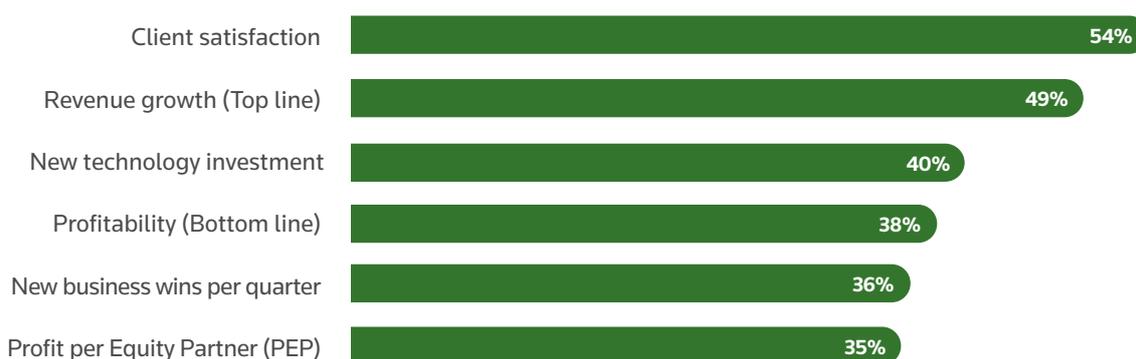
Q. How would you describe the following in terms of success in the past 12 months?



Firms focused on clients above revenue and profit

It is clear that the perception of 'success' is subjective and so we asked our survey respondents to highlight the criteria their firm uses. There was a broad range of answers, some focused on financial performance and some on less tangible measures. Within this myriad of different criteria it seems law firms are struggling to develop a clear definition of what success look like. The absence of any consistent industry norms means there are few starting points for law firms to start to look more strategically at their businesses.

Q. Which of the following criteria does your law firm use to judge success?



While there is no single factor that stands out, we note that law firms listed 'client satisfaction' more than any other criteria for success. Many of the respondents to our survey were fee earners who see their roles first and foremost to provide the best service to clients. Providing a positive experience for clients builds a strong reputation, platform for repeat business and internal satisfaction.

A 2015 report from Thomson Reuters (['What Clients Want – perceptions of legal affairs and legal advisors amongst SME decision-makers'](#)) showed that law firms are already achieving a high level of satisfaction from their SME clients. 86% of SMEs reported that legal advisors performed well in 'quality of advice'. We have no reason to believe that individual buyers feel differently.

If law firms are already achieving a high level of client satisfaction across the board we would argue that it is a pre-requisite for opening up the doors every day, rather than a true measure of success. When we look at measures that apply a greater level of business rigour, law firms are less certain – less than half look at financial performance as an indicator of success and within that, even fewer are focused on profitability.

These figures suggest that some firms may struggle to adapt in light of increasingly uncertain economic conditions, greater competition from alternative legal providers, and alongside growing pressure from regulators to provide more transparent, competitive and fixed fees.

Will law firm leaders in the future need to adopt the entrepreneurial spirit of many of their commercial clients? And are they aware of this shift?



Small and medium law firms struggling to perform against their own success criteria

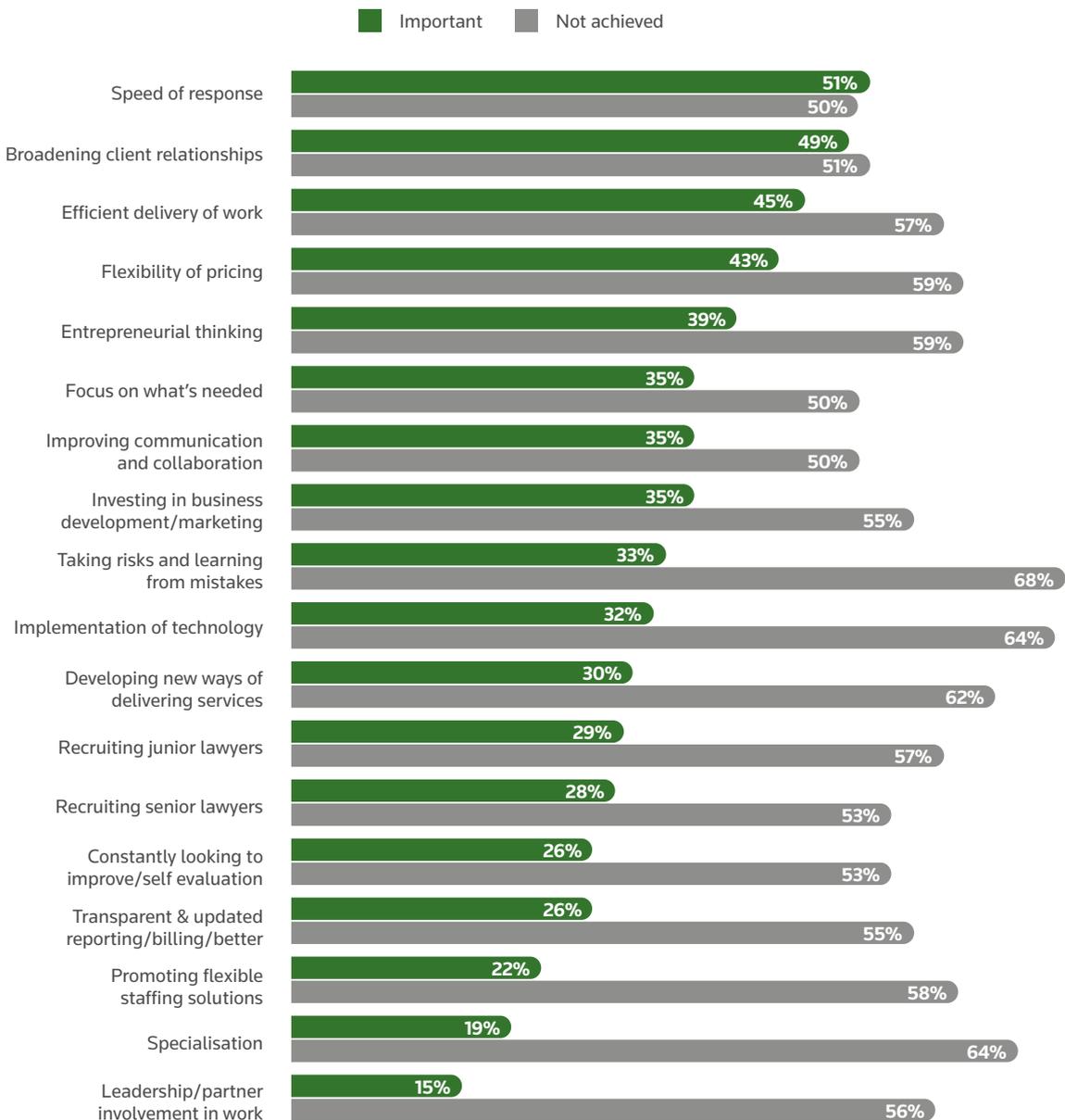
To delve more deeply we looked at which areas of focus law firms in general needed to address in order to achieve success and, more importantly, how well their own firm has performed against each of these.

It is here we start to see a gap in where firms want to be and where they really are.

Less than half of the law firms surveyed had fully achieved any of the criteria set out below, even those growth and efficiency drivers, such as client satisfaction, broadening of client relationships and efficient delivery of work which had been identified as important.

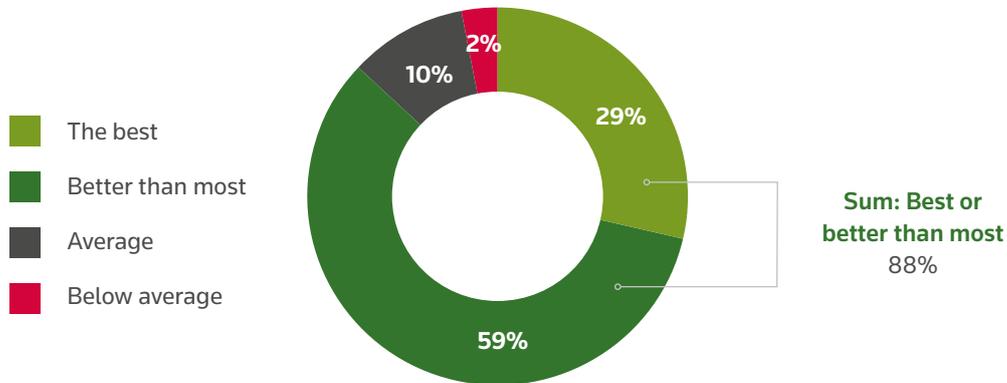
Q. Which of the following do you think is particularly important for law firms to achieve success?

Q. How would you rate the actual performance of your law firm for each of these areas over the last 12 months?



Looking more closely at efficiency – accepted as a key driver to profitability – we see a similar story in the gap between aspiration and reality. Law firms certainly perceive themselves as efficient – when asked to rank themselves against competitors, nearly a third said they were the ‘best’ and nearly two thirds ‘better than most’.

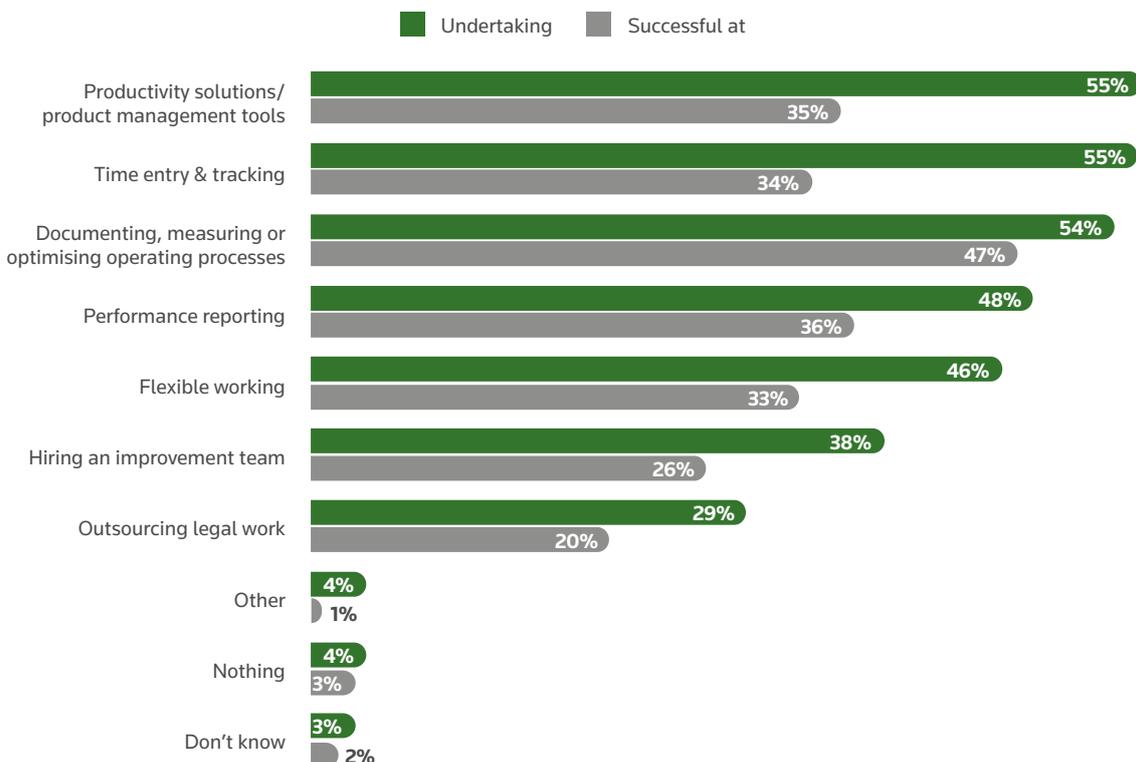
Q. Overall and to the best of your knowledge, how efficient would you describe your law firm when compared to your competitors?



However, while they are investing time and resource in creating more efficient processes, there is an acknowledgement work is still to be done in making this investment drive greater business efficiency. In our research on SMEs from 2015, we found that, while they were generally very happy with the service provided by law firms, speed and communication were areas that were in need of improvement. As we have discussed previously, providing high-quality legal advice is now seen as a given, rather than a differentiating factor. While law firms do not want to reduce quality in pursuit of higher profits, there are opportunities to focus on operational efficiencies to improve speed and communication. By adopting this client-centric approach to technology investments, the smarter law firms are looking to up their client service, while operating more efficiently.

Q. Which of the following is your law firm undertaking to drive efficiency?

Q. Which of the following would you consider your law firm successful at?

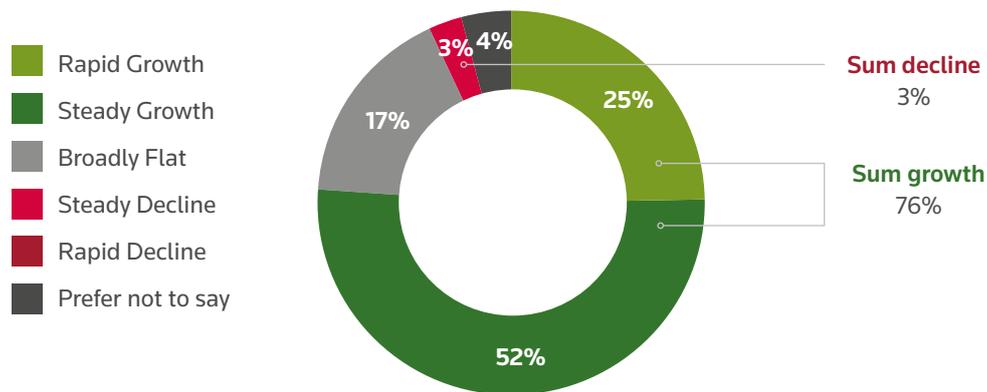




Small and medium firms expect revenue growth to continue...

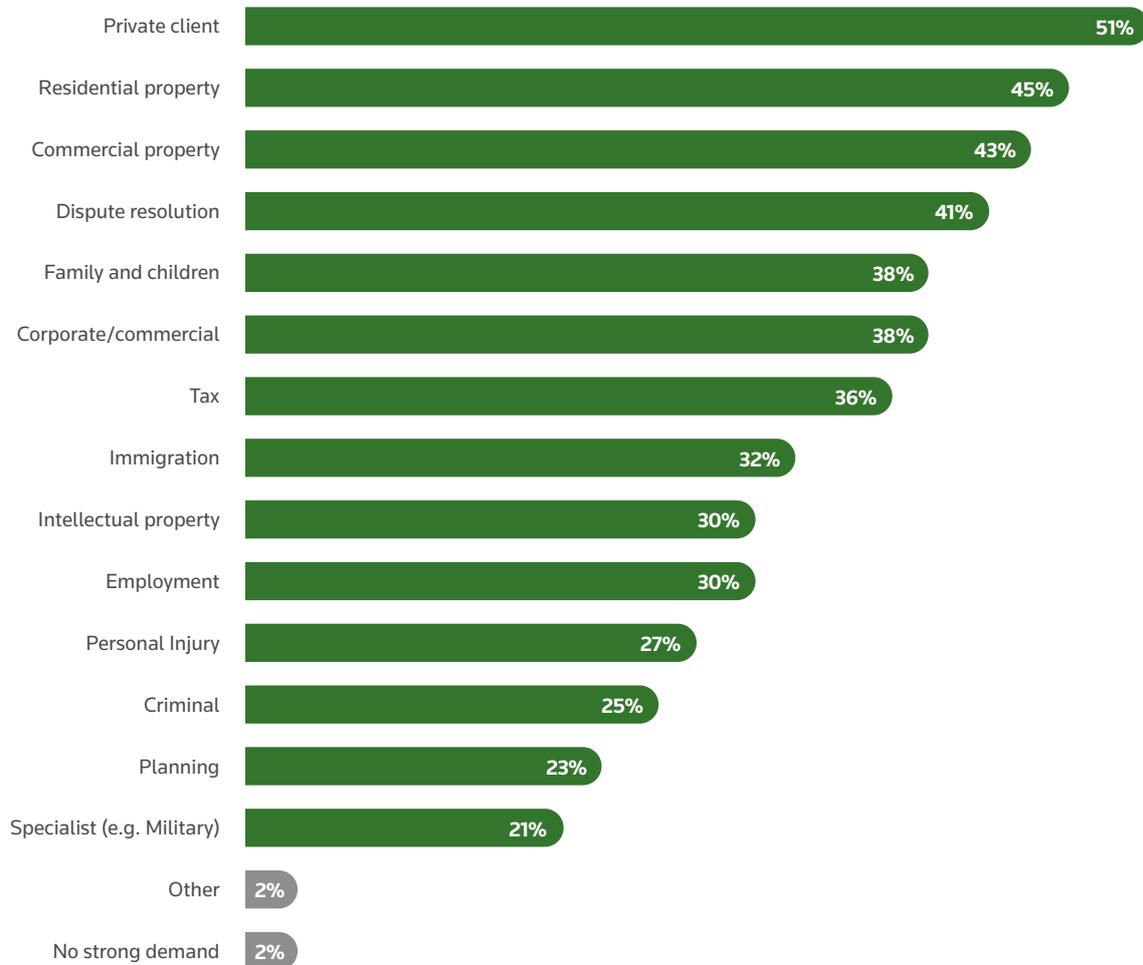
Despite some cracks in achieving some of the key efficiency drivers, law firms seem confident they will continue to achieve success in the next 12 months. In fact there is a slight increase in those that believe the firm will grow rapidly, up to **25%** from **20%** in the previous year.

Q. To the best of your knowledge, what is your forecast for revenue over the next 12 months?



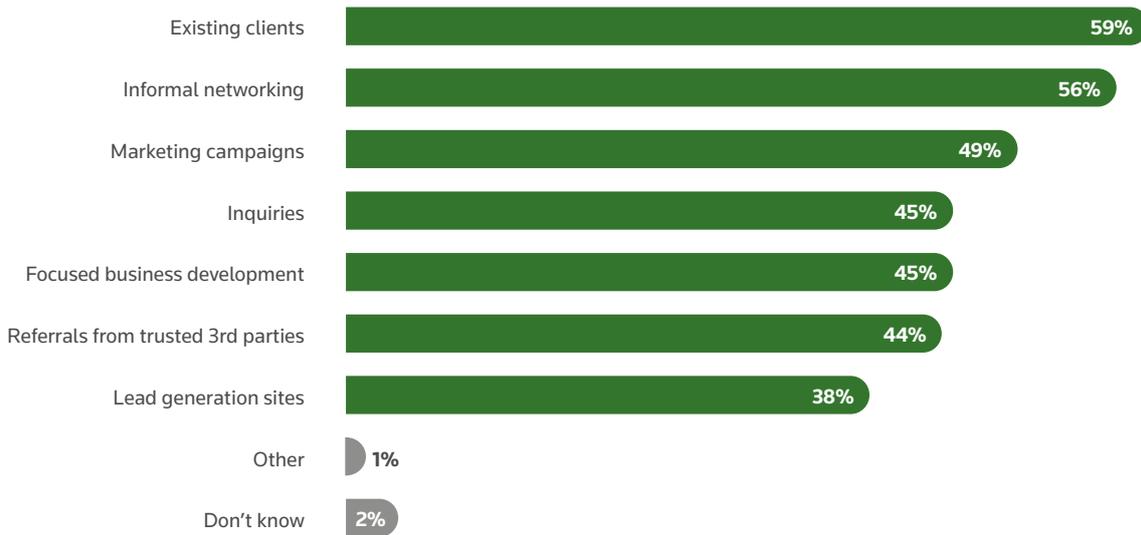
Firms anticipate demand for legal services to be broadly spread, with private client (e.g. Wills, Probate and Trusts) residential and commercial property and dispute resolution as the highest. 65% of our respondents described their firms as either 'Commercial Generalist' or 'Consumer/Personal Generalist', indicating firms feel that they offer a sufficiently diverse mix of legal services to meet the demand in the future.

Q. Which of the following types of work does your law firm expect strong demand for over the next 12 months?



In keeping with the focus of our respondents on existing clients and client service, the law firm leaders believe that the single biggest source for new business over the coming year will be from existing clients, closely followed by informal networking. Formal business acquisition processes, such as marketing campaigns, focused business development programmes and linking to lead generation sites appear to have less importance.

Q. Overall, which of the following do you feel are particularly effective sources for generating new business opportunities?



...But many find it hard to prioritise areas for sustained future growth

While law firms appear confident of their growth, 82% agreed that the legal market is tougher now than it was 12 months ago. So how are firms tackling this change?

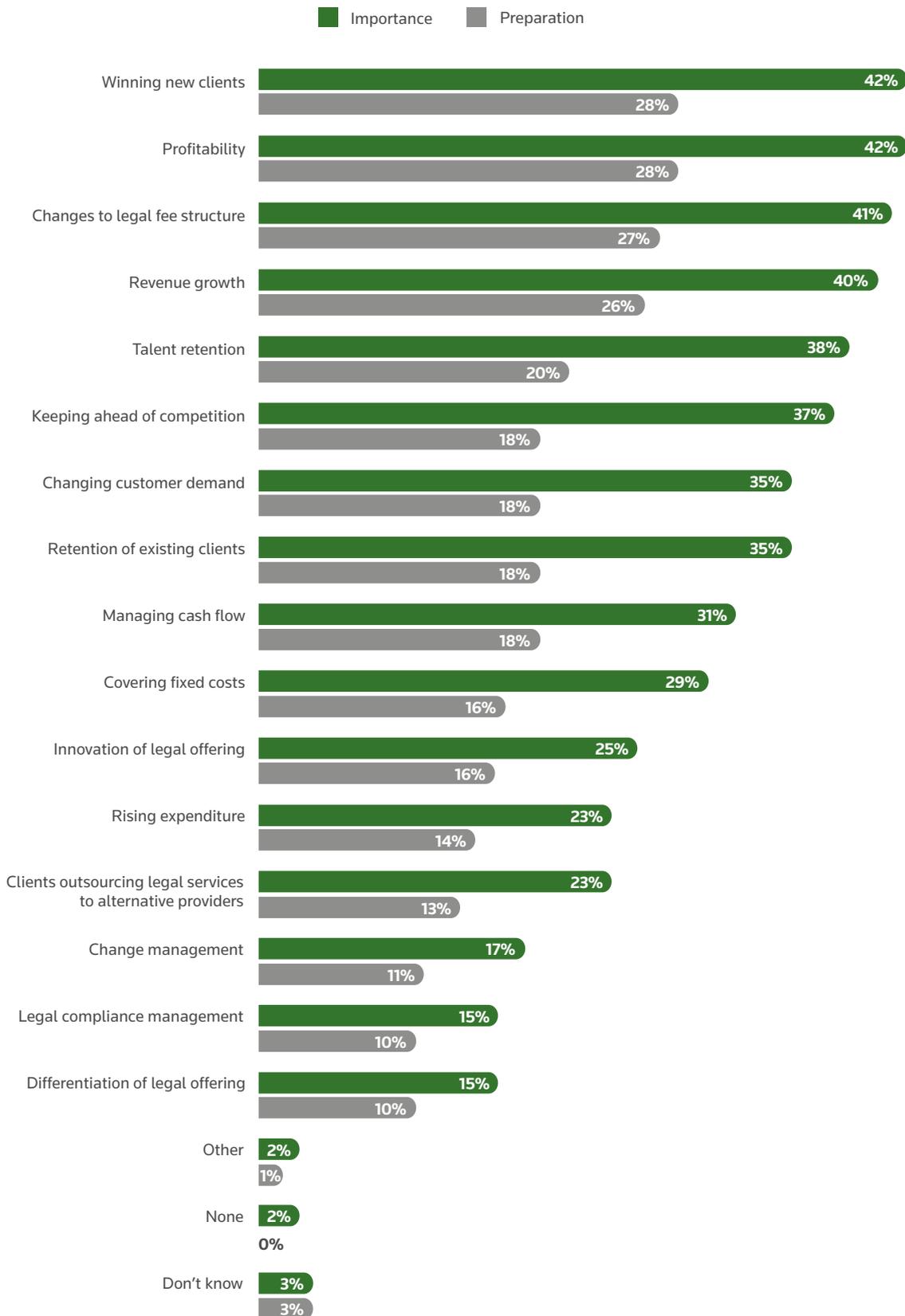
We asked the leaders of small and medium law firms about the areas of focus and importance for the next 12 months. This provided a very different picture to how firms had perceived their success to date. In the future respondents claimed they were most focused on achieving growth through: winning new clients, profitability and changes to the legal fee structure. Bottom of the pile was differentiation of offering – just 15% of firms claiming this will be a key focus in the next year.

While law firms admit the coming year will be tougher, it seems that firm leaders are retreating to their comfort zones – putting their faith in doing things the same but doing it better.

What is even more striking is a consistent gap in the importance given to an area and how well the firm is prepared to meet this, with the gap highest for profitability and talent retention. Grappling with the multitude of issues around profitability, process and people, it seems difficult to get a clear view of where law firms will focus their efforts to achieve success.

Q. Which of the following issues do you consider to be particularly important for your law firm over the next 12 months?

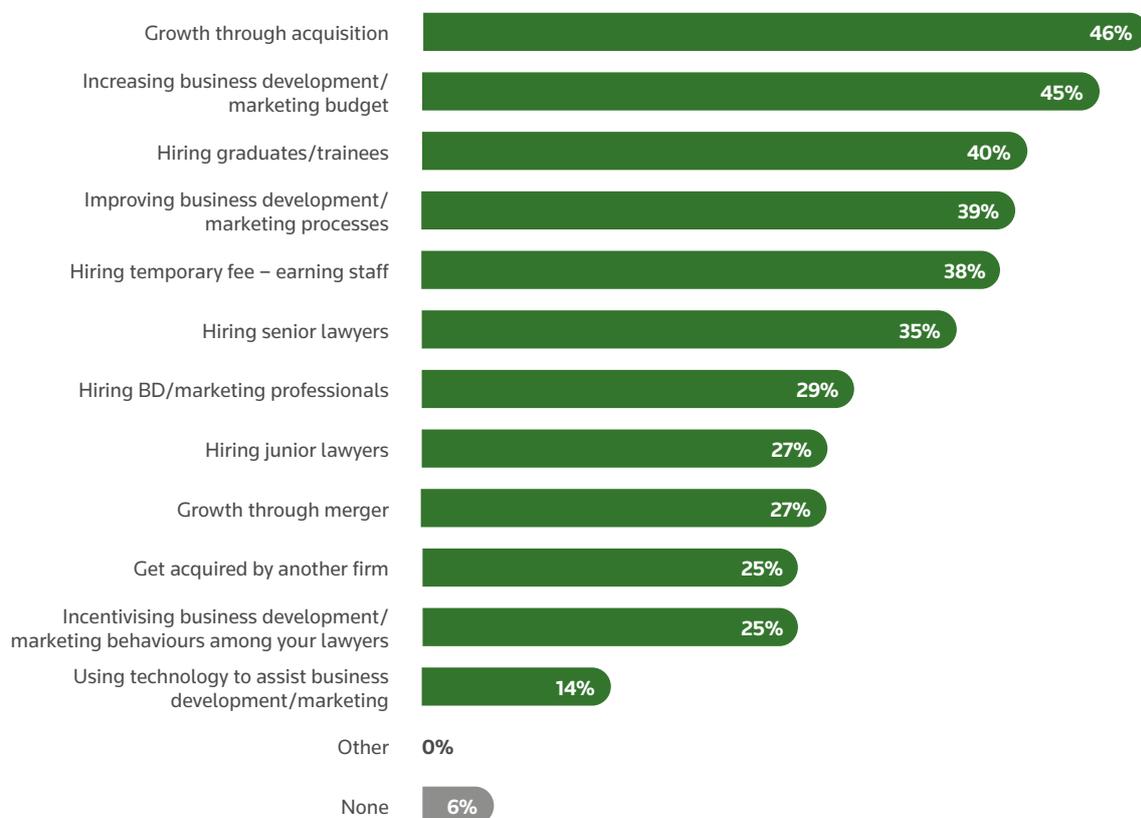
Q. Which of the following is your law firm prepared for over the next 12 months?



Beyond process and efficiency we asked firms about the appealing and likely ways they may grow over the next 12 months. Nearly half cited growth through acquisition, yet nearly half of that number again thought it likely they would grow through a merger or through being acquired. Logically, these figures suggest that only half of those looking at acquisition have actually made progress in identifying targets or partners.

Looking at organic growth, small and medium law firms say they will focus on business development and marketing processes, and a significant number looking to increase their numbers of business development and marketing professionals. These figures are unsurprising, given the drive to new client acquisition. However, far fewer say they will invest in the technology to assist business and marketing professionals, again indicating a ‘flight to safety’ – focusing on what they know and understand rather than adopting new ideas. Firms have already admitted that they have yet to fully realise the benefits of efficiency measures, so perhaps there is a concern about the new and unknown.

Q. Which of the following would be particularly appealing and likely for your law firm over the next 12 months?



Conclusion: a crowded comfort zone

On the surface, small & medium law firms appear confident, revenues are growing and there is a sense that lawyers are providing a vital service to their commercial and individual clients. However, beneath the veneer of confidence is a more confused picture. Beyond the day-to-day business of delivering client service, law firms know the market is changing and will get tougher.

There is recognition that the change cannot be managed by lawyers alone – business development, project management professionals and technology solutions will all play their part. Around half of law firms want to increase their business development budgets, for example.

Yet law firms appear to struggle in identifying the priority areas. This means they are looking to do a little bit of everything, are struggling to make a real impact. One of the most revealing findings was that while 39% think entrepreneurial thinking is important in achieving success, fully 59% think they aren't achieving it.

A change in mind-set will be crucial in driving success for the sector in the future. Doing the same things slightly better will inevitably lead to diminishing returns, and is no substitute for a genuine, innovative, long-term strategy. A given firm's legal advice can only be so good, and its high quality is something clients expect to be able to take for granted. Firms must look to other levers in order to achieve differentiation and growth.

We will be exploring these key levers for success in subsequent publications and forum discussions. But we also set these challenges to the market: are law firms willing to move out of their comfort zone and adopt a more entrepreneurial/business-focused outlook? Or will they do the same things they've always done, and expect different results?

Methodology

The research was conducted online by FTI Consulting with 110 senior decision makers in UK small and medium law firms – numbering between 2 and 80 fee earners – between 11 July – 1 August 2016. Please note the standard convention of rounding applied and consequently some totals do not add up to 100%.

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