



LEGAL SPEND WITH NO SURPRISES

Rocketing scrutiny, eroding trust

The changing PE legal spend landscape

Contents

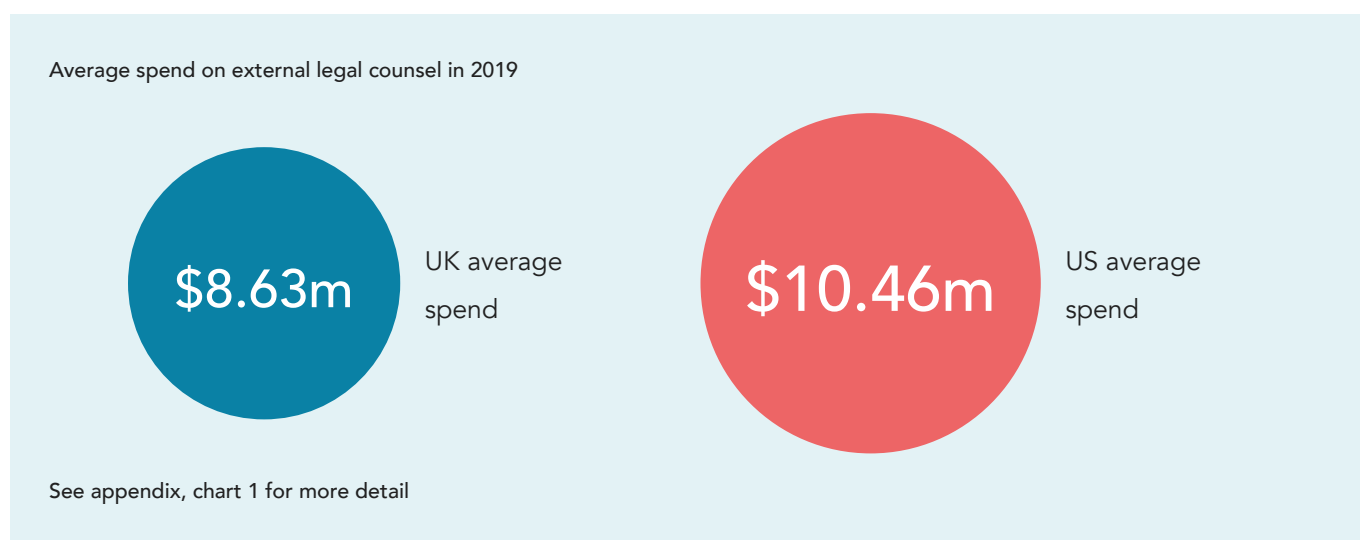
Analysing PE legal spend	4
Rocketing scrutiny	7
The problem is legal spend management	12
Grit in the machine or emerging systemic problem?	13
Towards a solution	14
About Apperio	16
Appendix	18

Analysing PE legal spend

The international investment community spends significant sums of money on external legal counsel, across a range of firms and disciplines. Against the backdrop of a softening market for M&A and fundraising, brought into sharp relief by the COVID-19 pandemic, Apperio commissioned a primary research study to better understand the legal spend of Private Equity (PE) firms, the pressures facing senior internal PE legal stakeholders, and their plans for the future.

During May 2020 independent research firm Coleman Parkes surveyed 100 senior legal stakeholders in PE houses in the US and UK with an average of more than \$10 billion under management across multiple funds. The results provide a unique insight into the changing PE legal spend landscape.

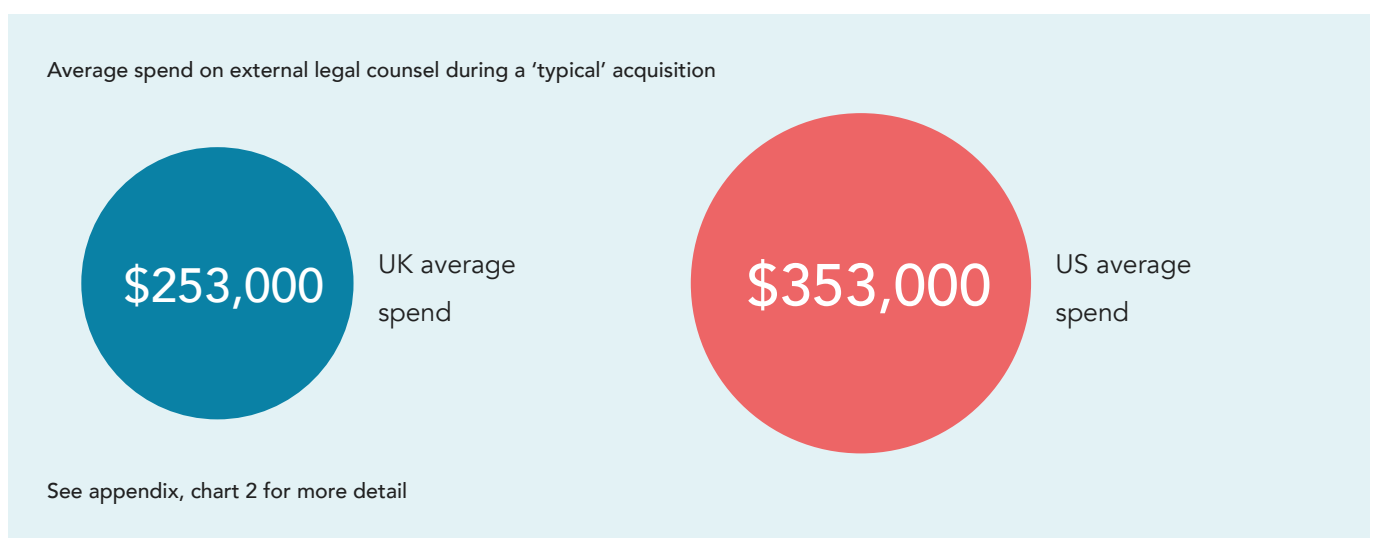
In 2019, US-based PE houses spent an average of \$10.5m on legal fees, while their UK-based cousins spent an average of \$8.6m on external legal counsel in the year. A small proportion (6% in the US and 4% in the UK) spent more than \$25m.



Nearly half of US-based PE houses (47%) worked with between six and ten external legal firms in 2019, though 75% of their spend was mostly claimed by between four and six advisors. In the UK, 60% worked with between one and five law firms, with 75% of spend going to two to three advisors. PE firms clearly represent a significant source of income for many law firms – predominantly around M&A and fundraising work.

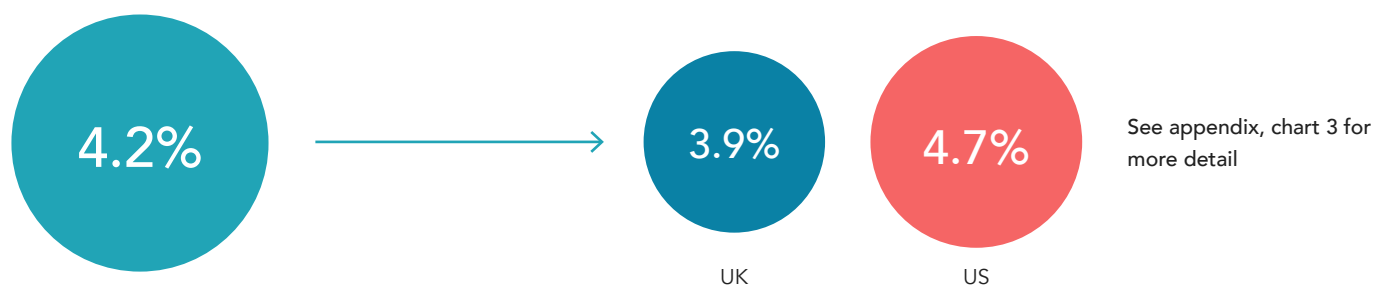


From an M&A perspective, US-based PE firms spend an average of \$353k on external counsel during a typical acquisition. In the UK, this figure stands at \$253k. Indeed, this is an area of specialism for many law firms – understandable given the market over the past few years.



Average legal costs associated with a PE fundraise account for 4.7% of a fund's total commitments in the US and 3.9% in the UK. While less frequent than M&A, total fund commitments are often measured in hundreds of millions or billions of dollars, making this an expensive business for in-house legal teams, and a valuable one for external advisors.

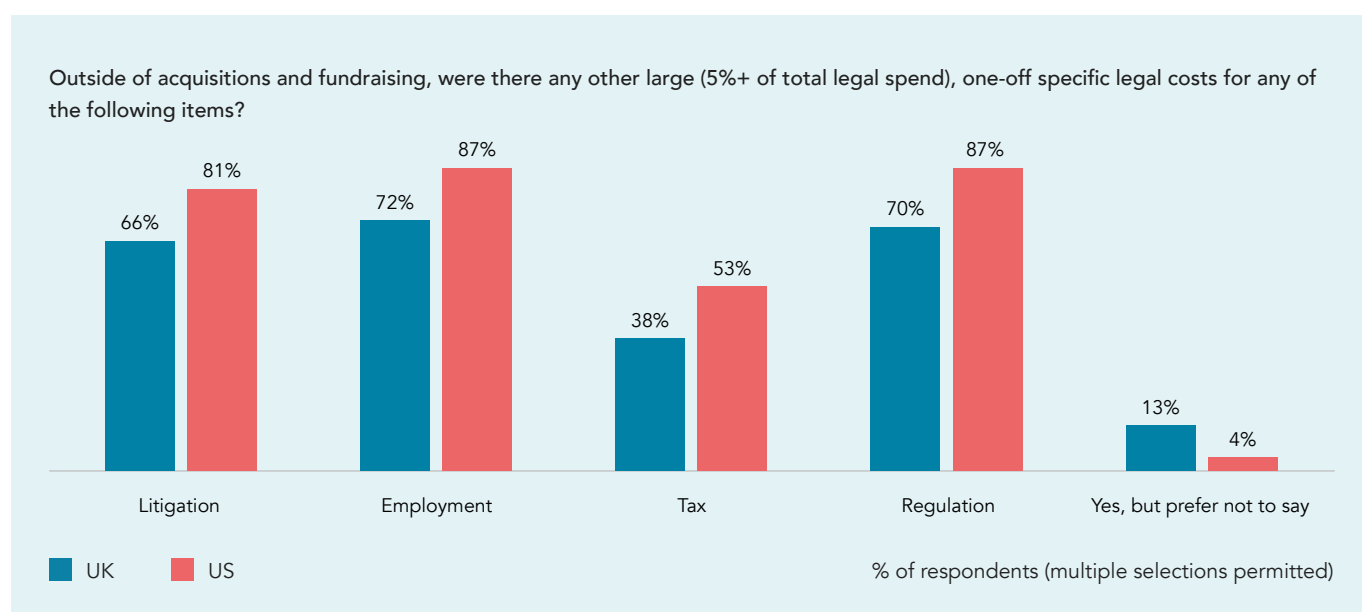
Average legal costs associated with a PE fundraise



Finally, more than 80% of US-based PE houses report large one-off legal costs (5% or more of total legal spend) on employment, regulation and litigation matters in the last 12 months. In the UK, 70% or more PE firms claimed to have invested 5% or more of their total legal spend on one-off employment and regulation matters in 2019.

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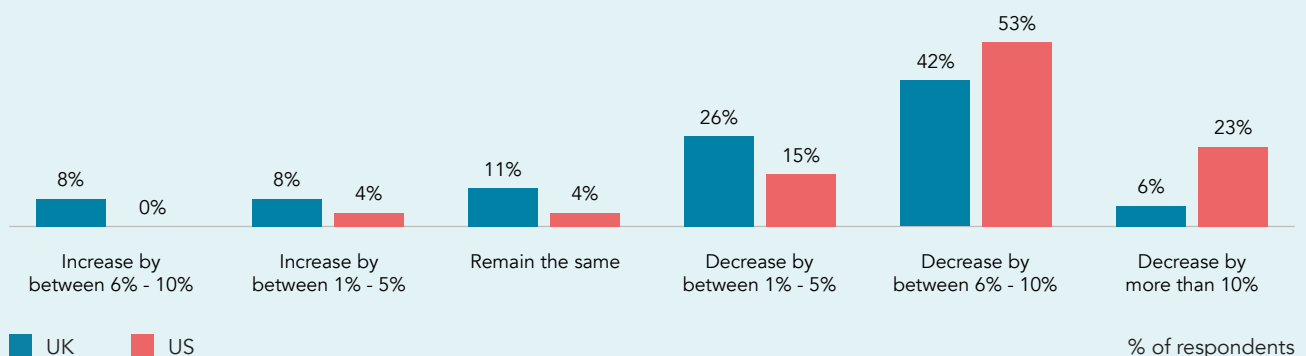
Rocketing scrutiny

However, we're entering challenging times for PE firms. Even prior to COVID-19, fears of an economic slowdown were leading to widespread predictions of a significant reduction in M&A activity. The data is compelling: the pressure is on in-house legal teams on both sides of the Atlantic to cut and better manage their legal spend.

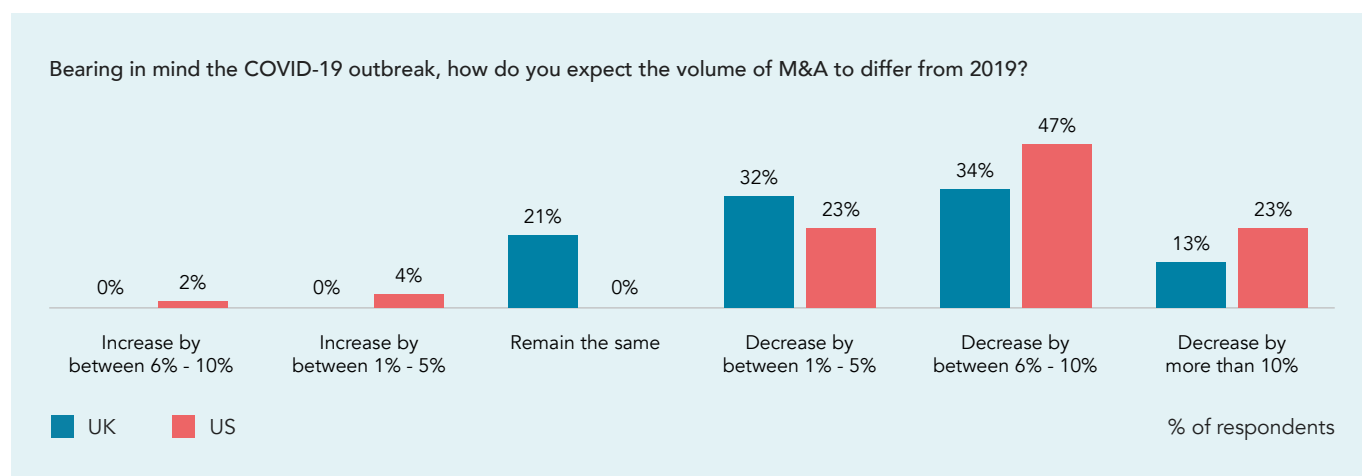
“ The pressure is on in-house legal teams on both sides of the Atlantic to cut and better manage their legal spend. ”

In the UK, 74% of senior in-house legal executives expected the volume of M&A in 2020 to decrease from 2019 levels prior to the COVID-19 outbreak. Only 16% expected M&A to increase modestly and 11% for levels to stay the same. Post COVID-19, no respondents expect M&A to increase. 21% believe it will stay the same and 79% believe it will decrease (nearly half by 6% or more).

Prior to the COVID-19 outbreak, how were you expecting the volume of M&A in 2020 to differ from 2019?



Ordinarily, the US market can be relied on for optimism. Not on this occasion. A staggering 91% of senior in-house legal stakeholders in US PE firms expected a decrease in M&A activity prior to COVID-19. Post COVID-19, 93% of respondents expect a decrease – 70% by 6% or more, nearly a quarter (23%) by 10% or more.



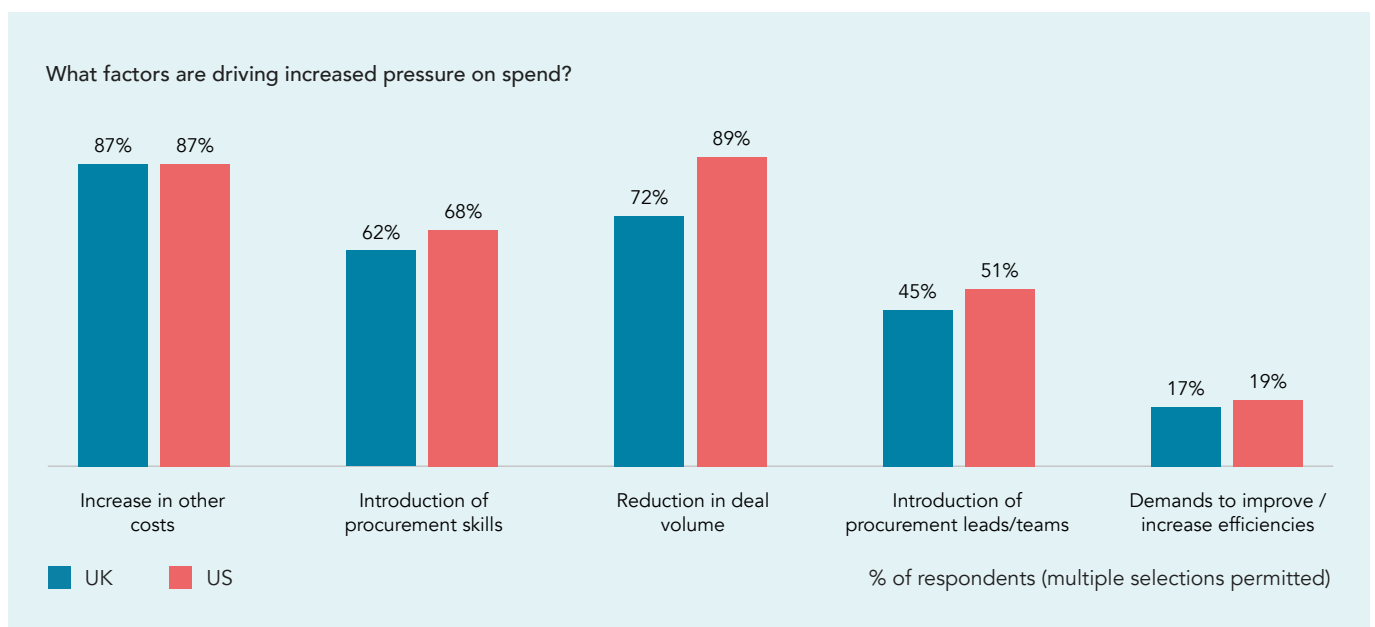
Across geographies 83% of senior internal legal PE stakeholders expected a slowdown in M&A pre-COVID, 86% post-COVID. This reduction in deal volume is a factor driving increased pressure on external legal spend for four in five respondents (72% UK, 89% US).



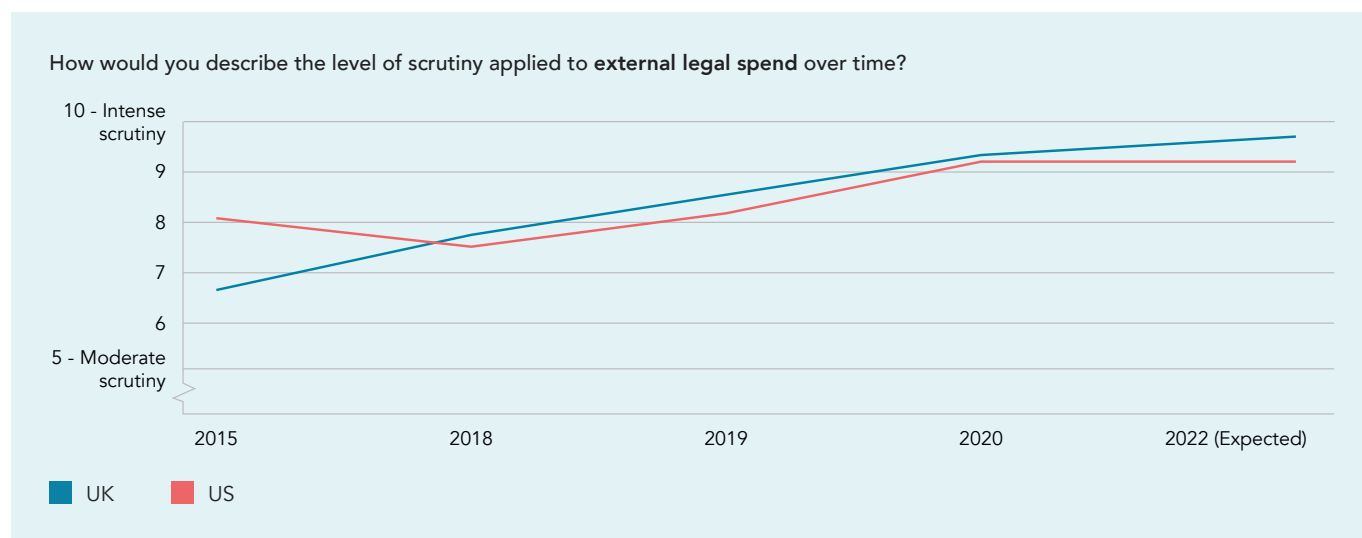
However, it's actually an increase in other costs that is reported as a more significant factor putting pressure on external legal spend, according to 87% of senior PE legal leaders in both the US and UK. The introduction of procurement skills into PE houses is the third most significant contributor to pressure on spend.

“ Pressure is ramping up for in-house legal teams to reduce costs. ”

With lower deal volumes, increased costs in other areas and the introduction of procurement skills and functions, pressure is ramping up for in-house legal teams to reduce costs.



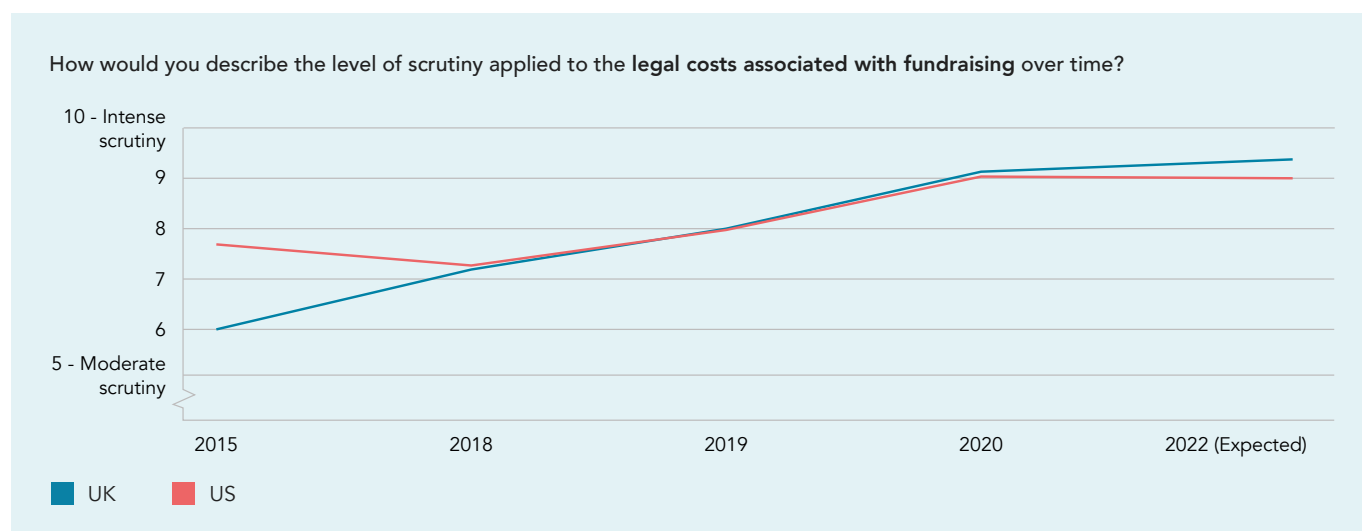
When asked to describe the level of scrutiny applied to external legal spend over time, internal legal stakeholders within PE houses report a trend of increasing pressure which will hit new highs in 2020 and 2022.



Putting this into context, the level of scrutiny applied to external legal spend has rocketed in the PE world. In the UK, it has climbed 41% since 2015 and in the US, it's increased by 24% since 2018. PE legal leaders do not expect this pressure to ease any time soon.

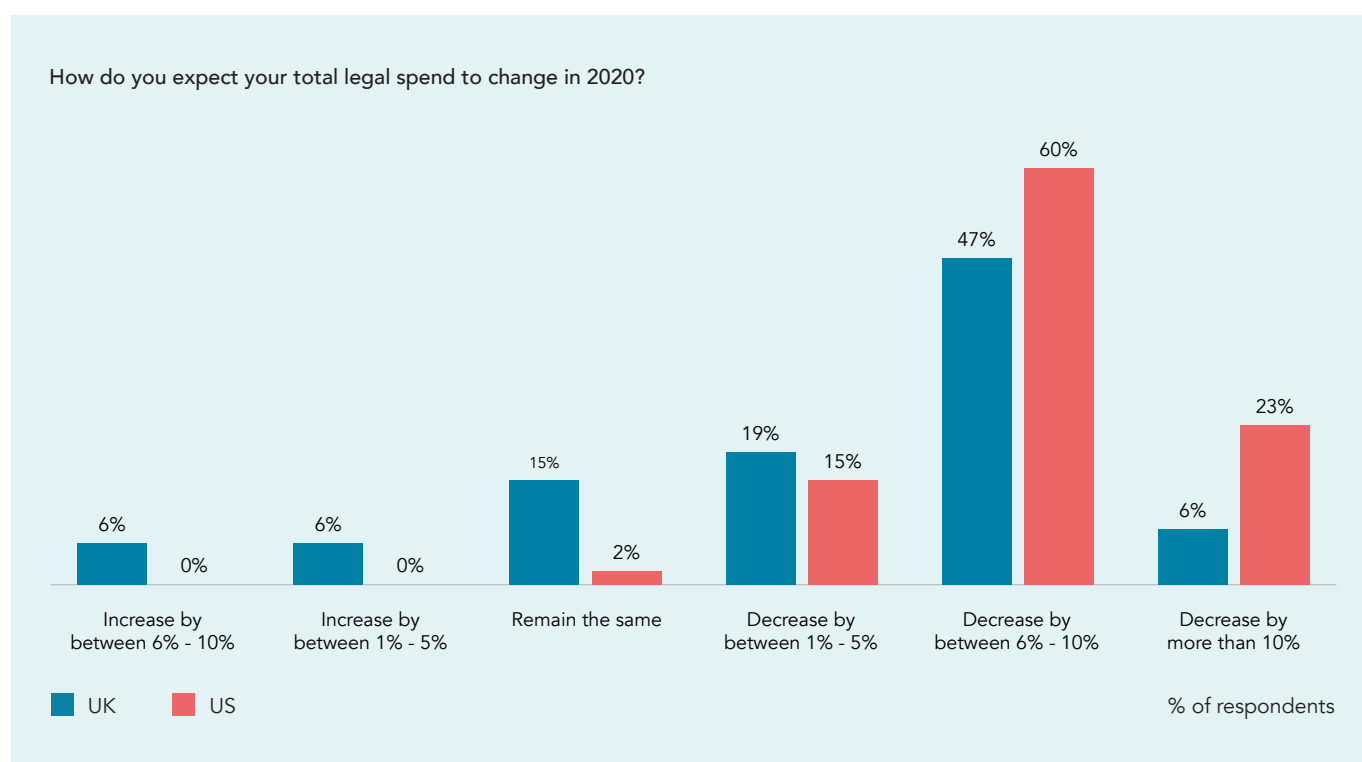
Looking specifically at legal costs associated with fundraising, one of the largest costs in-house legal stakeholders need to manage, levels of scrutiny are even higher.

“ The level of scrutiny applied to external legal spend has rocketed in the PE world. ”



In the UK, scrutiny on legal costs associated with fundraising is expected to climb 55% between 2015 and 2022 (50% to 2020). Senior in-house legal stakeholders in US PE firms report a 25% increase in scrutiny in the last two years.

The net result is that 86% of PE legal departments expect their external legal spend to reduce in 2020 – 74% in the UK and 98% in the US.



“ Rocketing scrutiny and cost cutting mean PE legal leaders must manage their legal spend more actively and effectively. ”

Again, the US is a source of pessimism. 98% of respondents expect their legal spend to drop, with nearly a quarter expecting this to decrease by more than 10%. UK PE leaders are more optimistic: 12% expect to increase their spend, however 72% still expect to spend less on external legal costs in 2020, with over half of respondents expecting this to decrease by 6% or more.

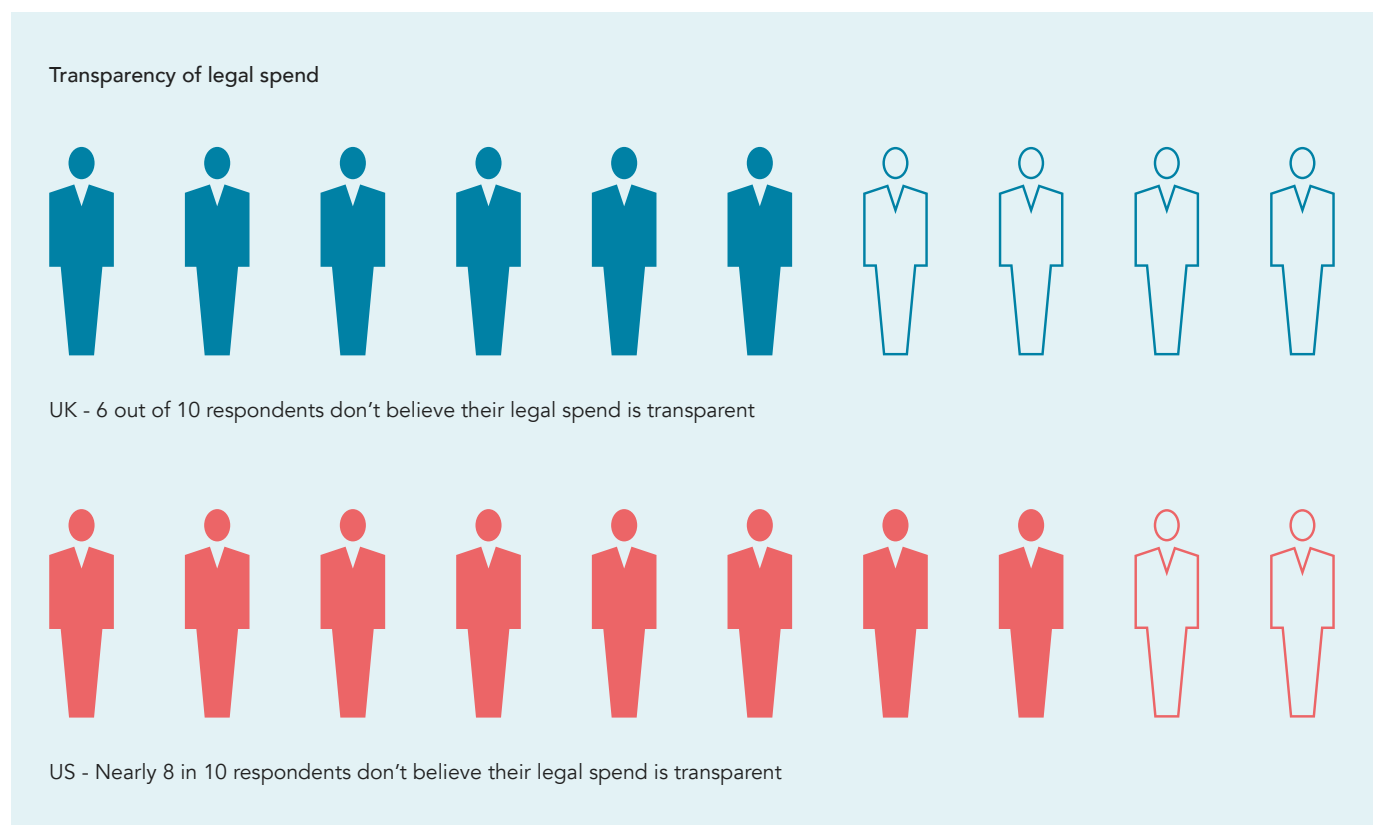
The result, however, is the same on both sides of the Atlantic: rocketing scrutiny and cost cutting. PE legal leaders must manage their legal spend more actively and effectively than ever before.

The problem is legal spend management

That said, PE houses are struggling to get a handle on their legal spend – which will make effectively managing these reductions extremely challenging.

Four in ten senior PE legal stakeholders do not believe that their companies currently make efforts to manage legal spend (42% in the UK, 43% in the US). Meanwhile, transparency seems to be a significant issue. Less than half of UK-based respondents agreed their legal spend was transparent and were never surprised by legal bills. Shockingly, just 21% of US-based senior in-house PE legal stakeholders agreed with this statement.

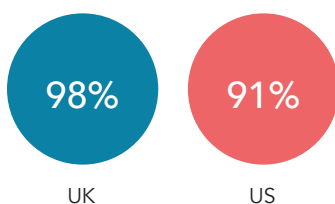
Put another way, nearly eight in 10 US-based respondents don't believe their legal spend is transparent and, it would seem reasonable to assume, are regularly surprised by bills from external legal counsel. This seems unfathomable given the costs involved.



Grit in the machine or emerging systemic problem?

While 92% PE legal leaders agree that their legal spend is predictable (94% in the UK, 89% in the US), two major findings contradict this idea. The first is that only 53% of senior in-house legal stakeholders in the US, and 55% in the UK, trust their external legal firms to bill them promptly. The second, and more startling finding, is that only one in three US and 45% of UK respondents trust their external legal counsel to bill them accurately.

% of senior PE legal professionals trust their external counsel to offer quality advice



This may appear to paint a damning picture of the relationship between PE legal professionals and their external advisors. However this is, categorically, not the case. 95% of senior PE legal professionals trust their external counsel to offer quality advice (98% in the UK, 91% in the US). Additionally, 92% trust external legal firms to bring them innovative ideas to support their business. Fundamentally, the quality of service provided by law firms is not in question.

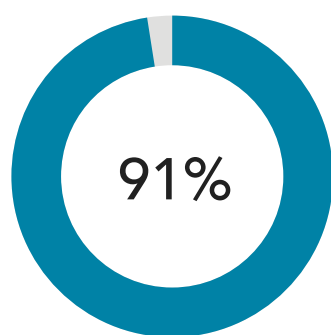


What this data does suggest is a growing, under-acknowledged and potentially systemic problem. One that will surely be magnified as scrutiny on legal spend increases. Administrative commercial issues - the timeliness and accuracy of invoices - are causing damaging friction between in-house teams and external counsel. Left unchecked, the frustration this causes may erode the very commercial trust that binds client and advisor.

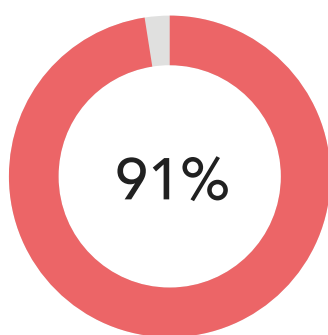
“ Left unchecked, the frustration caused by administrative commercial issues may erode the very commercial trust that binds client and advisor. ”

How did we get here? It's actually unsurprising, given current methods of spend management.

Staggeringly, 91% of PE firms still collate and analyse legal spend data manually in Excel. It's ironic that most of the firms investing billions of dollars in the technology companies that will underpin the workplace of the future are using technology first launched in 1985 to manage one of their largest costs.



UK



US

PE firms that still collate and analyse legal spend data manually in Excel.

Towards a solution

Obviously, things need to change. The COVID-19-driven reduction in deal volumes and the rocketing scrutiny on costs makes managing legal spend a critical issue for PE houses. But the erosion of commercial trust between in-house legal teams and external counsel and the outmoded approach to managing legal spend means that, unless something in the process changes, the situation could quickly become adversarial. It could even affect the quality of advice PE legal leaders receive – something that would be intolerable to all concerned.

In order to better manage external legal spend, PE houses need immediate and granular visibility on each in-flight legal matter. This will help PE legal leaders to see and manage work in progress across law firms, understand how matters are progressing and drive course-correction where necessary to prevent budget overruns and spiralling external costs.

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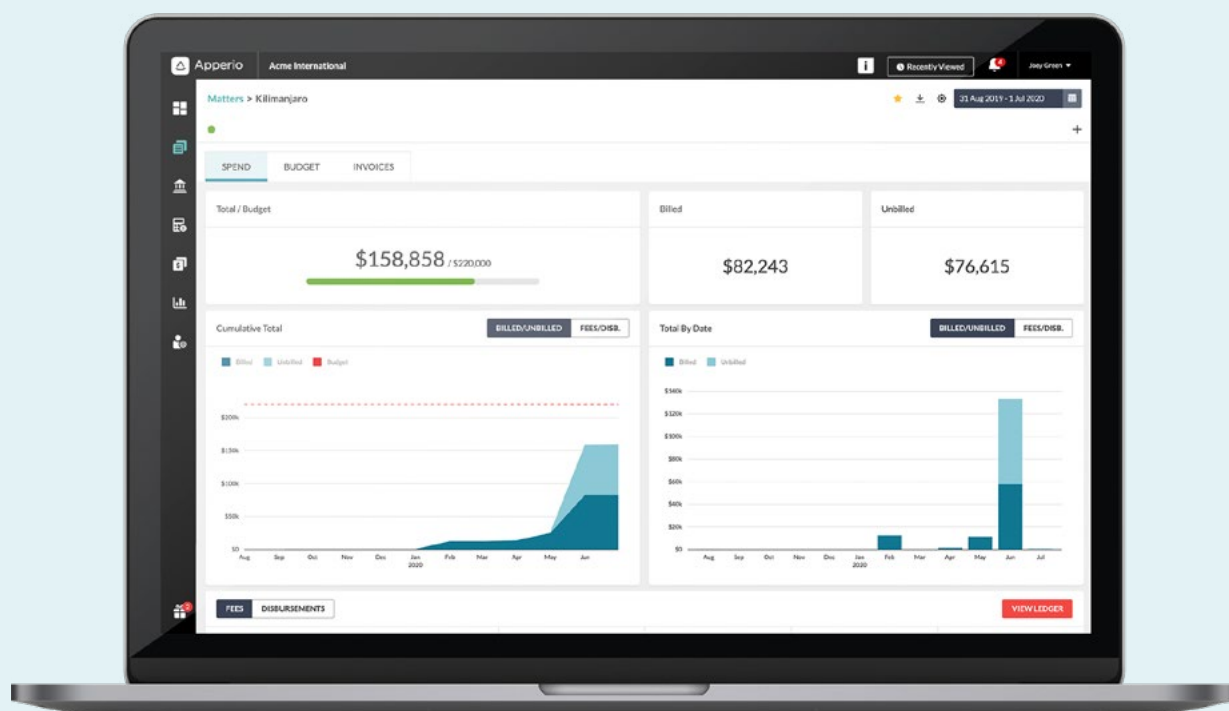
In-house legal teams at PE houses need a single source of spend data to provide live metrics on how firms are delivering against KPIs and prevent law firms over-charging. Being able to constantly monitor work in progress means issues of timeliness and billing accuracy simply disappear. Such a data source can also be used to provide a clear audit trail for regulatory compliance.

Today, a range of varied factors are driving the need for significant change in the way that PE in-house legal teams work with their external legal partners. Empowered with the right insights at the right time, legal leaders can meet the challenges before them and maintain positive and productive relationships with the firms they rely on for advice and counsel.

About Apperio

The Apperio legal spend management platform is specifically designed for in-house legal and finance teams. With ever-increasing scrutiny over how clients' funds are spent, Apperio helps PE firms to simultaneously manage multiple law firms and large projects, track day-to-day legal spend against budgets, improve the efficiency of their team and spend, and safeguard regulatory compliance.

To prevent the erosion of commercial trust with external counsel, Apperio uniquely connects directly to law firms' practice management systems to provide a live view of all matters, including unbilled work-in-progress and invoiced matters. Unlike eBilling solutions, which only provide visibility of invoiced matters that may have a lag of several months, Apperio provides instant visibility of both historic and unbilled legal spend data.



This transparency benefits both parties, with clients having greater confidence in their advisors' billing practices, and law firms experiencing fewer write-downs or payment delays that disrupt cash flow. In addition, Apperio removes a significant administrative burden on both sides by reducing the need to share data using imprecise telephone updates and manually-collated spreadsheets sent over email.

Apperio exists to make the global legal industry clear, connected and collaborative. Its founders understood how commercial trust between in-house legal teams and external counsel was suffering because of a fundamental lack of transparency. Today, Apperio is transforming how legal departments are run, starting with the most important thing when running a department - knowing how much you're spending.

To book a demonstration of the platform and understand how Apperio could help manage your legal matters and reduce your spend, visit www.apperio.com and click 'Find out more'.



Appendix

Chart 1

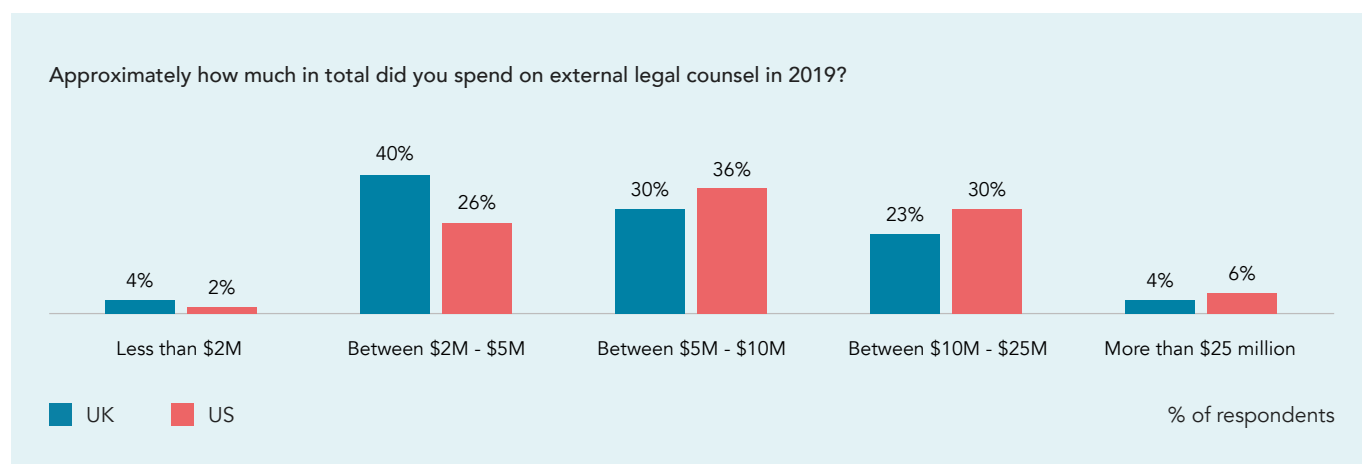


Chart 2

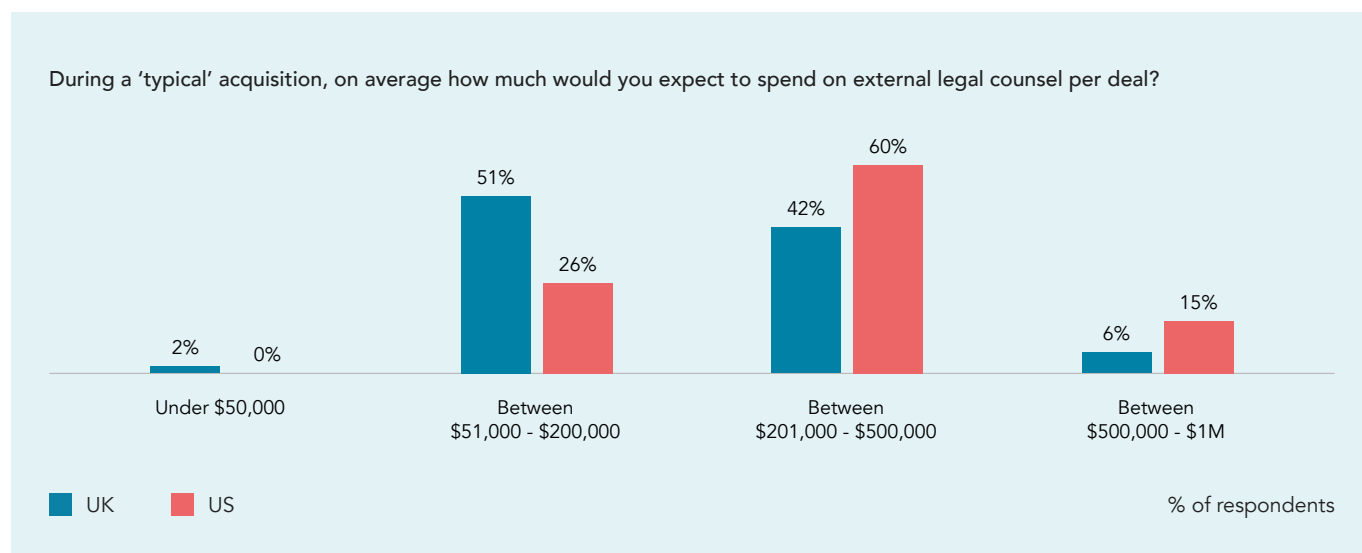
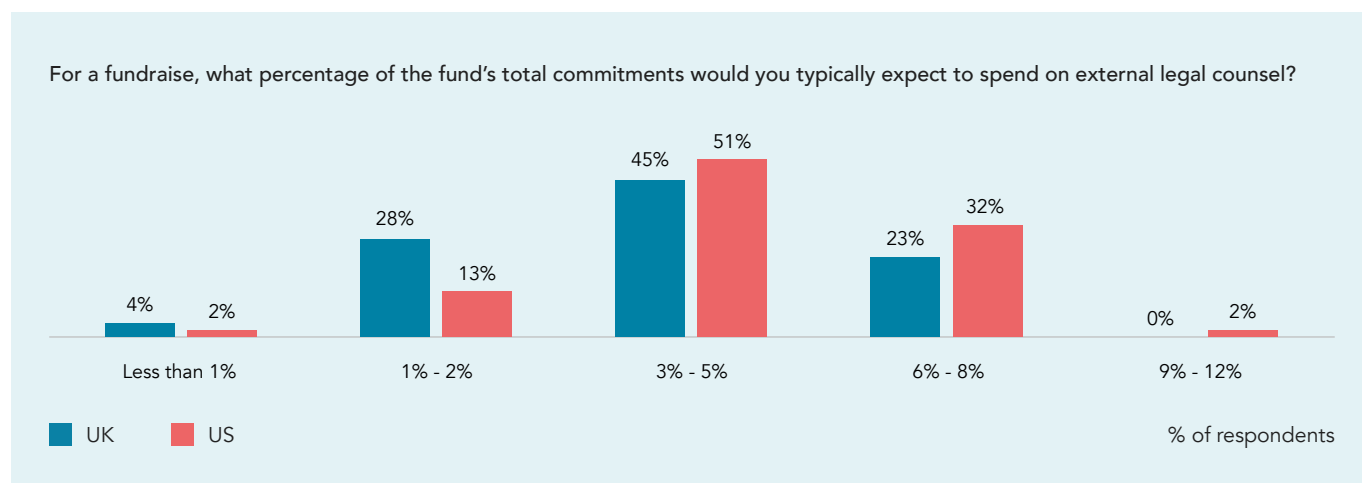


Chart 3



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