While the law firm continues its recent trend of lackluster albeit consistent growth, some noteworthy trends are emerging on the expense side of the equation as firms seek to bolster profitability in an environment of little topline growth.

Expense Growth Has Flattened

Firms have been working to control their overall expense growth — which has been consistently in the 2.3-3.2 percent range for the past year and a half for both direct and overhead expenses. While firms have been doing a laudable job of keeping expense growth steady, expenses are still running ahead of revenue, eroding profitability.

The desire to maintain or grow profits — as well as other factors — may be leading to some shifts among expense categories.

Technology Spending Is Slowing

A closer look behind the overall expense figures shows that spending on technology has been slowing.

Spending in terms of total dollars on technology is still significant and increasing. After compensation and benefits for professional staff, technology makes up one of the largest areas of overhead spending — about 8 percent. Am Law 100 firms annually invest an average of nearly $23,000 per lawyer in technology.

However, the year-over-year growth rate for investment in technology has been steadily slowing.

Annual increases in technology spending have been cut in half over the last 18 months, from 5.8 percent in Q1 2014 to 2.2 percent in Q2 2015. The growth rate of technology spend is now slightly below the overall growth for all overhead expenses (2.4 percent).

Am Law Second Hundred firms showed the smallest decline in technology spend growth. Firms outside the top 200 have slashed their technology spend growth from 6.9 percent to a mere 1.1 percent.
The natural question to ask is: If technology spend is slowing, where are the dollars going?

Expense categories that are showing accelerating growth include occupancy and professional staff benefits — which together make up nearly 40 percent of total overhead expenses. So technology spend may be slowing to compensate for items such as higher office leases and healthcare benefits.

Also, there was somewhat of a surge in technology spend in the 2011-2012 range, as firms caught up with technology investments that had been deferred during the recession. Because of the accelerated tech spending during that time period, firms may feel that they are now in a position to slow their spend rate slightly to provide some flexibility to shift spending to other areas.

Other areas that show slowing in spend rates are staff compensation, recruiting and office expenses other than leases.

Marketing and business development has seen a pull-back, another area besides technology that is typically viewed as a long-term investment rather than strictly as an expense (and an area that could well warrant its own separate analysis).

(Although not directly related to technology spending trends, one other noteworthy trend is that use of outside services for managing functions such as mailroom, copy center, records management, etc., is growing this year as firms strive to improve efficiencies.)

But overall, cost pressures for benefits including health care and rising office rents may be leading firms to trim spending in areas such as technology and marketing in an attempt to hold the line on spending growth.

Greater Productivity and Competitive Differentiation

Technology plays a critical role in enhancing productivity by automating simple or repetitive tasks, freeing up attorneys’ workflows to focus on providing higher-value services for clients. Improved productivity can enhance delivery of services, increase profitability and reduce client fees.

In addition, in a recent survey by ILTA titled “Legal Technology Future Horizons; Strategic Imperatives for the Law Firm of the Future”, 73 percent of law firm leaders said that technology-enabled innovation will be a crucial differentiator for law firms moving forward.

Conclusion

The growth rate of spending for technology has slowed dramatically over the last 18 months.

Because investments in technology can increase productivity, lower costs and improve competitive differentiation in the market, firms need to make sure they are taking a long-term strategic view that ensures they are maintaining an appropriate level of technology spend in order to remain competitive with their peers.

As the ILTA Legal Technology Future Horizons report concludes, “information technology is absolutely critical to strategic survival and future growth in a rapidly changing and highly competitive business environment.” At a time when topline growth remains a challenge, cost discipline needs to be balanced against the need for continual reinvestment in technological tools and infrastructure.