



## Spotlight on the Legal Services sector

2015



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# Executive summary

**A**s the legal marketplace in Canada and globally continues to change and evolve, it is affected by globalization, economic uncertainty, corporate consolidation, and an increasingly digital world. Clients are demanding greater transparency and increased service quality, and at the same time seeking better value. Law firms continue to adapt to a marketplace where global competitors are at their doorstep and new, disruptive sources for legal services are constantly being developed. Non-traditional players, such as Cognition, AdvanceLaw and CanLII, continue to expand into the legal space. As a result, Canada's law firms need to be more nimble to stay relevant and competitive in a shifting market.

Deloitte surveyed 28 law firms about their sector, growth opportunities and productivity management. We found that the outlook is cautiously optimistic for growth in business and profitability in the next 12 months. Client service continues to be the top priority for law firms. And despite consolidation being an increasing concern, the majority of Canadian firms would prefer to remain as independent firms.

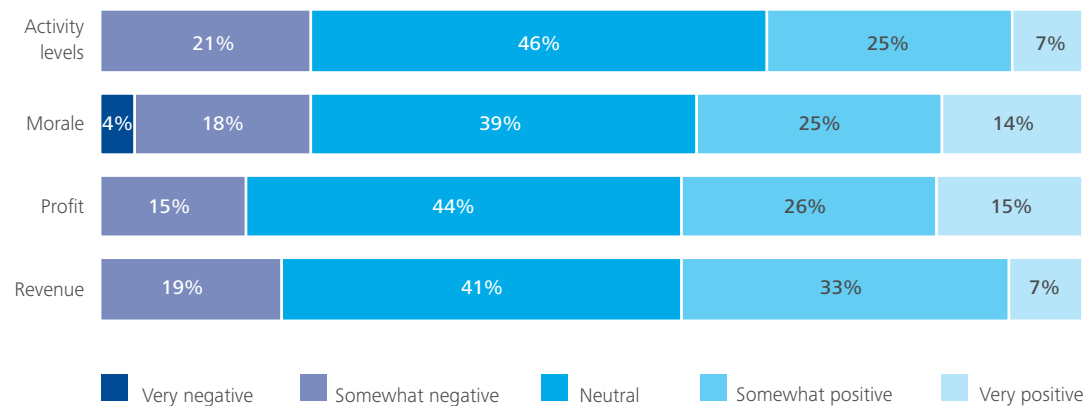


# The landscape

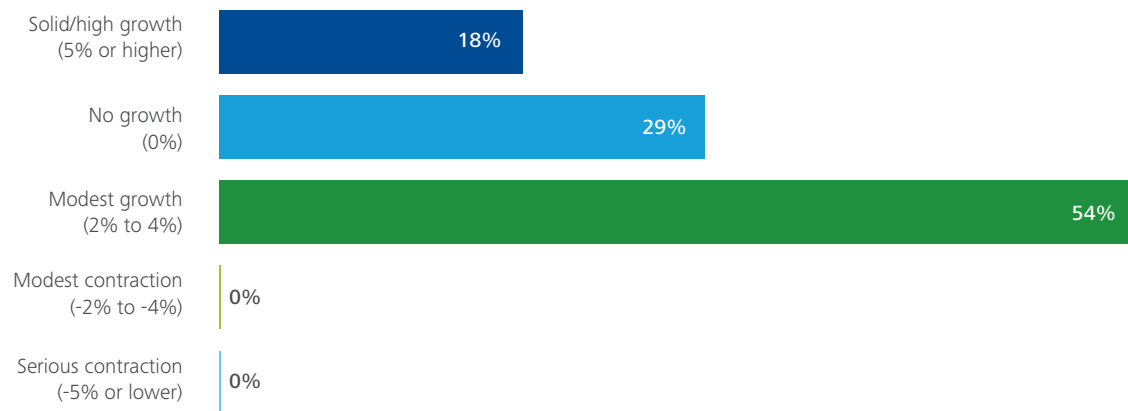
Things are looking up for Canadian law firms. Economic conditions in Canada over the past year have resulted in slightly positive revenues and profits, and most firms are planning for a modest 2-4% growth, an improvement from the previous year.

Top practice areas that have shown growth recently are Business Law, Intellectual Property and Labour Law. Bankruptcy, Insolvency and Restructuring, and Real Estate, however, all showed activity decreases.

## What has been the impact of the economic conditions on the following areas of your firm over the past 12 months?



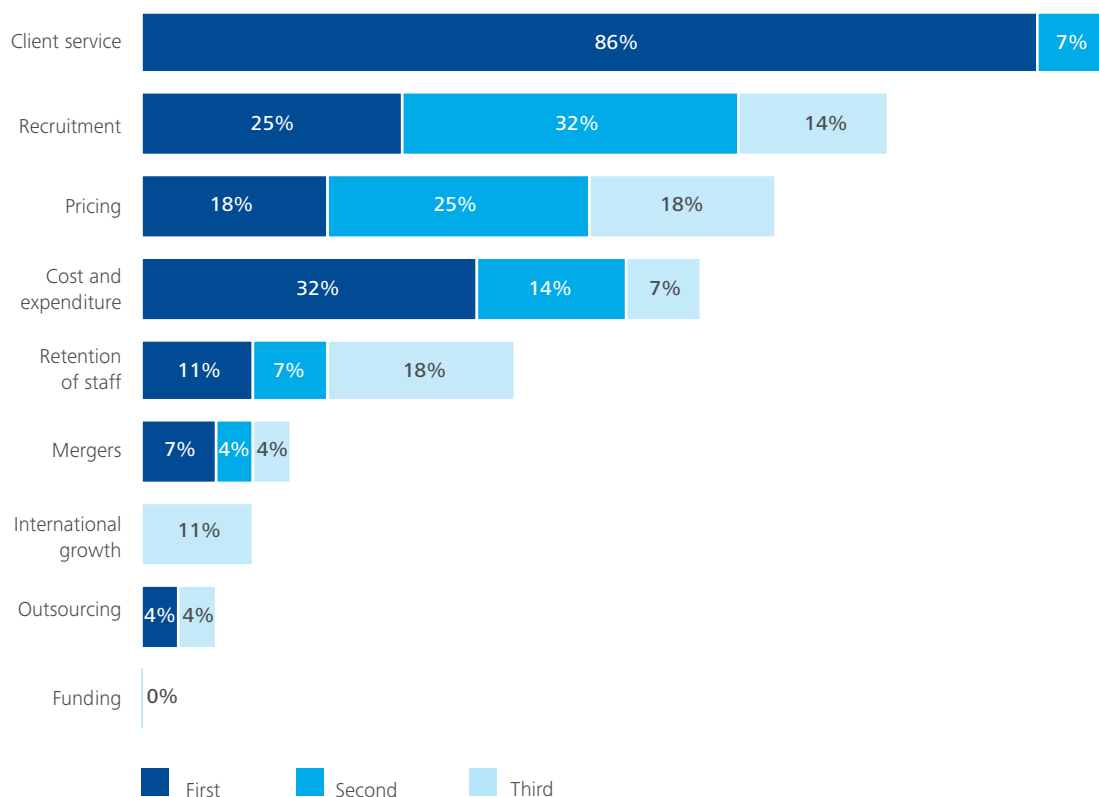
## What economic scenario are you planning for over the next 12 months?



Despite this more positive trend, firms cited the Canadian economy as their greatest threat over the past year. Holding steady from last year, Canadian competition continued to be a concern. Critically, a growing number of law firms are citing the U.S. economy as well as non-Canadian firms entering the country as threats, likely sparked by an influx in global firms entering the local marketplace.

Client service continues to be the top area of focus, a trend that continues from last year. Though still in the top three, recruitment and pricing have dropped farther down the list of strategic priorities. Conversely, we continue to see cost control and the potential for mergers gaining footing as key concerns. Innovation in technology and service delivery continue to be named the biggest impacts affecting marketplace change in the coming years.

### Thinking about your firm's current strategic priorities, what are your top three areas of focus?



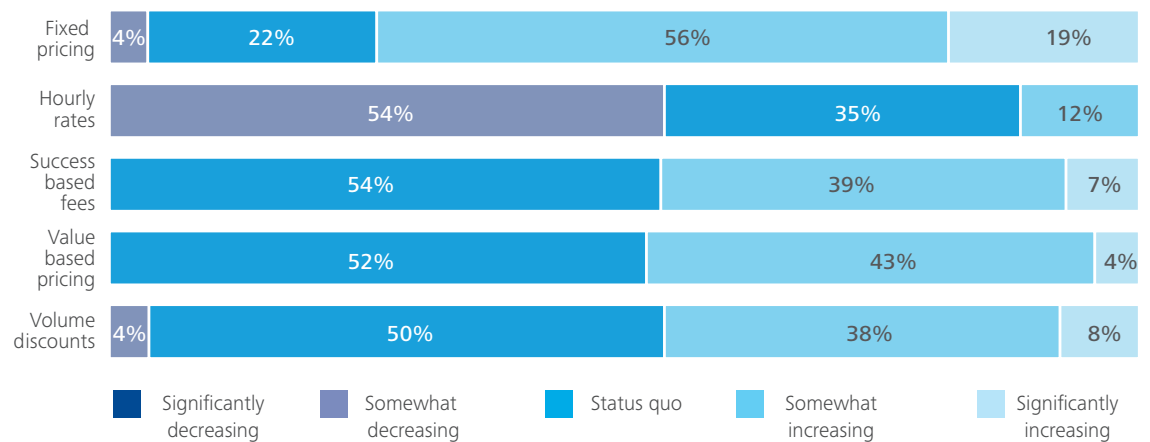
“Law firms need to be more collaborative and entrepreneurial in order to ensure long-term success. A more adaptable, more client service oriented firm will be able to fulfill a role not just in a legal capacity, but in an advisory capacity as well.”

Karen Werger, Partner, Financial Advisory

Through our own work, we observed that managing the rapidly changing dynamics of client service is a key concern for law firms. That said, the majority of firms surveyed feel that service delivery will not be a primary driver of market change in the future. The primary challenges law firms will face will be to manage practice group 'shape' (the number of lawyers and the number of paraprofessionals), quality, capability, pricing and profitability relative to the demands and needs of clients along with their service expectations.

Downward pricing pressures continue to increase for several reasons, including international firms quoting aggressive prices in order to gain market share, clients consolidating their list of approved firms to realize efficiencies and in-house counsel increasingly becoming demanding in requesting large discounts or alternative fee arrangements (AFAs).

### How did the frequency with which you use the following pricing structures change over the past 12 months?



“Law firms are beginning to achieve the benefits of reshaping and managing their practices in a disciplined yet innovative manner.”

- Chris Lynch, Partner, Monitor Deloitte

An increasing number of firms are using alternative pricing models. These structures include fixed pricing, volume discounts, value-based pricing and success-based fees. Not surprisingly, traditional hourly rates are showing a slightly decreasing trend in light of the emergence of other models.

The majority of firms are now leveraging AFAs in Canada and are beginning to experience success with their clients in this regard. Some firms are looking to analytics tools to drive matter pricing and profitability analysis.

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“When analyzing years of historic and current data (e.g., Human Resource, billing, client profile, engagement or matter types, etc.) we are revealing new insights to management as to what ‘profitable’ matters look like across each of the service offerings. Through the application of analytics and the visualization of operational insights, firms are identifying new opportunities to change pricing and engagement practices to optimize margins.”

- David Stewart, Partner, Analytics and Forensic Technology

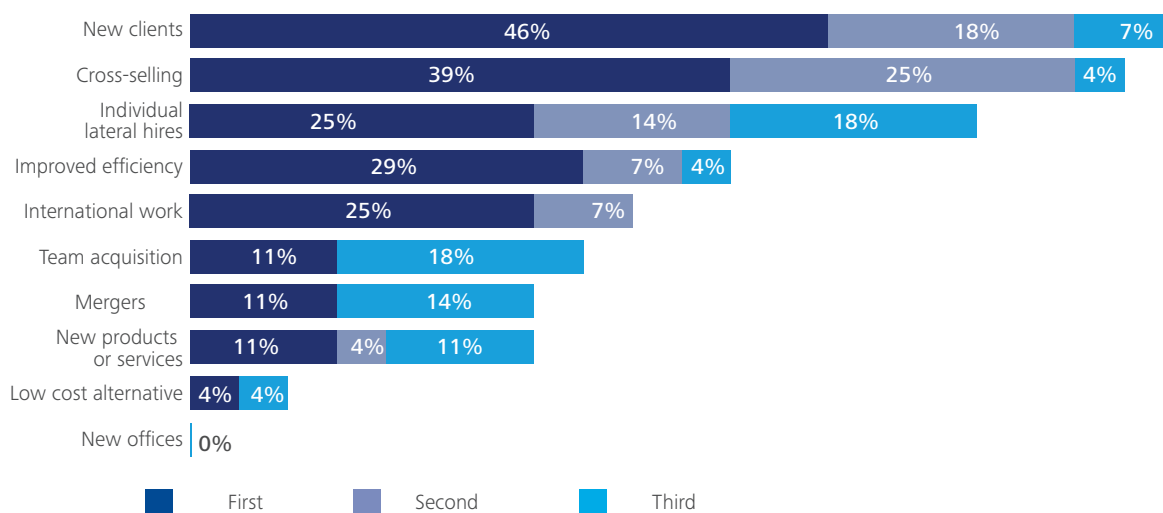


# Growth

Law firms continue to look at opportunities to build their businesses. While last year, cross-selling was ranked the #1 growth opportunity, this year it fell to second place, replaced by new client acquisition. For example, many firms are doubling down on their investments in industry and client planning.

International work, individual lateral hires and improved efficiency were also rated highly as potential avenues to increase market share. Mergers and acquisitions, along with new products and services, were all noted as moderate growth areas.

## What do you consider to be the greatest growth opportunity for your firm over the next 12 months?



Translating opportunity into action, firms are increasingly investing in cross-selling and building client relationships. Partner-time is being dedicated (and recognized) more towards sales at the expense of partner billable hours, which are beginning to be de-emphasized, albeit at a gradual pace. Additionally, firms are continuing to deepen their understanding of their clients' businesses and deliver value-add services, such as providing industry 'know-how' and insights, and broader project management skills.

### For example:

One regional firm is looking to drastically alter its partner incentives and compensation in order to encourage more profitable behaviours for the firm. Emphasis of incentive structure is shifting to sales-oriented metrics, in order to better capitalize on cross-selling opportunities, deepening of client relationships and acquisition of new business.

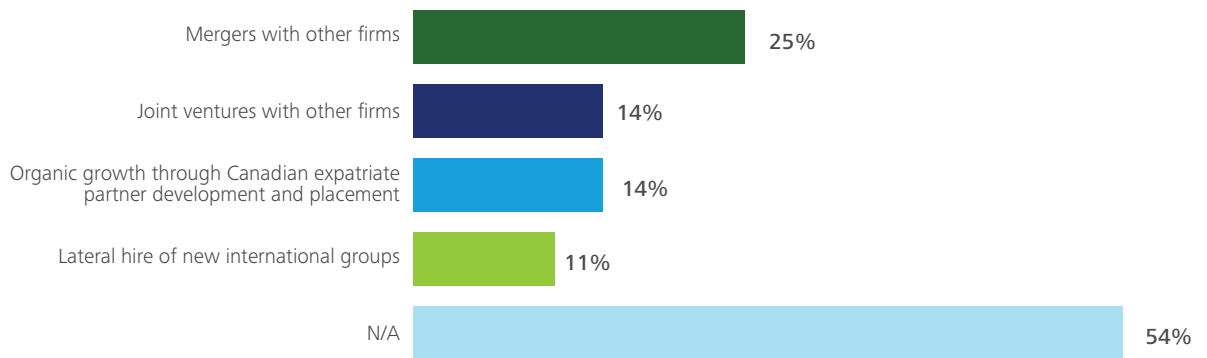


# International expansion

With international firms having a greater presence in Canada, it is only natural that Canadian firms would be exploring their opportunities to grow their businesses outside Canadian borders. Half of the firms surveyed have considered ways in which they would expand internationally. A quarter of respondents cited risk and cost as barriers to international expansion, followed by culture (19%). Economic uncertainty (14%) and regulation (12%) were also noted as obstacles to cross-border growth. Many law firms have refrained from expanding to the U.S. market to avoid conflict situations with U.S. firms that refer inbound work to them; the U.S. market is the largest source of inbound work for many large Canadian law firms.

For firms considering international expansion, both smaller and larger firms cited joint ventures with other firms as a preferred entry point. Larger firms were more likely to also include mergers with other firms or developing and placing Canadian expatriate partners as a means of expansion. A wide range of locations were cited as geographic expansion priorities, including traditional high-volume regions like the U.S. and Europe, in addition to emerging, high-growth regions such as Africa, China and Southeast Asia.

## How would your firm consider expansion internationally?



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“The most ambitious firms are finding ways to deliver legal services for their clients, wherever their clients are around the globe.”

- Steve Quinn, Manager, Monitor Deloitte

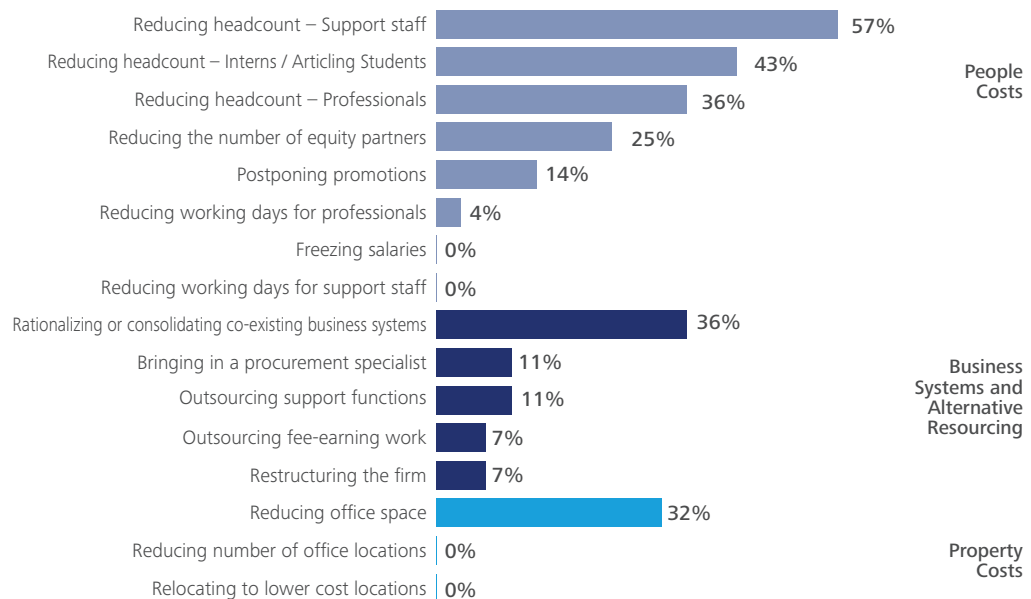
# Performance and productivity management

Law firms continue to investigate ways to reduce their overall cost base. In these efforts, reducing the headcount of support staff, professionals, interns and students was reported as a necessary measure, as well as consolidating co-existing business systems and decreasing property costs through reducing office space. Worth noting is that many Canadian law firms are beginning to assess the health of their business through the lens of firm net income and overall firm revenue – metrics that seem to have surpassed the traditional profit per equity partner measure in importance.

Despite growing concerns surrounding reducing costs and expenditures, most firms do not outsource to legal process outsourcing (LPO) services. Some firms, however, are partially outsourcing e-discovery technology services, which include data collection, processing and hosting.

When selecting an outsource provider, quality is the most important factor and price is second, providing an explanation for the hesitance to outsource to another country if quality is thought to be lower. The perceived lack of scale for many firms creates reluctance to outsource legal processes.

**To reduce your cost base, which of the following have you implemented in the last 12 months, or intend on implementing over the next 12 months?**

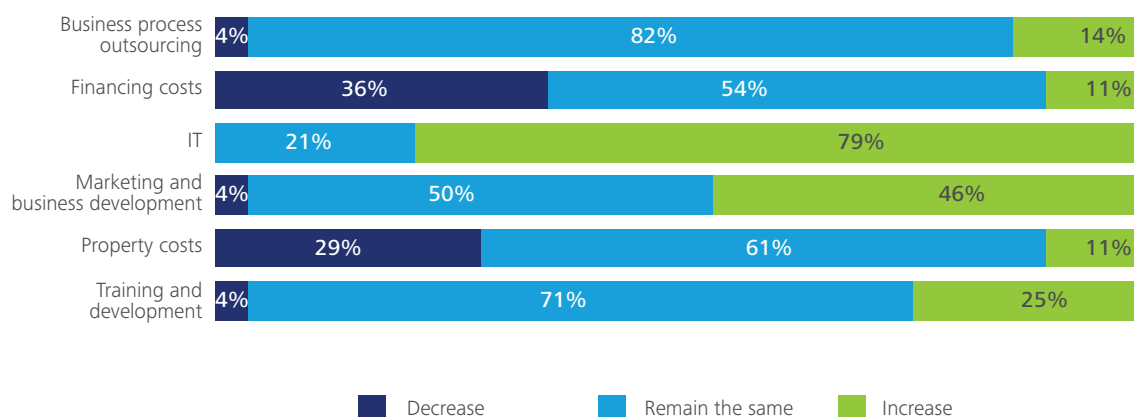


In terms of internal investments, IT is the area most likely to see an increase, largely as a means to improve efficiency, bolster client service levels and allow for better information management. For example, deepening capabilities of Matter Pricing Analytics and Business Intelligence are experiencing significant investment activity. Marketing and Business Development also showed signs of increasing. Firms are also reporting that the non-equity career paths they have in place cover a range of positions, from counsel and associate straight through to director or income partner. Several firms are looking to expand their non-equity career paths, as they aim to alter the 'shape' of their practice.

#### For example:

Leadership from a national law firm has taken action to allocate partners to a non-equity path and encourage some associates to aspire to similar career routes in order to adjust the shape of their talent pool while maintaining productive, exciting roles for those involved.

### To reduce your cost base, which of the following have you implemented in the last 12 months, or intend on implementing over the next 12 months?



“Firms are now recognizing the importance of measuring the firm’s health as a business, rather than its health as a group of equity partners.”

– Michael Parent, Senior Manager, Monitor Deloitte

# Mergers

Current pricing pressures and the constant emergence of new local and international competition has kept M&A concerns a focus for many Canadian law firms. As a result, consolidation continues to remain a key topic in Canada's legal circles.

Two-thirds of respondents had merger discussions in the past year, an increase of about 10% from the year before. More significant, however, is that less than a third of firms who ended up in merger discussions this year predicted they would be doing so. With 43% of law firms expecting to engage in merger talks this year, the underlying potential for game-changing choices continues to influence the Canadian legal landscape. Similar to last year, many Canadian firms continue to be viewed as attractive targets for international mergers or acquisitions, implying that C-level executives of mid- to large-sized firms will continue to have international growth strategies to plan and evaluate.

Despite the prominence of merger discussions, 64% of firms reported that their ideal strategic step in 2015 and beyond is to continue as an independent Canadian firm and maintain the status quo. It is clear that some firms are considering alternative options, however, as only 14% of firms indicated they would prefer to commit to a full merger, while 21% indicated that they would prefer an alternative strategic option (such as a cost-sharing Verein structure, or a strategic alliance). Firms that expect to be involved in a merger or acquisition over the next 12 months are aiming to broaden their practice areas and secure a greater geographical presence.

**Have you been involved in discussions about a merger or acquisition in the past 12 months?**



**Do you expect to be involved in a merger or acquisition over the next 12 months?**

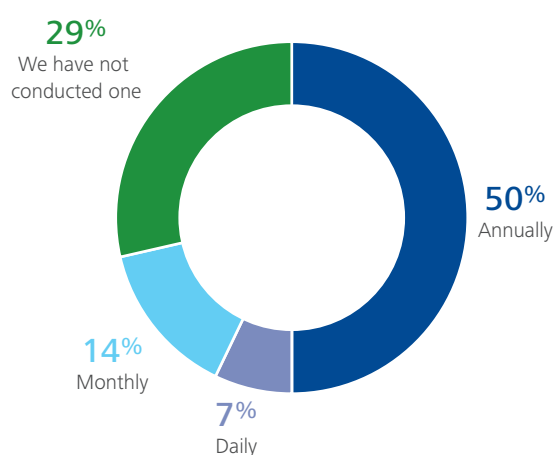


## For example:

A large Canadian firm is looking to expand its geographical footprint in order to better support its existing clients' international operations. Rather than expand organically, the firm has begun looking into alternative options with other global firms. The option of a strategic alliance allows for a 'trial period,' where firms can test the waters of international expansion, without the permanence of a fully integrated merger.

# Security & data

## How often does the firm conduct penetration testing of its network and systems?



In a world of constantly changing security risks, the threats that organizations must defend themselves against continue to increase. New to the survey this year, we asked Canadian law firms about how they defend against potential threats and how prepared they are.

Over half of firms have classified their data to determine its sensitivity to cyber breach, indicating that almost half of survey respondents may not fully understand the potential for cyber breach threats. Smaller firms are more likely than their larger counterparts to not have classified their data, partly due to smaller firms believing that their risk of being a target of physical or cyber-attack is low. Larger firms are more likely to be prepared, as the majority see themselves as a potential target. Firms tend to see themselves as adequately prepared, reporting a sufficient number of well-managed controls to effectively manage information security. Notwithstanding, penetration testing of networks and systems is mostly conducted by firms annually, showing a gap between anticipated cyber risk and action. Clearly, there is more to be done in this regard.

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“The game has changed. You need to understand the new rules in cyber security and to prepare for impending threats.”

— Simon Tang, Partner, Enterprise Risk Services

### For example:

Many executive leaders surveyed were not able to answer the cyber security questions without support from their IT departments. Although executive leadership does not need to know all of the details of their cyber security protocol, there is a risk when leaders are not broadly aware of the steps being taken to protect their firm.

# Deloitte's perspective

The legal marketplace in Canada and globally is fluid. Disruptive innovation, globalization and an increasingly competitive market will challenge Canadian firms in the near-term.

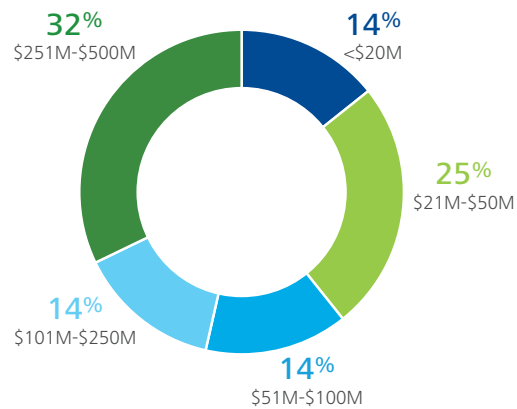
Deloitte's perspective is that Canadian firms can begin to address challenges with a few key actions:

- **Invest in your team:** Firms that invest in the development of their professional staff are also investing in their bottom line. Lawyers with strong project management skills and a deeper understanding of their clients' businesses are able to drive greater client impact and improve matter profitability.
- **Disrupt your business model:** Disruptive innovation is happening throughout the market. The firms who adapt to these new trends are the ones who will continue to be successful. What part of your business can you proactively disrupt this year? By finding additional value-added services for your clients, you can stay ahead of the curve.
- **Evaluate your growth options:** Sometimes, the status quo can be just as risky as pursuing new growth options. Whatever growth targets you have set, be sure to consider all possible options when targeting growth. Oftentimes, this 'blue sky' thinking brings leadership to strategies they never would have otherwise pursued.
- **Understand what really drives your business:** Stepping back can take you a step forward. Deepening your understanding of profit drivers through Analytics and visualization of historic and current operational insights can provide a laser-sharp focus on what matters really drive the business.
- **Educate yourself on cyber threats:** A single cyber breach could be enough to cripple any client service organization. The repercussions of these low-frequency, high-impact threats are often significant news media events. Don't let yourself become one of these statistics.

# Methodology

The findings of this report are based on the responses of representatives from 28 law firms across Canada.

Breakdown by size/revenue of the 28 law firms that participated in Deloitte's Canadian Law Firm survey



# Contributing authors



**Karen Werger**  
Partner,  
Financial Advisory  
kwerger@deloitte.ca  
+1 416 601 6058



**Michael Parent**  
Senior Manager,  
Consulting  
mparent@deloitte.ca  
+1 416 643 8396



**Chris Lynch**  
Partner,  
Consulting  
jclynch@deloitte.ca  
+1 416 601 6581



**Steve Quinn**  
Manager,  
Consulting  
squinn@deloitte.ca  
+1 416 775 8558



**David Stewart**  
Partner,  
Financial Advisory  
davstewart@deloitte.ca  
+1 416 775 7484



**David P Stewart**  
Consultant,  
Consulting  
davistewart@deloitte.ca  
+1 416 813 2346









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