2017 PREDICTIVE LEGAL TRENDS

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Overview

This report focuses on the changing landscape of the legal industry and explores trends for 2017 and beyond. Broadly, we found traditional law firms continue to face both internal and external threats, and clients continue to expect “more for less,” requiring firms to revisit their business models, offerings and ultimately their value propositions to navigate this new reality.

Predictive Legal Trends

• **Bigger pie, but smaller slice.** Although the demand for legal services has been on the rise, the percentage of work assigned to traditional law firms is shrinking as clients move more legal services in-house or turn to alternative service providers and legal tech startups.

• **It’s a buyer’s market.** Clients are continuing to demand more for less, and firms and players that can meet this request are emerging as winners in this new legal industry environment.

• **Looking inward – time for repairs?** Beyond external threats (e.g., new competitors, more holistic offerings, technology efficiencies and the shift to in-house counsel), law firms are also facing internal challenges: overcapacity of underperforming lawyers; a wave of standout partners set to retire; and a less than favorable pipeline of incoming talent as law school enrollment dwindles and graduates turn to alternative career options outside of the traditional firm and partner-track route.

• **Business model innovation.** To successfully position themselves in the evolving industry, traditional law firms are slowly – but nonetheless more frequently – recognizing that they need to make changes to their BigLaw business models, reducing costs, offering greater flexibility and transparency, and expanding their offerings to better compete.

• **Disruptors – if you can’t beat them, join them.** Strategies being undertaken by firms include collaborations with those that are presenting the greatest threats: their clients, alternative service providers and legal tech startups. In addition, proactive firms – and those with the available resources – are making strategic investments and building up their own technologies and alternative provider options.

• **Trends are gaining momentum.** Although many of the themes and challenges for the industry remain the same as last year, their impact is increasing. Firms continue to see a wane in demand, which creates additional pricing pressure on firms that can no longer afford to ignore the industry’s new reality.

State of the Legal Market

The legal industry’s performance in 2016 was generally sluggish, a refrain that has become common since the 2008 recession. According to Thomson Reuters’ [Peer Monitor Index Q3 2016 Report](https://www.thomsonreuters.com/): “Average demand is trending in a negative direction. After the second quarter broke a string of nine consecutive
quarterly gains in demand, the third quarter saw not only a continuation of the decline, but an acceleration, with the average firm’s demand falling 1.1 percent.”

Citi/Hildebrandt, on the other hand, which suggests demand is on the rise, makes the important distinction that although demand for legal services has been increasing, the demand for services provided by traditional law firms has been more modest. As Legal Business puts it: “Shrinking demand is not the same thing as shrinking demand among clients. [...] Just because law firms aren’t getting as much work as they used to, that doesn’t mean there’s less work to be gotten. Corporate clients are actually spending more money; they’re just not spending it on law firms.” This statement is supported by HBR Consulting’s survey of corporate legal departments. It shows that there was a small 1 percent increase in total legal spending year-over-year in 2016, but that corporate spending on outside counsel, for its part, decreased by 2 percent.

**Law Firms Face Demand, Profit Pressures**

Looking at the financial results of U.S. law firms, Altman Weil’s 2016 Law Firms in Transition Survey notes that just over two-thirds of law firms reported year-on-year increases in gross revenue and revenue per lawyer, while profits per equity partner were on the rise at 65 percent of firms. Further, many law firm leaders said they were not optimistic about the ability of their firm to continue an upward trajectory when it comes to profitability, with 47 percent of leaders considering a slowdown in profit-per-partner growth a permanent trend in the industry. Optimism regarding demand is also tempered, with only 38 percent of law firm leaders claiming that demand for their firm’s services has returned to pre-recession levels. A small group of firms (12.5 percent) believe pre-recession demand will return within a year or two, but nearly half of all firms think the return of this level of demand is at least three to five years out, if even at all.

According to Citi/Hildebrandt, law firm revenue, despite modest growth in demand, was up 3.7 percent overall in the first nine months of 2016, a growth driven in large part by lawyer rate increases of 3.2 percent. Expenses were up 3.4 percent at the nine-month mark of 2016, the biggest driver of this growth being the increase in associate salaries, but other contributors included technology and cybersecurity-related investments.
Looking at practice area demand trends, Citi/Hildebrandt found that for the law firm industry as a whole, the only practice area to experience growth in a year-over-year comparison of the first nine months of 2016 was corporate law, and demand here is mostly seen among Am Law 100 firms. Looking at other size firms, midsize firms appear to be the only firm size maintaining demand among other practice areas like real estate, patent litigation, litigation and labor/employment.

![Chart 2: Practice Area Demand, 9mo'16 vs. 9mo'15](image)

**Source:** Citi/Hildebrandt

### Forces at play

The weak demand for services provided by law firms is the product of a combination of market forces. Altman Weil’s survey notes that price competition, increased commoditization of legal work, use of technology to replace human resources and non-traditional service providers are among the main forces recognized by law firms as a permanent trend that will continue to put pressure on their traditional workflow coming from clients.

The same survey reveals that the most immediate threat faced by law firms is their own clients, with 68 percent of firms reporting they’ve lost business to corporate legal departments that chose to insource more work. Another 24 percent of firms identify this trend as a potential threat. Many firms also consider their clients’ adoption of new technologies a major threat, as it reduces the need to hire lawyers and paralegals. Larger firms, according to the survey, are at greater risk of losing business than their smaller counterparts.
Even though most firms recognize that the competitive landscape is changing, law firms have yet to adopt any dramatic changes in their behavior to meet these new challenges. When asked by Altman Weil why firms weren’t putting more effort into changing the way they deliver legal services, most signaled that their clients weren’t asking them to, or that there wasn’t enough economic pressure to justify changes to their delivery model. As such, many partners feel it’s not worth rocking the law firm boat just yet. That said, the most significant barrier to change identified by 64 percent of law firm leaders was resistance by partners. Notably, these statements were very similar to the sentiment expressed in the 2015 Altman Weil survey.
In addition, on a scale of zero to 10, only 4 percent of law firm leaders scored their partners as highly adaptable to change. However, almost ironically, 77 percent of law firm leaders expressed a moderate or high level of confidence in their firms’ capacity to adapt to the challenges of the legal marketplace. As Altman Weil stresses: “If the strategy is simply to keep up with the pack, it misses the point that most of the pack is itself lagging and just a small increase in pace can distance a firm from its undifferentiated competitors. A firm can never get ahead by merely aspiring to keep pace with sluggish competitors.” In other words, the window of opportunity for law firms to move ahead is now.

In addition to the some of the external threats identified above, law firms are also faced with internal threats, including overcapacity and underutilization of resources. Just over half of all firms surveyed by Altman Weil said their equity partners were not sufficiently busy, while 62 percent of all firms said that underutilization was worst among non-equity partners. “Widespread overcapacity is holding down profitability in 60 percent of all firms and in 76 percent of larger firms,” Altman Weil notes. The most obvious way to deal with this problem would be to cut underperforming lawyers. According to the survey:

- Fifty-four percent of firms said they have dropped lawyers who did not have a sufficient amount work.
- Seventy-three percent said they removed partners that chronically underperformed.
- Forty-eight percent have taken the half-measured approach of de-equitizing partners, excluding them from the profit-sharing class.

That said, law firms remain divided when it comes to their stance on the strategic value of staffing growth – over half of firms said growth in the number of lawyers is necessary to their firm’s ongoing success. For firms looking to grow their ranks, lateral acquisitions are viewed as a strategic way to grab a larger share of the market. Eighty-five percent of law firms said they added lawyers who brought with them new business to the firm. However, a law firm’s gain as a result of a lateral move is another firm’s loss, with that poached lawyer typically taking firm business with them.

This report explores the legal industry’s external and internal pressures in greater detail, in an effort to prepare firms for what’s to come in 2017 and beyond. Turning a blind eye to these emerging trends can have significant implications for firms – even if they may not appear to present an immediate threat.

The Legal Market in 2017 and Beyond

Low single-digit growth in industry revenue and profitability is expected to persist in 2017, with wide dispersion and persistent volatility – which have characterized the post-recession legal industry – anticipated to continue.

In the U.S. market, transactional legal work is expected to drive demand more than litigation in 2017. Citi/Hildebrandt’s assumption is that the 2016 slowdown in capital markets, particularly in the number of IPOs, means there is a high level of capital held by U.S.-based companies and private equity firms that
has yet to be invested. As such, there might be an upswing in M&A and capital markets work as the Trump administration moves in and more details about its economic policies are made public. With respect to litigation, Citi/Hildebrandt believes there could be a slowdown in regulatory work under the Trump administration.

From an expense standpoint, the impact of the 2016 associate salary increases should be fully felt in 2017, potentially “placing even greater pressure on firms who may not have experienced the levels of productivity and revenue growth to justify raising salaries, but who did so to remain competitive in the talent market,” according to Citi/Hildebrandt. Additional pressures on expenses will come from:

- The continuing trend of hiring high-caliber non-legal professionals (e.g., CFOs, COOs, CIOs) to lead key business functions.
- More investment related to the adoption of artificial intelligence and cybersecurity solutions.

Alternatively, law firms are expected to focus on improving efficiency, such as reducing office space and making changes to their leverage model, as a way to save money.

Citi/Hildebrandt expects that in order to maintain a strong balance sheet in the context of a turbulent market, most firms will continue to raise partner capital requirements, a trend that’s been ongoing for many years. With firms looking to invest in new technologies, institutional borrowing in the current low-rate environment should also be expected in the years ahead.

**2017 Market Trends**

There are a number of overarching themes playing out across the legal industry. The following table, a summary of trends identified by Citi/Hildebrandt, explores major trends and key market characteristics that will impact firm business models.

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<thead>
<tr>
<th>Source: Citi/Hildebrandt</th>
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<tbody>
<tr>
<td><strong>Macroeconomic fragility and uncertainty</strong></td>
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<tr>
<td><strong>Erosion of client loyalty</strong></td>
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<tr>
<td>Intense pricing pressure</td>
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<tr>
<td>Technology, artificial intelligence, cybersecurity and data privacy</td>
</tr>
<tr>
<td>Shrinking talent pool</td>
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<td>Continued market consolidation</td>
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**A Buyer’s Market – Shifting Client Preferences**

The legal industry remains characterized as a buyer’s market. This is a trend that’s been ongoing for a number of years, but one that is becoming more entrenched as the purchasing of legal services by corporate clients has become more diversified. Clients are looking to find the best value for their money and, as such, are spending less on traditional (and often expensive) law firms to help them meet their legal needs.

For instance, Deloitte found that the overall demand for legal services by in-house legal departments, as well as their legal spend, was increasing, but that their purchasing patterns were changing. Notably, the in-house lawyers and executives surveyed by Deloitte shared that traditional law firms are failing to meet their business’ legal needs. More than half of them (55 percent) said they had taken steps, or were considering doing so, in reviewing their current supplier of legal services.
While corporate clients have been channeling their legal spend in several non-firm directions, insourcing legal work remains the most common alternative. On that front, data collected by Thomson Reuters for its 2016 Legal Department In-Sourcing and Efficiency Report indicated that in an attempt to free up more time for their in-house lawyers, so they can insource more substantive legal work, big companies have been increasingly turning to legal department operations (LDO) professionals to manage the operations of their legal departments. “Bringing in LDO professionals to concentrate on business operations allows corporate counsel to focus on legal work and become more proactive and strategic in how they advise the business. With more time dedicated to the practice of law for these corporate counsel, less work has to go to outside counsel,” Thomson Reuters reports. Financial planning, project management and outside counsel management are some of the main responsibilities undertaken by LDO professionals. An additional step taken by corporate clients to reduce their legal spend has been to adopt new technologies, especially solutions for document/knowledge management.

The growing practice of large companies hiring non-legal professionals to manage the operations of their legal departments, including the procurement of outside legal services, also suggests that the nature of the relationship between law firms and their corporate clients is changing; it is becoming more transactional. Law firms, once considered a company’s trusted advisor, are now often downgraded to the less prestigious status of vendor. The fact that many companies now regularly use RFPs to vet law firms is a testament to this change in mindset. As Bloomberg Law suggests: “No doubt all this comes, in part, as response to billing excesses by firms and the erosion of trust that has created. At the same time, clients either value a law firm – and specific lawyers – or they go elsewhere. [...] It’s the free agency era.” In other words, choosing a legal service provider has less to do with loyalty these days than finding the best value for money, as the refrain goes.

To meet this challenge, law firms have been – in a way that essentially mirrors what corporate legal clients are doing – hiring non-legal professionals to help them manage their business operations and cultivate more proactive client relationships. A growing number of Am Law 100 firms have invested in the field of legal project management, hiring project or pricing managers to track progress and data, which is then used to update clients on the work that’s been accomplished and what’s left to be done. This provides clients with more predictability and transparency when it comes to costs.

Furthermore, Deloitte found that one in three in-house legal departments purchasing legal services said that they would like their legal services provider to bring industry, commercial and non-legal expertise to the table. Deloitte also added that clients “want law firms to be more savvy on global data and cybersecurity protection issues and more proactive in sharing knowledge across many jurisdictions.”
Cost isn’t the only reason corporate clients are choosing to insource their legal work. As Legal Mosaic CEO Mark Cohen puts it: “Knowledge of the client’s business is another key factor in the corporate build-up. True, the best lawyers (law firm or in-house) acquire a keen understanding of their client’s business; however, most firm lawyers are removed from the actual client. In-house counsel, by contrast, are embedded with the client, operate under its management and DNA, and are expected to ‘provide answers’ to business challenges. Translation: in-house lawyers enjoy a ‘home field advantage’ over their law firm counterparts, and they are expected to function not simply as lawyers but as business partners with legal expertise.”

**Legal Tech Becomes a Bigger Reality**

While corporate legal departments have started to embrace the idea that technology could allow them to become more efficient – spending less time searching for information, for instance – there is still “room for growth in technology across legal departments,” Thomson Reuters stresses.

Although many companies have yet to board the legal technology train at exponential rates, legal software company Mitratech found that corporate legal departments now spend about $1.5 billion on software on an annual basis, but that amount could more than quadruple in the span of a few years. According to Mitratech, knowledge management, legal analytics, legal project management, contracts management and governance and compliance software are the legal technology areas that are growing at the fastest pace.
Some lawyers view the invasion of technology in the industry as a threat to the way they’ve traditionally done things, while others see it as an opportunity to gain a competitive advantage with clients that are asking for more efficiency from their law firms. “The firms that see this as an opportunity and who are pursuing innovation to meet clients’ needs are already seeking licensing agreements or joint partnerships with those players involved in artificial intelligence,” conveys Gretta Rusanow, head of advisory services for City Private Bank.

**Artificial Intelligence and Law**

Technologies that fall under the category of “artificial intelligence” – machine learning, natural language processing, expert systems and others – enable computers to complete legal tasks they were not able to perform in the past, helping law firms become more efficient by reducing the amount of time it takes to complete specific tasks or by simply taking duties away from human lawyers.

In an article published in *Forbes* magazine, Legal Mosaic CEO Mark Cohen wrote that while artificial intelligence will not replace lawyers, “it will profoundly alter the way legal services are delivered. It will redefine the tasks and functions lawyers perform as well as the business models delivering them.”

Corporate clients are attracted to law firms that use artificial intelligence solutions because they can curb the cost of legal work. As LexTalk notes, “clients primarily care about the accuracy, speed and volume of legal services, and in the past to improve those factors they have had to pay for the necessary labor costs of throwing more lawyers at a problem.” In addition, the adoption of artificial intelligence could prove to be a potential solution for law firms looking to cut labor costs or those that are faced with a shortage of new, young lawyers. The president of the Jacksonville Bar Association, Geddes Anderson Jr., states in no uncertain terms that “the traditional revenue structure of teams of associate attorneys billing at high hourly rates to review ESI, conduct nationwide research on a body of law and prepare multiple versions of lofty memorandums will not survive the rise of artificial intelligence.” The reason that clients in the near future will simply refuse to pay for some mundane legal work is because artificial intelligence solutions can do the same work – like preparing thousands of documents to
complete a real estate transaction – with as just as much accuracy, if not more, and in a fraction of the time.

Powered by IBM’s Watson, the “artificial intelligent attorney” developed by Ross Intelligence is a great example of how artificial intelligence is changing the way legal work is approached. Nicknamed Ross, the virtual assistant “uses natural language processing to understand questions posed to it by lawyers and to return information on relevant court cases and legislation in a matter of seconds,” Law360 notes. The virtual assistant has been tested by about 20 law firms. It has learned bankruptcy law and is expected to branch out into other practice areas like labor and employment, intellectual property, tax law and personal injury. Several firms have already struck licensing agreements with Ross Intelligence for Ross.

With the advent of artificial intelligence, some law firms are now able to diversify their service offerings and fee structures, stepping away from the billable hour model that continues to grow unpopular with clients. Because lawyers’ time is not scalable, that model puts a hard cap on the amount of money a firm can generate without increasing hourly rates. The use of artificial intelligence technology could allow law firms to be more economically scalable. For instance, Law360 reports that some firms have started to offer “based fixed-price pay models on so-called expert systems, a kind of artificial intelligence that replicates expert knowledge to offer legal advice according to users’ responses to a series of questions.” Software companies like Neota Logic have developed expert systems allowing firms to build custom applications that are able to provide on-demand guidance to clients. Not only can firms charge a subscription to give clients access to the applications, but it frees lawyers from having to answer the same kinds of questions over and over again. Experienced lawyers are then consulted by these same clients for high-level analyses when required, for which they won’t mind paying the typical hourly rates.

The Players
There is an increasing number of startups emerging in the legal tech space. The following image, produced by CB Insights, illustrates some of the market leaders and up-and-comers in legal tech as well as their respective functions and capabilities.

Source: CB Insights
NewLaw – The Threat of Alternative Legal Service Providers

Traditional law firms continue to face pressure from an endlessly evolving group of competitors. Dubbed NewLaw, flexible alternatives to the BigLaw business model continue to disrupt the status quo – reducing costs and ushering in new value propositions for clients. Beyond the rise of boutique firms – firms that focus on a niche area of practice – the pool of alternative legal service providers continues to grow in its “types” of players. Ranging from legal process outsourcers to secondment and virtual firms, among others, each has varied characteristics and capabilities, but all cater to a general counsel’s demand for “more for less.” And, although alternative service providers currently represent only 1 percent of the legal market, which is leading many traditional firms to turn a blind eye, these disruptors are expected to grow exponentially by 2020 at an annual growth rate of 20 to 30 percent, picking away at traditional law firm revenue (and client relationships) one move at a time.

Alternative Legal Service Providers

The threat of alternative legal service providers is not a new development – the space emerged nearly two decades ago. Industry leaders, such as Axiom, have found their place in the industry, offering legal services without practicing law (something that – for now – is restricted in the U.S.).

Companies that followed in this group’s footsteps have predominately stuck to lower-end, commodity-type work (e.g., e-discovery and legal process outsourcing); however, as more companies automate certain legal services or improve human capabilities tied to such services, the threat of disruption continues to build.

When reviewing the differences between traditional BigLaw and NewLaw, three characteristics stand out, according to law practice management software company LegalTrek: flexible work arrangements, alternative fee arrangements and the active use of legal technology. Each of these NewLaw features brings its own benefits in the eyes of clients:

- **Flexible work arrangements** – Moving away from the 2,000-hours-a-year model at traditional firms, NewLaw models give lawyers greater flexibility and freedom as well as a better work-life balance.

- **Alternative fee arrangements** – Alternative fee arrangements, according to some firms using these fee structures, have outperformed the billable hour model in terms of benefits, value and efficiency, leading to cost savings for clients and a reduction in administration requirements for firms.

- **Legal technology** – Legal technology is streamlining aspects of workflow, improving communication and increasing transparency, all aspects of legal services that clients are demanding.

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1 Axiom is now one of the largest providers of legal services in the U.S., counting over half of the Fortune 100 as clients, according to the University of California, Hastings College of the Law.
The Big Four

The threat of the Big Four accounting firms has largely remained off many traditional law firms’ radar in the U.S. This is likely due to the fact that the Big Four are prohibited from practicing law in this jurisdiction. But, developments continuing to unfold elsewhere in the world are raising the stakes for this group of heavy hitters to significantly disrupt the legal industry. U.S. firms, particularly those with multinational clients and operations, should be attuned to the value proposition the Big Four can provide in regions where alternative business structures (allowing non-lawyer firm ownership) are permitted (e.g., Canada, the U.K., Australia and Singapore).

In an effort to cater to the complex needs of global organizations, the Big Four are effectively positioning themselves as multidisciplinary professional service organizations (MDPs) – that is, offering the full gamut of professional services. They are doing this organically and through acquisitions. With deep pockets, ample staffing resources, world-renowned brand recognition and cross-border capabilities, the Big Four are offering a value proposition that many companies can’t ignore. In structuring their legal service offerings in a manner that complements their existing consulting, transactional, tax, compliance and risk management offerings, this group of disruptors is becoming a one-stop shop for large multinationals – strengthening their provider-client relationships and creating efficiencies in complex multi-practice dealings.

Although regulations in the U.S. still prohibit the Big Four from practicing law, there’s a certain sentiment that this could change in the coming decade. Alternative business structures are seen as a method to promote competition within the legal industry, and an increasing number of jurisdictions are allowing their presence.
The Staffing and Succession Challenges

Even though overcapacity and underutilization of resources are recognized by many law firms as significant problems, the market for lateral hires remains as active as ever. “The lateral frenzy underscores the fact that a main growth strategy for firms continues to be taking market share from competitors via productive laterals,” *The American Lawyer* explains. This is based on the assumption that lateral hires bring their clients with them. As such, the law firm from which the partner has been poached typically loses business in the process. Partner poaching, however, is not without risk.

For the hiring firm, Thomson Reuters notes, the failure of a lateral partner hire to meet or exceed expectations – by bringing in a sufficient number of new clients to the firm, for instance – can potentially affect the firm’s bottom line and the payouts to equity partners. Thomson Reuters goes on to cite a study from professors at Indiana University and Penn State University that found “zero statistical evidence that an aggressive lateral partner hiring strategy in and of itself is associated with greater law firm profitability.” That said, because of ongoing merger talks and financial instability, law firms will continue to be on the lookout for prominent business-generating partners, although their approach may become more cautious.

To deal with the problems of overcapacity and underutilization, national legal staffing and outsourcing company Lumen Legal recommends that law firms align themselves “on a lawyer staffing strategy that sets a target for the percentage mix of permanent vs. contract lawyers.” This would allow firms to better handle the peaks and valleys of their workloads, it says. “As law firms look to staffing adjustments as a way to maintain or fatten their profit margins, and young lawyers seek alternate employment routes in lieu of the traditional partner track, the role of contract attorneys is likely to gain prominence,” *The Legal Intelligencer* contends. While the use of contract attorneys is not new, it has become more widespread as law firms’ e-discovery needs increase and as firms attempt to lower their overhead costs by cutting the expense of employing full-time associates.

The majority of law firms, the Altman Weil survey found, practice some form of labor arbitrage, either shifting work to less costly lawyers or to part-time and contract lawyers to meet demand while lowering costs.

### Comparison by firm size:

<table>
<thead>
<tr>
<th></th>
<th>Under 250 lawyers</th>
<th>250 lawyers or more</th>
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<tbody>
<tr>
<td>Using part-time lawyers</td>
<td>52.7%</td>
<td>75.3%</td>
</tr>
<tr>
<td>Using contract lawyers</td>
<td>49.4%</td>
<td>75.3%</td>
</tr>
<tr>
<td>Using staff lawyers</td>
<td>33.7%</td>
<td>78.8%</td>
</tr>
<tr>
<td>Outsourcing non-lawyer functions</td>
<td>21.8%</td>
<td>30.6%</td>
</tr>
<tr>
<td>Creating a low-cost service center for back office</td>
<td>5.8%</td>
<td>21.2%</td>
</tr>
<tr>
<td>Outsourcing legal work</td>
<td>6.6%</td>
<td>15.3%</td>
</tr>
<tr>
<td>None of the above</td>
<td>23.5%</td>
<td>4.7%</td>
</tr>
</tbody>
</table>

Source: Altman Weil
The practice of turning to part-time and contract lawyers also comes at a time when law school enrollment and applications are hitting historical lows. For the greater part of the last half century, law school was considered a growth industry, with enrollments peaking at just shy of 38,000 in 2010. But since then, enrollments have fallen by more than 30 percent. In 2016, the number of first-year students across the U.S. increased for the first time since 2010, albeit only slightly. *The National Law Journal reported* that American Bar Association-accredited campuses accounted for an additional 36 first-year law students in 2016, for a total of 37,107. In other words, enrollment remained flat. Overall, students enrolled in Juris Doctor programs “fell from 113,900 in 2015 to 100,951 in 2016, a nearly 3 percent decline that reflects the fact that each graduating class is slightly larger than the ones behind it,” *The National Law Journal added*.

Both the practice of hiring contract or part-time lawyers (instead of hiring full-time associates) and the decline in the number of law school graduates, which points to a potential shortage of legal talent in the near future, might eventually become problematic for law firms as they come to terms with the looming issue of succession planning.

According to an article published in *The American Lawyer*, lawyers from the boomer generation and a smaller number of over-70s from the silent generation account for almost half of all partners at Am Law 200 firms. Being the partners with the greatest seniority, these lawyers make up the majority in the equity and management ranks of law firms while also controlling the larger share of client relationships. The impact of their retirement, especially since the hiring and promoting of lawyers have slowed down since the financial crisis of 2008, should not be underestimated. The main risk related to these retirements is the potential loss of clients. “Firms that aren’t focused intently on transitioning client relationships by now – particularly firms that emphasize originations and billings over collaboration – are at greatest risk,” the same article states. It goes on to add: “Firms are also facing increased obligations or costs associated with retired partners. A minority with unfunded pension obligations [...] face increased costs as fewer current partners support successively more retired partners. Firms with tax-qualified defined benefit plans [...] carry the risk of topping-up costs if a retirement investment portfolio underperforms. And with partnership headcount flat, most firms are returning more in capital to retiring partners than they’re taking in from new junior partners.”

The succession planning challenge may help explain why some law firms are on the lookout for lateral hires. But at a time when firms are feeling the pressure of the rapidly changing market landscape, the issue of succession planning should remain top of mind – this could be the factor that separates the next set of leaders in the race to retain/gain talent and market share.

**Consolidation – A Continued Theme**

Altman Weil reported that there were 85 law firm mergers in the U.S. in 2016, marking the fourth consecutive year that the total of combinations hit 80 or more. *According* to Altman Weil principal Tom Clay, “it’s a post-recession reality that with market demand flat-lining, the most-effective way to add new business is to acquire another law firm. [...] But as the supply of prime targets inevitably shrinks, we expect the competition to make high-quality deals will intensify in 2017.”
The largest law firm consolidation of the year took place in mid-December when Eversheds, a London-based firm that employs about 1,900 lawyers, joined forces with Atlanta-based Sutherland Asbill & Brennan (about 400 lawyers) to form a new global firm. The combination was one of eleven other cross-border deals announced in 2016, a record year for international tie-ups. The biggest move by a U.S. law firm was Littler’s acquisition of 170-lawyer Paris-based firm Fromont Briens.

Within the U.S., Washington, D.C.-based Arnold & Porter and New York-based Kaye Scholer joined forces (effective January 2017), marking “a rare merger of Am Law 100 law firms [...] that created a new 1,000 lawyer Middle-Atlantic powerhouse,” Altman Weil said. Other domestic moves included the addition of 110 lawyers to Baker Donelson’s ranks with its acquisition of Baltimore-based Ober Kaler, and Husch Blackwell’s Midwestern expansion with its acquisition of Whyte Hirschboeck Dudek in Milwaukee, which increased its total headcount to about 700 lawyers.

Along with some of the large-firm combinations mentioned above, 2016 saw a string of smaller acquisitions. In fact, roughly 85 percent of all mergers in 2016 involved small firms with 20 or fewer lawyers, and just over half of the deals were same-state combinations. The acquisition of smaller law firms or boutiques remains part of many Am Law 100 firms’ strategies to gain market share amid stagnant demand for their services. That said, the legal industry has consolidated so much in the years following the 2008 recession that it is becoming more difficult to find acquisition targets. Some recent moves, however, were not mergers in the usual sense of the term, but mass lateral hires, allowing dissolving firms to shed liabilities. For instance, Houston-based Andrews Kurth increased its headcount by taking on 55 lawyers from New York-based IP boutique Kenyon & Kenyon. With law firms on the lookout for talent, it is possible that mass lateral hires could continue in the future as a substitute to consolidation.

Who’s Winning?

Firm Reactions and Strategies
Proactive law firms are recognizing the threat (and the potential) these disruptive trends present for the industry and for their revenue. Rather than dismissing these developments, firms on the leading edge are identifying ways to shed costs, expand offerings and attract new talent. Many of them are entering collaborative partnerships with alternative legal service providers and startups or building their own alternative legal service provider capabilities in-house.

Other firms are moving to offer non-legal services (e.g., tax) in an effort to build their value proposition for clients – and possibly prepare themselves for the looming threat the Big Four present.

The reality for a lot of firms, however – apart from those with the largest legal departments – is a lack of resources needed to completely overhaul their business model or to launch their own alternative service models and offerings. As 2017 unfolds, it is likely that there will be greater collaboration between legal services vendors, legal tech startups and other emerging players looking to scale up and traditional law firms looking to meet changing client demands.
Traditional firms will need to look at areas of their operations and offerings where automation is possible and work to identify where they can reduce costs and increase efficiencies for their clients. As the threat of legal tech, alternative legal service providers and the Big Four becomes a bigger reality, traditional firms that do not equip their toolbox with the proper tools risk losing client relationships and revenue to firms that do.