



ACRITAS PATTERNS IN LEGAL SPEND REPORT

Part 1

A thought provoking look at patterns in legal spend as a proportion of revenue which points to the need for organizations to seek relevant benchmarks.

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June, 2017

Acritas
SHARPER INSIGHT

Executive summary

Legal spend is highly variable. The characteristics a company has are likely to define its level of spend – from headquarters location to industry sector and size, notwithstanding its geographic footprint, growth trajectory and approach to managing risk. In this report, we look to examine the differences observed across these characteristics with a view to helping organizations think more about the environmental factors that influence their spend levels and how they might be able to drive more value from their investment.

The dataset within this report is sourced from an annual, global telephone survey of approximately 2,200 senior in-house counsel across the globe. Respondents provide Acritas with their external and internal legal spend, team size and other demographic factors such as location, industry sector and revenue. We are able to calculate **the proportion of revenue allocated to legal spend** and compare this across different types of organization. We are then able to identify which types of organization are typically high spending and, conversely, low spending.

Globally, the median proportion of revenue spent on legal, both internally and externally, is 0.23% – in other words just under a quarter of 1%, but this is highly variable across different regions, industries and size of business. This means it is rarely useful to benchmark your organization against global or even country averages. You are unlikely to be in line. It is important to find a peer group benchmark.

To help companies find a more appropriate benchmark, Acritas created an algorithm, an estimating model which takes into account the different characteristics and provides a relevant benchmark for each individual organization. As the dataset builds, we continue to develop this model. We're currently looking at the different relationships between region, industry sector and size of business, where sometimes the effect of layering these characteristics can be cumulative, creating significantly higher spend.

Developing the model was not easy. We had to discard nearly 50% of the data, where people could not provide reliable spend data. But even within the 1,973 data points we did use, many companies were way out of line when compared to the average, either over-spending or under-spending. One in five respondents told us it had been a particularly high spending year, above their usual level of spend. This compared to only one in 20 who had experienced a particularly low level of spend. The over-runs were usually caused by extraordinary events, such as a large dispute or transaction, and on average caused a 50% over-run – something that CFOs need to be prepared for – typically once every five years.

In light of the range of responses and the pattern of data, we chose to run our analysis looking at the median average, the middle of the range, for each group, to remove the effect of outliers. This figure has stayed consistent for the last three years.



Key findings

REGIONAL DIFFERENCES

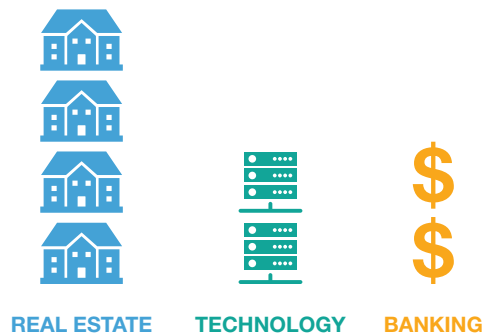
Across countries, the highest spending is the US, at nearly double the global average. This is partly driven by higher rates and higher salaries, but also the higher volume of legal needs when operating within the US. Conversely, the lowest was China, where the spend level is approximately an eighth of the global average.



Can you relocate any of your legal work to lower spending countries, or lower cost regions within countries?

INDUSTRY DIFFERENCES

Across industries, at a global level, real estate was the highest spending industry, at nearly four times the global average. This was followed by technology/media/telecoms and financial services who were spending nearly double the global average – although the pattern wasn't always consistent within each country. Lower spending industries were automotive, retail and food/farming, spending approximately half the global average. Going forward, as technology plays an increasingly important role in these industries, it will be interesting to observe whether legal spend increases to be more in line with the tech companies.



Is your organization a disruptive player in your industry and therefore likely to have a higher spend than more traditional competitors?

ECONOMIES OF SCALE

The biggest range in ratio of spend to revenue was observed by size of company. This is where economies of scale come into play. Those with revenues of less than \$500m were generally spending around 10 times the average ratio of those between \$6bn and \$20bn.

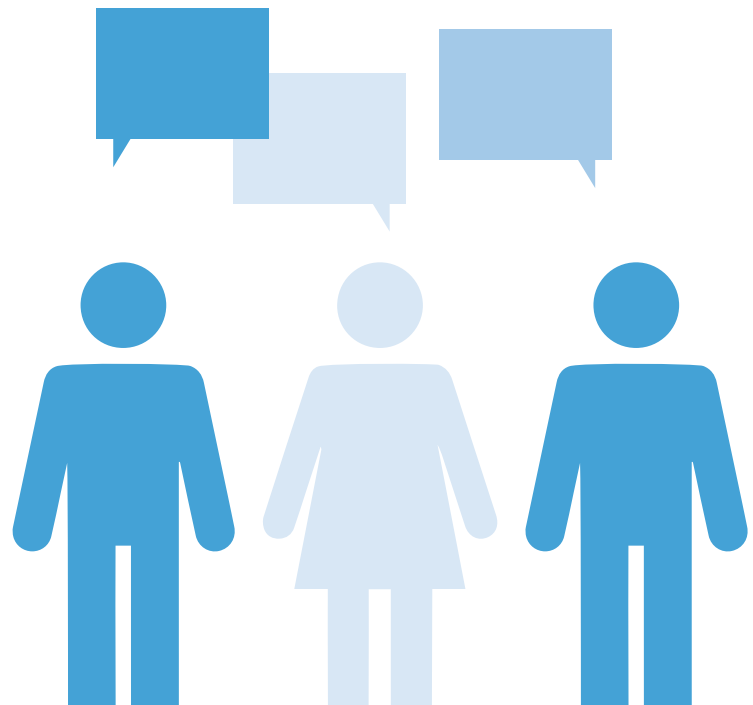
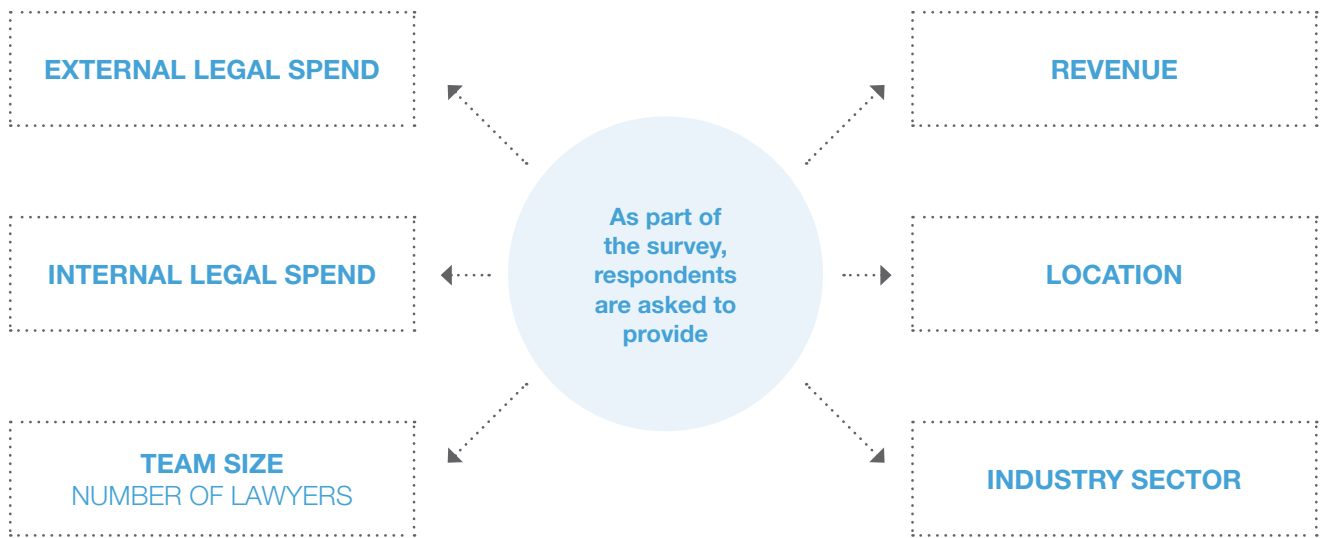


How can you access economies of scale earlier in your growth evolution?

We hope you enjoy this report, which is the first in a series. The next report will look at the influence of internal and external split of budget and provide team size benchmarks.

Methodology

Acritas conducts a global telephone survey of approximately 2,200 senior in-house counsel in large organizations across the world. Respondents are asked a range of questions relating to their goals, challenges, buying behaviors, perceptions and experiences with external providers.

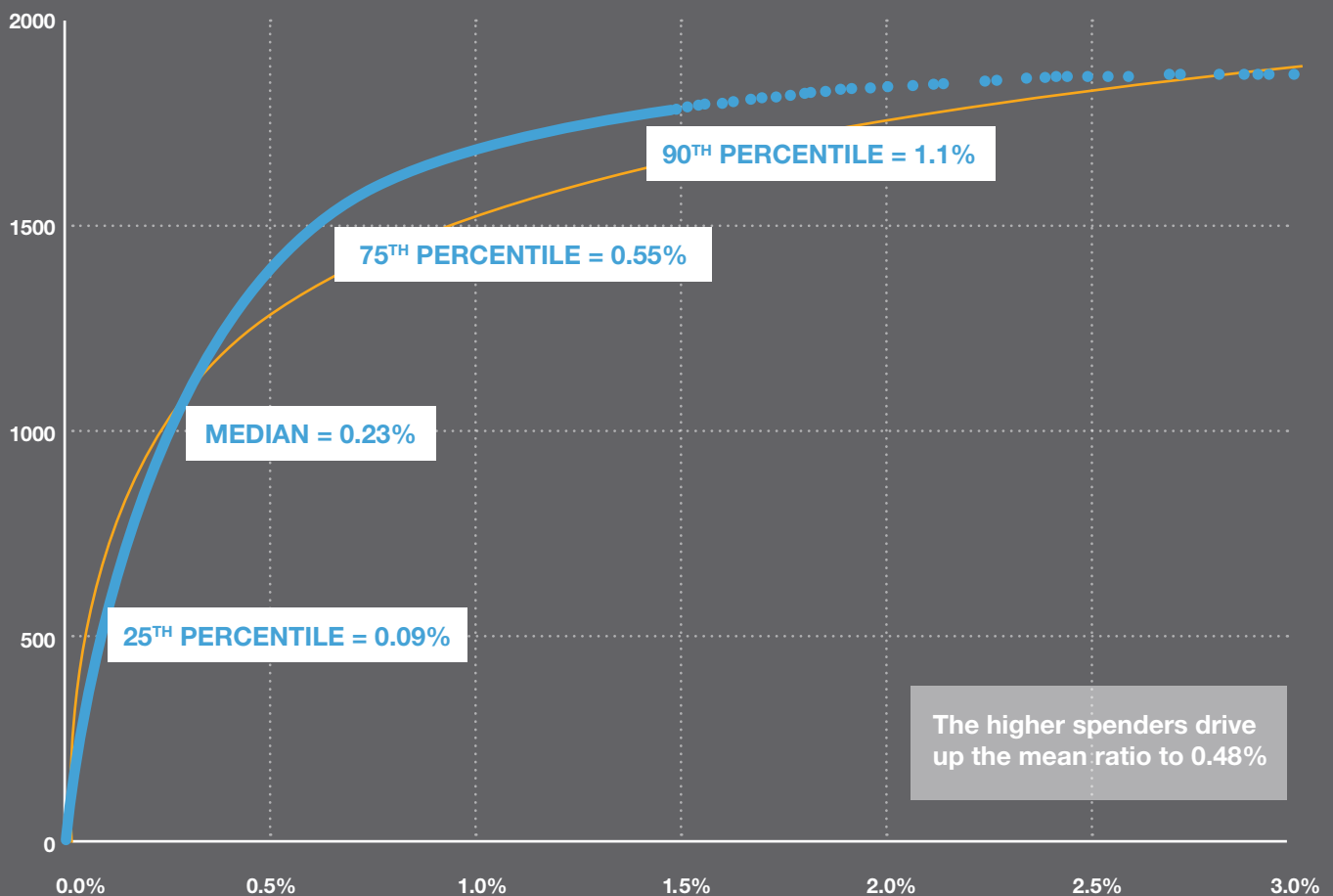


The chart below shows the spread of responses received from 1,973 organizations over the last two years.

The total legal spend is divided by revenue to determine the proportion of revenue allocated to legal services for each organization. The resulting percentages are placed in order, low to high, and the mid-point of the range, the median, is then used as the average. This prevents outliers having too much influence which can happen if you use the mean average.

TOTAL SPEND AS A % OF REVENUE

Full dataset of 1973 organizations



We have pinpointed the 25th, 50th and 75th percentiles – all below 1%.

It is not until the 89th percentile that the figures move above 1%. From that point onwards, the outliers start to emerge – often in fast growth companies, that are preparing their platform for much higher revenue, or organizations which have experienced extraordinary events.

The top 3% of responses were removed as outliers.

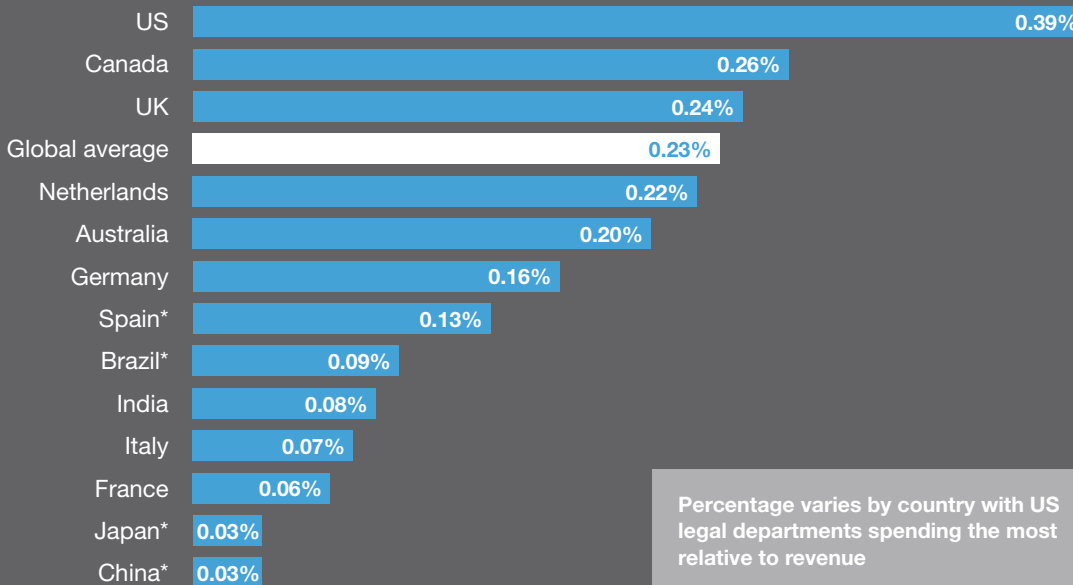
Top 59 (3%) removed from chart as outliers – ratio above 3%

Base: 1973

Regional differences in legal spend

SPEND % REVENUE: BY COUNTRY

Medians by country



Base: US (709), Canada (270), UK (215), Netherlands (49), Australia (107), Germany (69), Spain (22); Brazil (20); France (68), Italy (34), India (33), Japan (27), China (24) *Low base

The country where an organization is based has a big impact on its expected spend level. Most countries sit below the global average. The largest part of our sample base is located in the US (39%), and this, combined with the significantly higher ratio of legal spend to revenue here drives the global average up above most other countries.

Canada also sits above the average and the UK is virtually on the average. Sitting just below the average are the Netherlands and Australia. It is interesting that four of the top five are predominantly English speaking, common-law countries. Germany comes next and then the ratio drops as we move across Mainland Europe, South America and Asia with China and Japan the lowest.

These differences are driven by a range of factors – higher rates and pay levels, higher levels of regulation and more dynamic regulation, and a more complex legal framework, often more litigious.

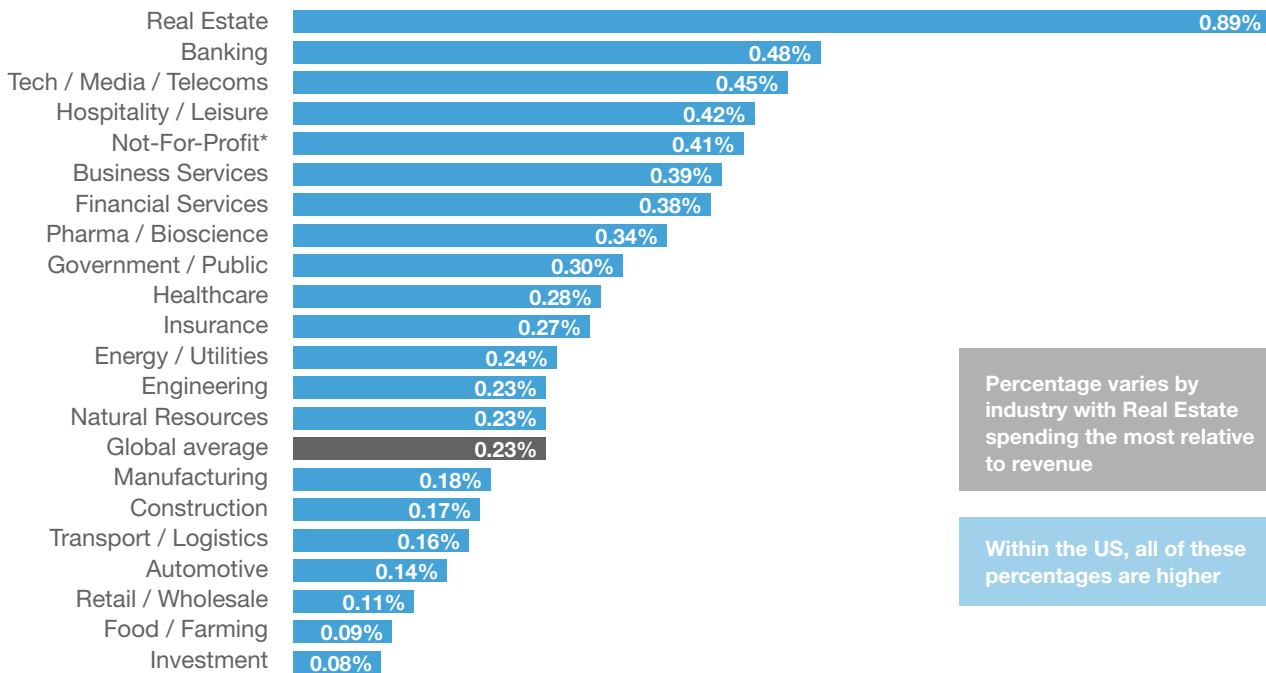
POINT TO CONSIDER

For organizations with a global footprint but heavily resourced in high spending locations, it may be worthwhile considering allocating some of your legal work to the lower cost countries, when you have a choice.

Industry differences in legal spend

SPEND % REVENUE: BY INDUSTRY

Medians by industry



Percentage varies by industry with Real Estate spending the most relative to revenue

Within the US, all of these percentages are higher

Base: R. Est. (39); Banking (42); TMT (211); Hosp./Leis. (34); Not for profit (20); Bus. Svcs (52); Fin. Svcs (55); Pharma (41); Gov't (55); Health (114); Ins. (63); Energy (162); Eng. (49); Nat. Res. (70); Manu. (304); Constr. (98); Trans./Log. (111); Auto. (55); Retail (130); Food (105); Inv. (55) *Low base

Like region, industry sector also has a big impact on the expected level of legal spend. Real Estate reported the highest level of spend overall, nearly four times the global average – possibly explained by a revenue model which is more focused on assets. Banking and Technology/Media/Telecoms come next.

We generally see the more heavily regulated industries sitting above average. Although, these patterns do differ depending on which geography you are sitting in, as regulatory frameworks can differ. In general we would see higher figures for every industry within the US.

In the chart above we have looked at traditional industries – but those who sit across more than one industry, a hybrid business for example, such as bio tech or fin tech, are likely to have even higher spends. These, and other ‘disrupter’ businesses are blurring the boundaries of traditional industries and regulatory frameworks, resulting in higher levels of legal spend.

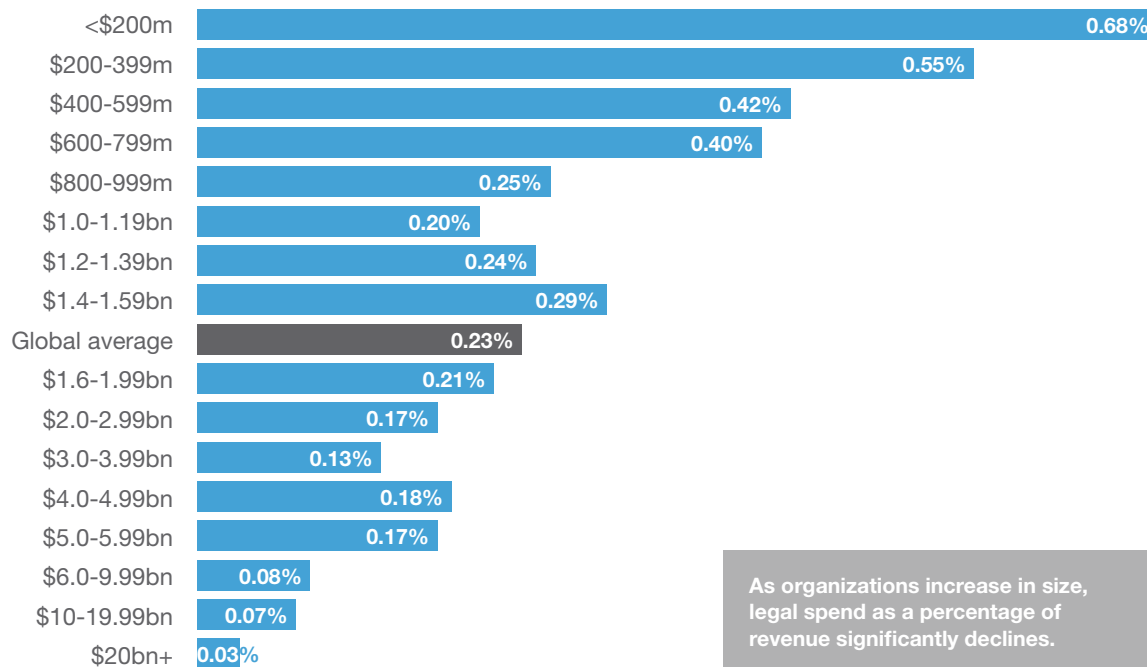
POINT TO CONSIDER

Think about the different environments you are exposed to, including commercial drivers and risks, regulatory and legal frameworks. Does your spend level reflect adequate investment to ensure your organization is sufficiently protected?

Differences in legal spend by size

SPEND % REVENUE: BY SIZE

Medians within revenue bands



Base: <\$200m (169); \$200-399m (203); \$400-599m (137); \$600-799m (81); \$800-999m (91); \$1.0-1.19bn (155); \$1.2-1.39bn (88); \$1.4-1.59bn (73); \$1.6-1.99bn (95); \$2.0-2.99bn (222); \$3.0-3.99bn (101); \$4.0-4.99bn (71); \$5.0-5.99bn (55); \$6.0-9.99bn (128); \$10.0-19.99bn (106); \$20bn+ (116)

Size was the factor that caused the biggest diversion in legal spend – an organization with less than \$200m revenue was typically spending nearly 10 times the proportion of its revenue on legal as an organization with \$10bn revenue.

There is a very clear correlation – the higher the revenue band, the lower the ratio. Of course spend does go up in absolute value terms – but as a proportion of revenue, spend reduces – meaning there are significant economies of scale in legal spend.

THOMSON REUTERS LEGAL TRACKER

We partnered with Thomson Reuters Legal Tracker, to try and find out which work-types were most likely to benefit from economies of scale and which weren't. The results were fascinating and identified specific areas where larger companies spent more of their budget than smaller companies. These areas are generally more unpredictable and costs can be difficult to control. Business-as-usual areas, meanwhile, generated bigger economies of scale, as companies learned to work smarter and leaner.

POINT TO CONSIDER

How can you access economies of scale quicker? What are the areas which most drive economies?

The complex relationship between different demographic factors

The patterns we observe by industry and size are not the same in every jurisdiction. As the cost of lawyers differs by market, along with the legal and regulatory framework, this impacts the scope and total cost of legal needs for each organization. The characteristics of each jurisdiction also have an impact on the type of companies within each sector – for example, whether the country is rich in natural resources, the consumer purchasing power and how evolved the infrastructure is. All of these characteristics shape the resulting demand in legal services and ultimate spend.

We also find when different demographic factors are layered on top of each other, such as industry, region and size, that they often have a cumulative effect. We are currently developing our estimating model to factor in these effects.

The example we have shown here is within the US – where looking at the US overall average and the global tech average, you would expect a US tech company to land somewhere between the two. In reality, the company faces an uplift in spend from being based in the US, and then a further uplift from being in tech. The result is therefore half as much again, at 0.68%. This is before we consider the impact of size!

0.40%

US

0.45%

TECHNOLOGY

0.425%

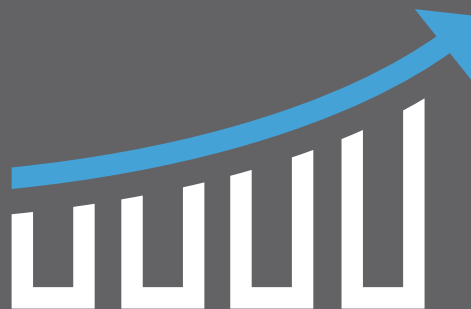
AVERAGE

0.68%

REALITY

POINT TO CONSIDER

Organizations must compare themselves to a peer group which takes into account region, industry – and size – in order to have a realistic benchmark.



Accessing relevant benchmarks

Free year-round access to your peer group benchmarks

Acritas can provide access to its online analytics platform in return for participating in a 25-minute telephone interview. You will be able to benchmark your spend and team size against peers with similar characteristics. You can adjust the filters to view data in a different region, adjacent sector or for different sizes as you look to grow or downsize, or move into new markets.

We provide this for free as an incentive to participate in our global research. The collated results of this research are sold to law firms for business planning purposes and that is how Acritas funds its business model.

The analytics tool also provides access to a database of exceptional Star Lawyers, as recommended by other survey participants, across more than 50 countries worldwide. You can see why the Star is recommended and the demographics of the client making the nomination.



To participate and access Acritas Analytics, please email appointments@acritas.com

with your preferred time and phone number. You must fit our qualifying criteria to gain free access which include a minimum revenue of \$50m and being a decision-maker when it comes to procurement of legal services. Paid access is available for \$995 per annum.

Building up to a suite of metrics – Acritas PEER Model

This is a free report containing a framework of metrics which are being used by large legal departments to help demonstrate the value they bring to their organization. The metrics cover efficiency but also look at effectiveness and preventing legal risk. This model was developed after talking to over 1,000 legal departments across the world and refined with our advisory board of General Counsel and legal operations experts.



Visit www.acritas.com/acritasPEERmodelTM.com for free download

What next?

Our next report, which will be published in September, will look at the internal and external split of budget and provide benchmarks for the number of lawyers on your team.

In addition to evolving our estimating model to include the impact of layering demographics, Acritas is committed to building an even smarter dataset, where we start to look at the impact of different buying approaches – such as use of AFAs and alternative legal services providers, adopting formal panels and legal risk management. We will also explore the impact of other organizational characteristics such as geographic reach, growth trajectory and appetite for risk.

If you would like to contribute ideas to this project or become part of our advisory board please get in touch. We look forward to hearing from you.

Lisa Hart Shepherd

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Acritas provides market analysis, benchmarking, research and advisory services, through a unique combination of:

- ▶ Our research-led scientific approach
- ▶ Our unparalleled legal market dataset and related insights
- ▶ Our systems and dashboards specially developed for the legal sector.

For further information on how Acritas can help you and your organization, please contact Lizzy Duffy on eduffy@acritas.com or +1 646 480 5738 or Jo Aitken on jaitken@acritas.com or +44 808 178 3020.

We look forward to hearing from you.

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