RISE OF THE TRANSACTIONALS

HOW TRANSACTIONAL PRACTICES ARE INCREASINGLY ASSUMING LEADERSHIP FOR LAW FIRM GROWTH

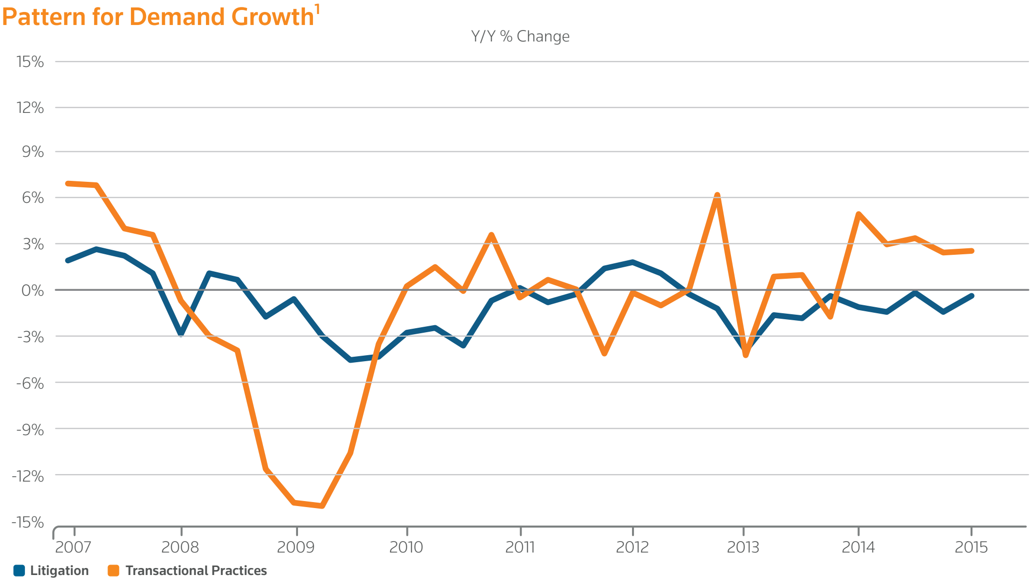
Litigation has traditionally been the largest – and arguably most important – practice. Even today, it accounts for 36% of large law firm billings, the biggest share of any practice. But that percentage was more than 40% some twenty years ago.

Not only is litigation no longer a growth engine, it has been in a slow, steady decline, by some accounts even pre-dating the 2009-2010 recession. Since that time, it has clearly not recovered as other practices have. Litigation has fallen for a remarkable eleven consecutive quarters and has not had a positive quarter since Q1 2012.

Transactional practices have outpaced litigation in nearly every quarter over the last two years. As a result, transactional practices have gradually been growing share, and now make up approximately 32% of large law firm billings.

Recent data shows no break in this trend. Demand for litigation declined just under 1% in 2014. At the same time, transactional practices grew 3.3% last year – and all four transactional practices (general corporate work, Mergers & Acquisitions (M&A), real estate, and tax work) were positive. In the first quarter of 2015 this trend continues: transactional practices rose 2.5%, while litigation declined 0.3%.

Pattern for Demand Growth[1]



[1]All timekeepers, billable time type; U.S.-based firms

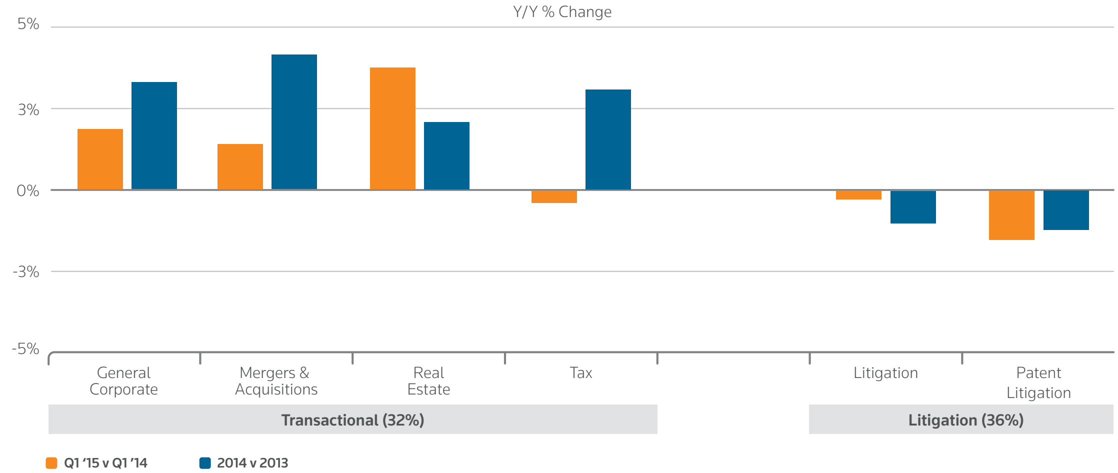
BY SEGMENT

The trend of growing transactional work is currently favoring Am Law Second Hundred firms. Last year, the Am Law Second Hundred saw transactional practices grow a robust 5.0%, compared with only 3.4% for the Am Law 100. That difference accounted for much of the overall outperformance by the Am Law Second Hundred market segment last year. In 2014, for both segments, the main driver of demand growth appears to have been corporate work, which rose 4.3% for the Am Law Second Hundred and 4.1% for the Am Law 100.

That trend is continuing so far this year, although the gap is slightly narrower, with transactional practices up 3.7% for the Am Law Second Hundred and the Am Law 100. One of the main drivers of transactional demand performance in Q1 2015 for both segments was real estate, with growth at 6.2% for the Am Law Second Hundred and 3.8% for the Am Law 100. Corporate work remained strong as well. However, tax work lagged in comparison to last year, which is weighing down the overall transactional growth so far this year.

Demand[1]

Transactional – Litigation

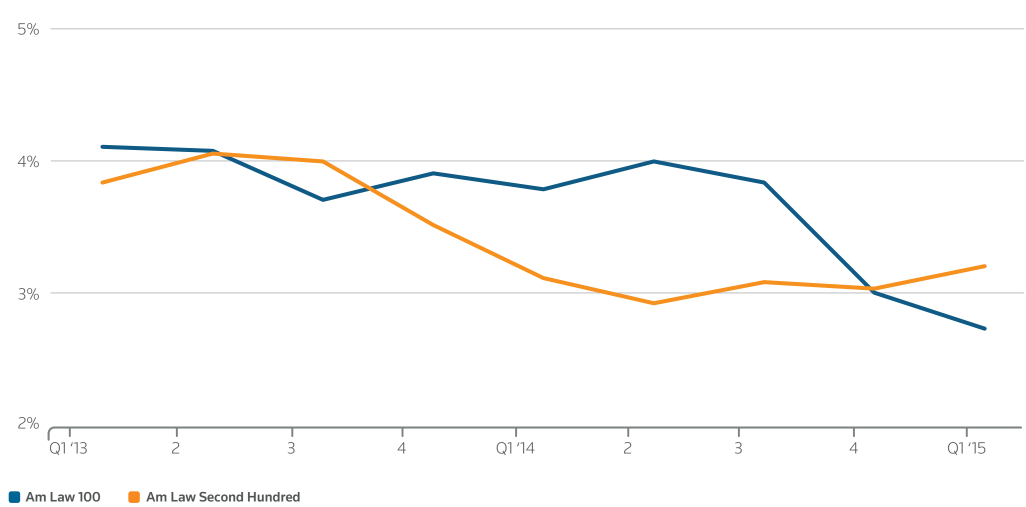


In terms of market share, as noted above, litigation practices account for 36% of large law firm billings; breaking that up by segment, in 2014, litigation work accounted for 30% of the work done by the Am Law 100 compared to 33% for the Am Law Second Hundred. Looking back, ten years ago that figure was 3.5 percentage points higher in both segments.

STRONGER RATES & REALIZATION TOO

There is also a difference in rates that compounds the relatively better strength of the Am Law Second Hundred vs. the Am Law 100 in transactional practices. In the past two years, both segments have seen some erosion in worked rates. But this weakness has been much more pronounced for the Am Law 100, which has seen worked rates for transactional practices fall by 1.39 percentage points since Q1 2013. Over the same period, Am Law Second Hundred rates also fell, but only 0.63 percentage points.

Transactional Practices Worked Rate Growth[1]



[1]All timekeepers, billable time type; U.S.-based firms

LARGE FIRMS VS. "LARGE ENOUGH" FIRMS

This phenomenon of transactional practices growing faster for Am Law Second Hundred firms than Am Law 100 firms is unmistakable. Somewhat less clear are the reasons. At a time when corporate spend on outside counsel is increasingly under pressure, moving work away from the largest global law firms may be attractive for clients seeking to reduce costs.

It may be relatively easy for clients to move transactional work slightly down-market without significantly altering their risk profile. A sizeable portion of corporate work, such as contracts, HR issues, etc., as well as some real estate and tax work, often involves routine, repetitive, and replicable form-based matters.

For such transactional work, instead of engaging "the biggest of the big" firms, hiring a firm that is "big enough" may be seen as a more prudent move.

GOLDILOCKS & THE THREE LAW FIRM SEGMENTS

The *2014 Report on the State of the Legal Market* from the Georgetown Law Center for the Study of the Legal Profession and Peer Monitor® noted that firms just outside the very top tier may enjoy efficiency advantages that can translate into offering more cost-effective services over their larger competitors:

> *"[Law firm] economies of scale tend to diminish above a certain size. It is rather that, once a firm achieves a certain size, diseconomies of scale can actually set in. Large firms with multiple offices – particularly ones in multiple countries – are much more difficult to manage than smaller firms. They require a much higher investment of resources to achieve uniformity in quality and service delivery and to meet the expectations of clients for efficiency, predictability, and cost-effectiveness."*

A certain level of scale is still required, to be sure. Factors such as having a firm with a national footprint and a legal staff that is relatively deep mean that clients cannot risk moving too far down-market. Regional firms, no matter how qualified or competent, oftentimes simply may not have the geographic reach and bench strength to compete for that business.

This may explain why Midsize firms – those outside the Am Law Second Hundred – are not enjoying the same growth in transactional practices that Am Law Second Hundred, or even Am Law 100 firms are enjoying.

CONCLUSION

At a time when overall demand for law firm services is flat to slightly higher, and realization rates are among the lowest ever seen, transactional practices are seeing modest but steady growth, as well as collected rates that are comparatively stronger than other practices.

Continued improvements in efficiency of delivering services, demonstration of the value of those services, and providing innovative and cost-effective pricing models may be required to continue the strong performance of transactional practices as clients continue to demand greater value for their legal spend.

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