Apperio

LEGAL SPEND WITH NO SURPRISES

Controlling costs in private equity:

The PE legal spend landscape for 2022

PE firms have a heightened appreciation for their legal departments because of the pandemic, but it's also changed their priorities around legal costs.

Dear Reader,

This survey and report revealed private equity firms value their in-house legal teams more because of the pandemic. This new-found appreciation is noteworthy, not just because of the times in which we are living, but also because it emerged against a backdrop of increased spending, workload and headcount for the legal departments surveyed.

The new reality brought by the pandemic has had a profound impact on priorities too. For the first time, reducing spend is not the top priority for legal departments. Instead, as we move into 2022, improving visibility and control of legal spend are at the top of the list.

Whilst it's clear from this survey that there is an abundance of legal spend data available to in-house teams, merely having the data is just the beginning. Indeed, persistent issues remain that prevent this data from being used to inform strategic legal decision-making.

These issues include inconsistent data formats from legal service providers, high volumes of complex legal matters, and business units that instruct law firms directly – outside the purview of the in-house legal team. In our view, these barriers reinforce the sense that legal departments in PE often lack control of their legal spend, even if reducing such spend is not the main priority.

The capacity to improve control lies in understanding and interpreting legal spend data long before an invoice is received. Current visibility into work-in-progress (WIP) and accruals enable legal leaders to make proactive decisions that avoid the inherent risks of unpredictable invoices.

We hope you find this report helpful. We would love to hear from you regarding your own experience and what this means for your organization in the year ahead - please email us at info@apperio.com.

Best,

Nicholas d'Adhemar
Founder and CEO, Apperio

Executive summary

This report is based on survey responses from 100 senior professionals working in private equity, from legal (63%) and finance (37%) teams. Respondents hail from PE firms based in the US (71%) and UK (29%) who all have between $3 billion and $15 billion in assets under management (AUM).

Most respondents (63%) are the decision-maker for legal spending, while the remaining 37% are part of a team of decision-makers. Collectively, respondents work for, or with, legal departments in PE firms that employ an average of 11 lawyers and allied professionals. These teams oversee between $3 million and $20 million in annual outside legal spend.

The full survey methodology is available at the end of this report.

Private equity firms value their legal teams more because of the pandemic

Seven in 10 (71%) of PE respondents say the legal team is more valued in the wake of the pandemic. However, 73% say workload, headcount and legal costs have all grown over the last three years. Nearly one in three respondents say each area has "increased significantly" which was quantified as growth of greater than 20%.

Barriers to legal spend data collection

About three-quarters of respondents usually collect data to determine where it is spending on legal services, however, barriers remain. These include inconsistent data formats (54%), the volume or complexity of legal work (54%), and business units instructing law firms directly (52%). Notably, 41% said the "legal department is overwhelmed," which suggests the problem can't be solved by adding human resources alone.

The top legal spend priorities are controlling costs and data analysis

Controlling costs (57%) and better leveraging data to make decisions (51%) are the top legal spend priorities for the next year. In contrast, reducing outside legal costs (15%) was among the lowest priorities. This underscores the desire to better control legal costs rather than pursuing a pure reduction in legal expenses.

The most effective techniques for controlling legal costs

Alternative fee arrangement (AFAs) (76%), specialized software for managing legal costs (68%) and centralizing all legal spend through the legal department (51%) ranked among the most effective techniques in-house lawyers have for controlling costs. Outside counsel billing guidelines came in last among a list of 11 possible techniques with 21%.

Investment in legal technology continues

Eight in ten (81%) respondents believe their organization has invested sufficiently in legal technology. What's more, 73% of respondents said the level of investment in legal tech would increase over the next 12 months. Among the top tech tools in which PE in-house legal teams plan to invest include risk management (64%), legal spend management (54%) and e-billing (46%).

The top metrics law departments in PE are tracking

Most respondents (62%) say the in-house team is regularly measuring the value they contribute to the business. The top measures legal departments in private equity are tracking include the "outcome of legal matters" (68%), the "hourly cost per lawyer" (60%), and "risk exposure" (50%).

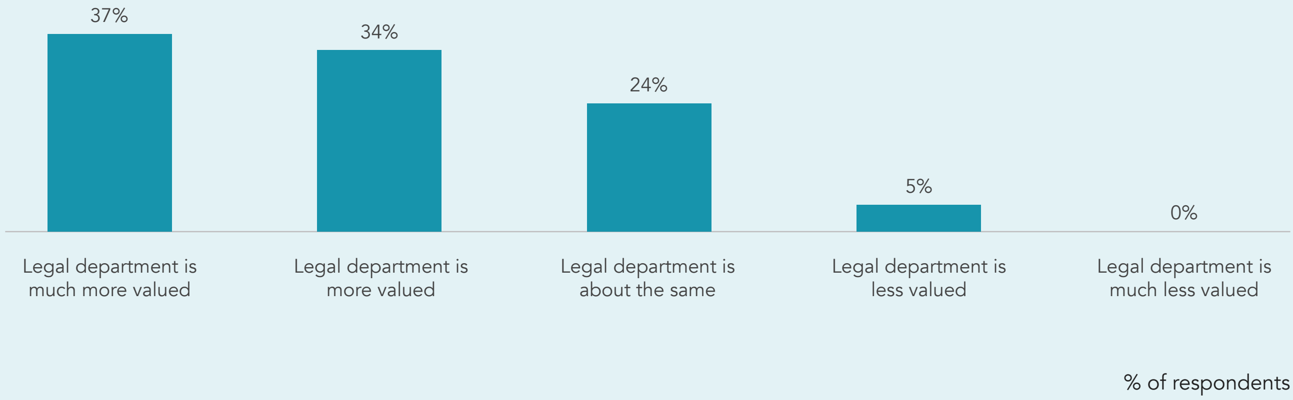
PE firms value their legal teams more following the pandemic

The risk and uncertainty that accompanied the Coronavirus pandemic caused PE firms to view their legal departments and in-house lawyers in a new light. In-house legal teams are now more valued than ever.

When this survey asked respondents, "What effect did the pandemic have on the perceived value your legal department delivers to the business?" 71% said the legal team was "more valued" (34%) or "much more valued" (37%).

What's driving this new sense of heightened appreciation of the legal team? The business "had to face challenges they didn't face before," wrote one chief counsel at a private equity firm in an open-ended commentary.

Fig. 1. What effect did the pandemic have on the perceived value your legal department delivers to the business?



Workload, headcount and legal costs have all grown

The newly heightened level of respect has been hard-earned because the in-house team's work volume has grown too. Most respondents (73%) said the legal workload has "increased" (38%) or "increased significantly" (35%) over the last three years.

The survey quantified "increased significantly" as a workload that had grown 20% or more. This means almost one in three legal departments experienced such an increase.

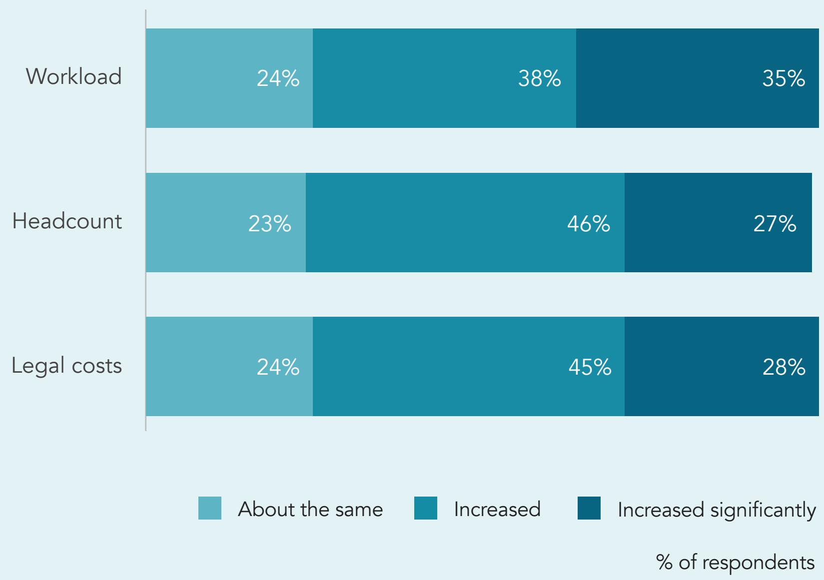
The results also showed a strong correlation between work volume and the growth in legal department headcount. Indeed, nearly three-quarters of respondents (73%) indicated headcount has "increased" (46%) or "increased significantly" (27%) over the last three years, alongside corresponding increases in workload.

Here again, "significant" growth was labeled as a headcount increase of 20% or more. That's a sizable uptick that arguably no other function in business sustained – especially during the early days of the pandemic. Headcount growth can be viewed as another vote of confidence the private equity sector has cast in favor of their legal departments.

However, there is a cautionary tale in the results as well. As workload and headcount have grown, so too have legal expenses: 73% of respondents also said legal costs have "increased" (45%) or "increased significantly" (28%) over the last three years.

When asked what's driving up costs in an open-ended question, some respondents cited the effect of COVID-19, inflation and the fact that costs in legal increase every year. This is an area for legal departments in private equity to watch closely as previous research shows that growing expenses in PE tend to draw increased scrutiny.

Fig. 2. In what ways have the workload, headcount and legal costs changed in your legal department over the last three years?



Data collection and reporting improves

Legal departments are gaining confidence in their legal spend data collection abilities. Around three-quarters of legal departments say they collect data to determine where it is spending on legal services.

More specifically, the survey asked respondents, "To what degree does the legal department have a detailed breakdown of where it spent money on legal services" over three conventional financial reporting periods:

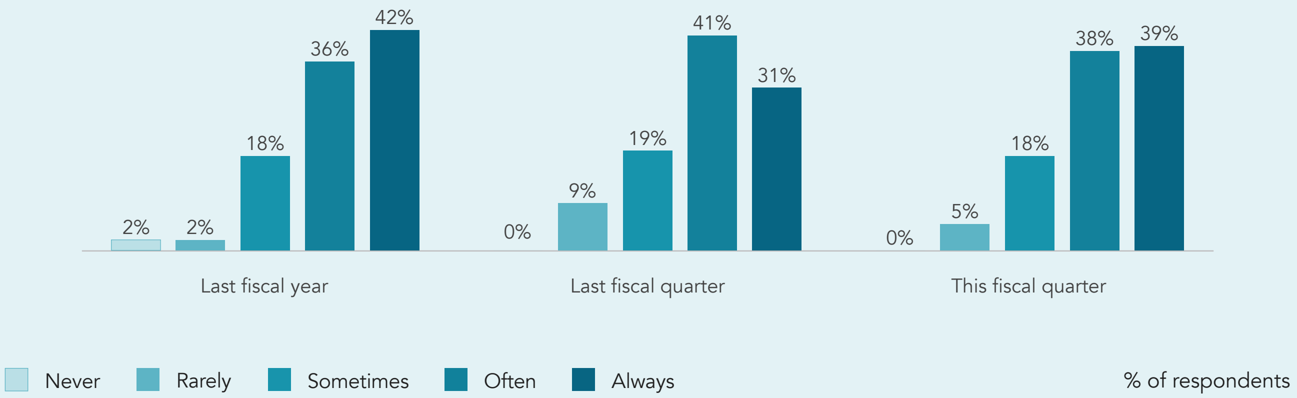
Last year. 78% of respondents said they "always" (42%) or "often" (36%) have a detailed breakdown of legal spending from the last year.

Last quarter. 72% of respondents said they "always" (31%) or "often" (41%) have a detailed breakdown of legal spending from the last fiscal quarter.

Current quarter. 77% of respondents said they "always" (39%) or "often" (38%) have a detailed breakdown of legal spending for the current fiscal quarter.

Notably, about one in five respondents said they collect legal spend data "sometimes" across all periods. Similarly, the number of respondents that said "rarely" or "never" ranged between 4% and 7% across all periods.

Fig. 3. To what degree does the legal department have a detailed breakdown of where it spent money on legal services for each of the following?



Barriers to legal spend data collection and analysis remain

Despite the upbeat findings about legal spend data collection, some challenges remain. These cast a shadow on the capabilities of in-house teams to obtain a comprehensive understanding and insight on how legal expenses affect their organization. This question asked respondents to rank their top barriers to gaining a detailed breakdown of legal spend in their organization.

The top challenges, among in-house teams in PE firms, included the following:

Inconsistent data formats from service providers

More than half (54%) of PE respondents cited "inconsistent data formats from service providers" as a top barrier. When clients ask for budget status updates, they receive it in various formats – spreadsheets, presentations, phone calls and email updates – which makes it difficult and labor-intensive to collate and analyze.

Volume or complexity of legal work

More than half (54%) of respondents also said the "volume or complexity of legal work" is a barrier to legal spend data collection. Legal work in fund management tends to be variable even within the same matter category. For example, we spoke with one PE firm that found an Employee Retirement Income Security Act (ERISA) review cost $5,000 in legal expenses for one limited partner – but a similar review cost $250,000 for another.

As Paul Dali, Managing Director of Legal for EQT once noted, "With 500 investor interactions in a fundraising, the legal counsel costs for agreeing to such terms can easily get out of proportion".

Business units instructing law firms directly

A little more than half (52%) of respondents placed the answer, "business units instruct or manage law firms directly" as the third barrier. Investment managers in PE need to move quickly on competitive deals – and therefore often work directly with a law firm on a preferred service provider list.

This decentralized model puts the legal team in the delicate situation of being accountable for legal spend, without the means to control that spend effectively.

Late or delayed invoices from legal service providers

Just under half (48%) of respondents said "late or delayed invoices from service providers" was the fourth barrier to gaining a detailed breakdown of legal spend. Late invoices can inhibit data collection and reporting for months. Further, relying on invoices to understand the status of overall legal spend is inherently reactive. This is especially true if the invoice exceeds expectations.

Manual collection or analysis process

The fifth barrier was "manual collection or analysis process" according to 46% of respondents. Obtaining legal spend data about a specific matter or law firm is just the first step. That data must be aggregated and normalized to compare spending across multiple law firms to identify trends and find ways to better control costs. This is time-consuming, error-prone and tedious. It may offer an explanation as to why ~18% of respondents say they collect legal spend data only sometimes.

Poor transparency over unbilled or accrued spend

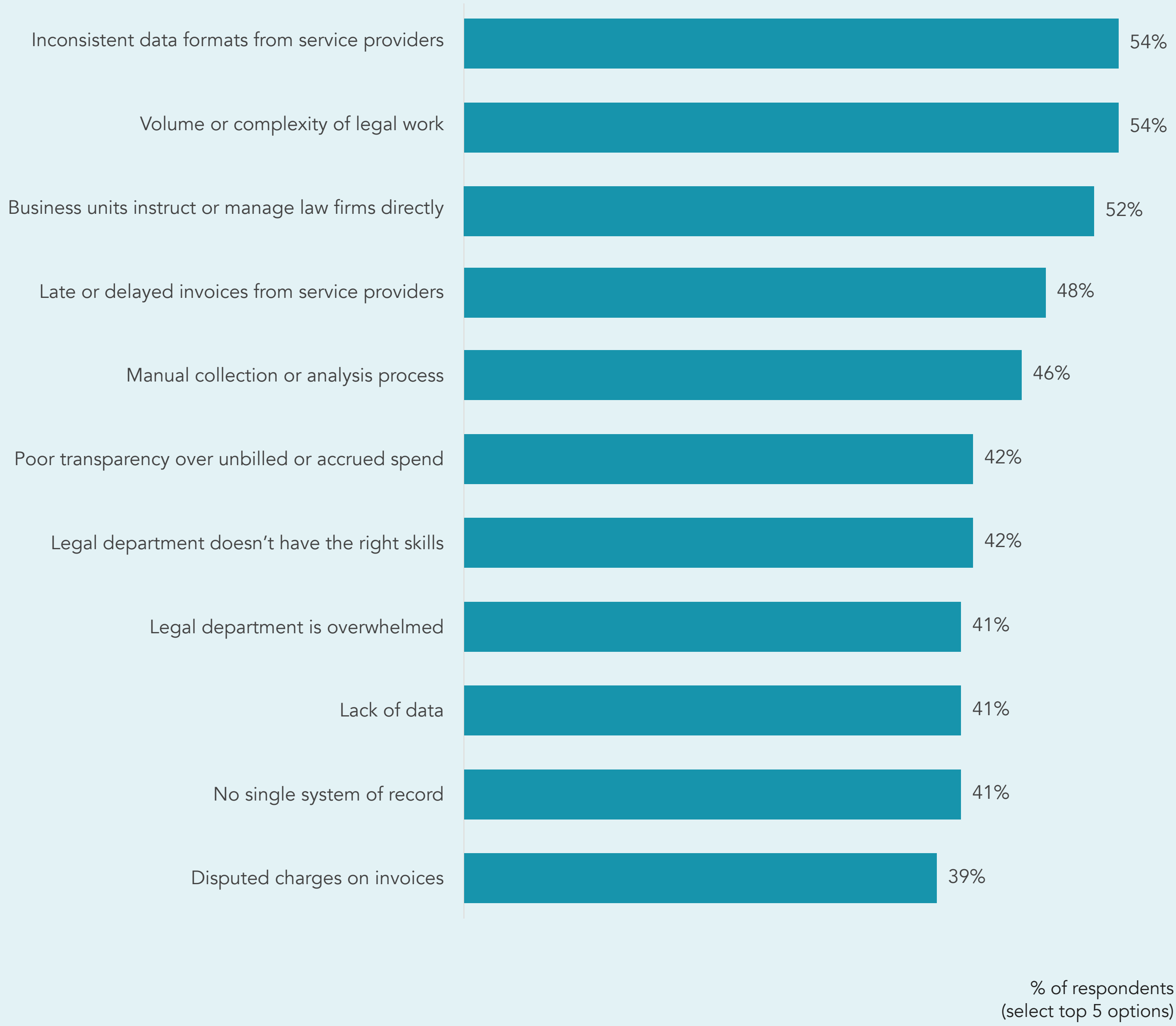
A further barrier to gaining a detailed breakdown of spend was cited by 42% of respondents as "poor transparency over unbilled or accrued spend". Bill Priestley, the Chief Investment Partner at Epiris, called this one of the main "bugbears" of legal fees. "You'd get a quote for the deal, work on the deal, and then invariably the cost at the end would be considerably more than the quote".

Lacking the right skills

Some 42% of respondents said their "legal department does not have the right skills to track legal spend" – putting it joint sixth on the list of top barriers to legal spend data collection. It's no secret that training to be a lawyer does not typically include data or technology skills. That's a driving reason behind the trend to bring in more allied professionals such as legal operations staff. A separate research organization found legal ops roles jumped more than 75% since 2018 across the corporate legal sector.

Note: Also see our separate report on the five legal operations trends to watch in 2022.

Fig. 4. Barriers to gaining a detailed breakdown of legal spend in your organization



Many legal departments in PE feel overwhelmed

Another barrier to data collection that's just outside the top seven, but merits highlighting, is the notion that the "legal department is overwhelmed", according to four in 10 respondents (41%). It reflects fatigue that is common to all the barriers – even as the volume of legal work continues to grow.

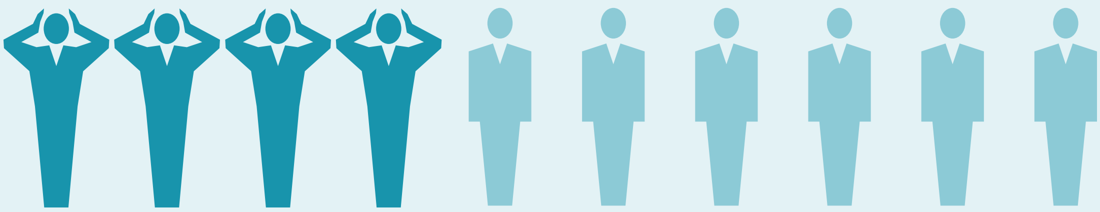
To be clear, this sense of being overwhelmed isn't limited to just lawyers in private equity. It was reflected across financial services in the larger data set. It may also be true in the broader corporate legal community too. A July 2021 survey of 202 corporate lawyers by a separate market research firm found "54% are exhausted to some degree, with 20% scoring as highly exhausted."

This is an important finding because, despite the growth in headcount, it suggests the problem can't be solved by adding human resources alone. Legal leaders must also improve legal processes and tools to improve efficiency and alleviate the strain on their team.

Fig. 5. Four in ten respondents say that legal spend data collection is hindered because the "legal department is overwhelmed"

41%

of respondents



Top priorities: controlling external legal spend and leveraging data

When asked about legal spend priorities for the next 12 months, controlling external legal costs (57%) and better leveraging data to make decisions (51%) were at the top of the list. Improving the predictability of legal spend ranked in third place with 45% of respondents selecting this option.

Interestingly, reducing internal legal costs (12%) and reducing outside legal costs (15%) were at, or near, the bottom of the list. This underscores a stronger desire to better control costs rather than merely reducing them.

Private equity firms are willing to pay for good counsel – but they want to be in full command of that spend – and don't want to be surprised by a higher-than-expected invoice that arrives months after a deal closes.

Fig. 6. Which of the following are the top legal spend priorities for your legal department over the next 12 months?

The struggle to make sense of data

In the context of the full survey, the finding around legal spend priorities casts a shadow of doubt over the extent of insights being gleaned from legal spend data collection. Inconsistent data formats, manual process for collection and analysis, and the expressed need for better control all suggest in-house teams in PE collect legal spend data but struggle to aggregate and analyze it to find actionable insights.

In other words, the ability to obtain a breakdown of legal spend about a given matter, or even from a specific law firm, is not in question. In-house teams are asking for – and receiving – detailed budget status reports from their law firms. However, that data quickly grows stale, and doesn't provide a comprehensive view to compare legal spending across the organization.

The alternative is to automate the collation and aggregation of spend data from law firms, ideally prior to invoices being received. This can allow for a real-time view on spending and accruals, allowing comparisons to be made across different time periods, law firms and similar matter types, to improve control and drive strategic decision making.

This conclusion points to the next logical progression in legal spend management process maturity. And it may well be a step towards relieving that sense of being overwhelmed, which many law departments in PE are experiencing.

Most effective techniques for controlling legal costs

The survey found that a number of techniques are used to control legal costs. The three that ranked as most effective are: structuring more legal work under alternative fee arrangements (AFAs) (76%), utilizing specialized software for monitoring and managing costs (68%) and centralizing all legal spend through the legal department (51%).

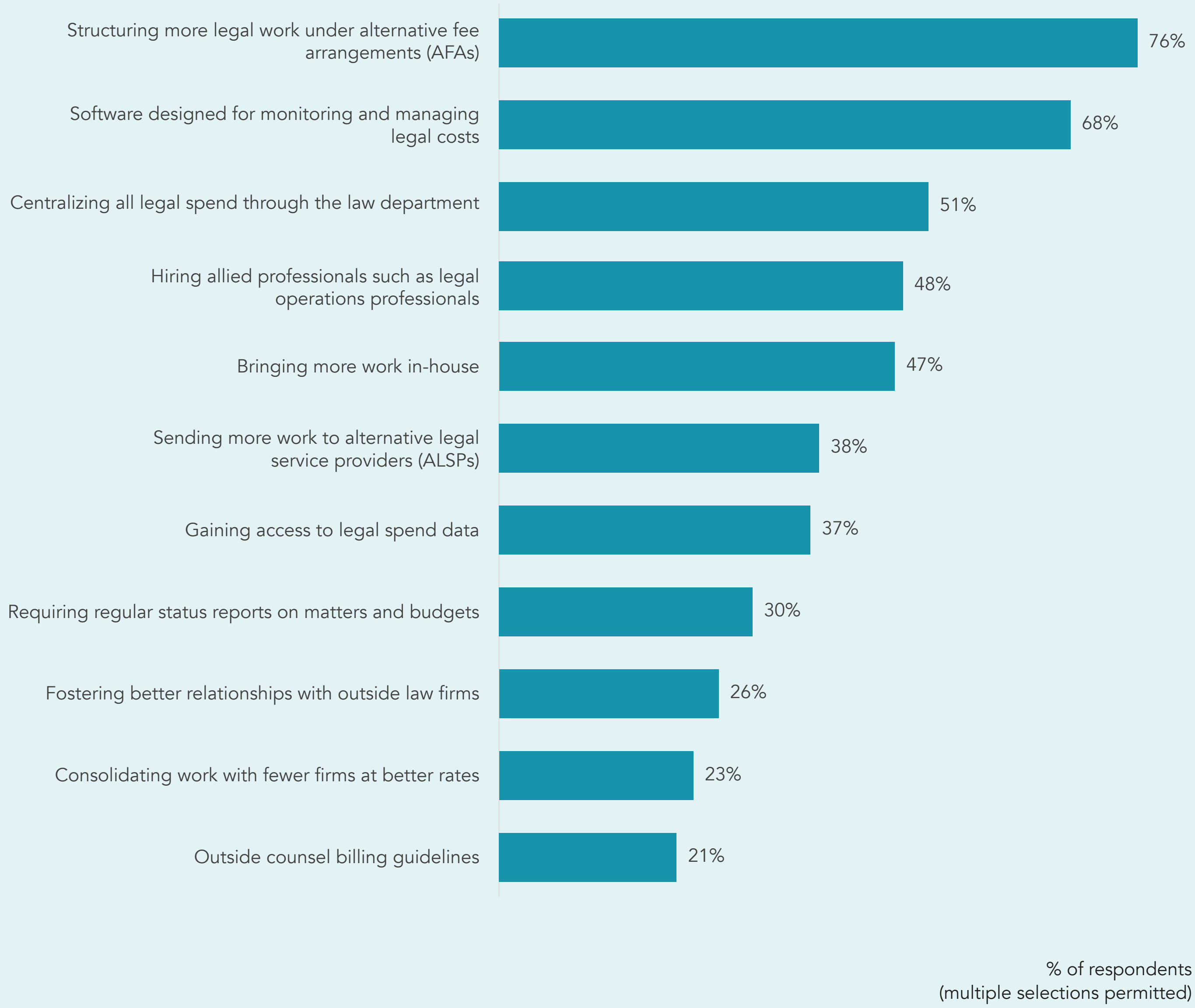
AFAs are an effort to eliminate the asymmetry that exists in legal time, billing and invoicing. Specialized software promises to automate manual tasks – like aggregating and analyzing non-standard legal spend data to drive better decision-making. The centralization of legal spend speaks to the paradox legal departments in PE face over the growth in legal costs: they lack control but are still held accountable.

Any effort to centralize legal spend is likely to be met with substantial organizational resistance. For example, speed in the pursuit of investment opportunities is crucial to the success of a deal team – and requires access to the law firms for legal counsel. An easier path is to improve internal processes and visibility, with tools that enable in-house teams to oversee and manage legal spend without requiring investment managers or deal teams to change the way they work.

Modern problem solving involves people, process and technology – and the human element was evident in the next three techniques: hiring allied professionals such as legal operations (48%), bringing more work in-house (47%) and sending more work to alternative legal service providers (ALSPs) (38%).

Finally, it was surprising to see outside counsel billing guidelines ranked last (21%) – they've clearly fallen in popularity. A few years ago, outside counsel billing guidelines were heralded as a key solution to controlling costs. However, as these proliferated, they often grew longer and proved unwieldy both for law firms to comply and law departments to enforce.

Fig. 7. Techniques that are the most effective at helping to control legal costs



Ample investments in tech – and more to come

Legal departments in private equity say they've made ample investments in legal tech – and fully intend to keep pressing forward. The vast majority of respondents "agreed" (47%) or "strongly agreed" (34%) that their organization had invested sufficiently in legal tech over the last three years.

What's more, over the next 12 months, 73% of respondents said the level of investment would "increase" (41%) or "increase significantly" (32%). The top technology tools respondents are considering implementing in the next year include, risk management (64%), legal spend management (54%), e-billing (46%), contract management (42%) and compliance tools (41%).

Fig. 8. Moving forward, which of the following best characterizes the level of investment your organization is planning to make in legal technology over the next 12 months?

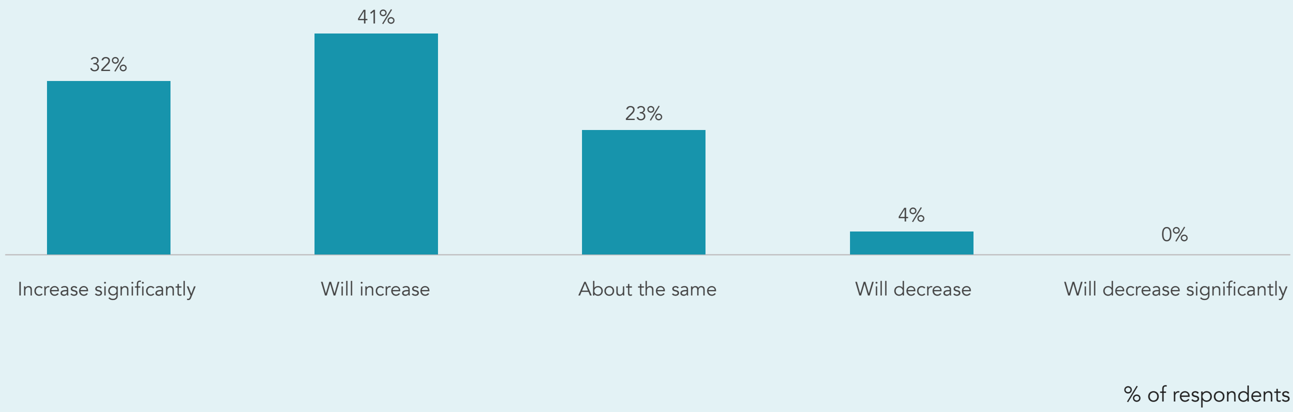
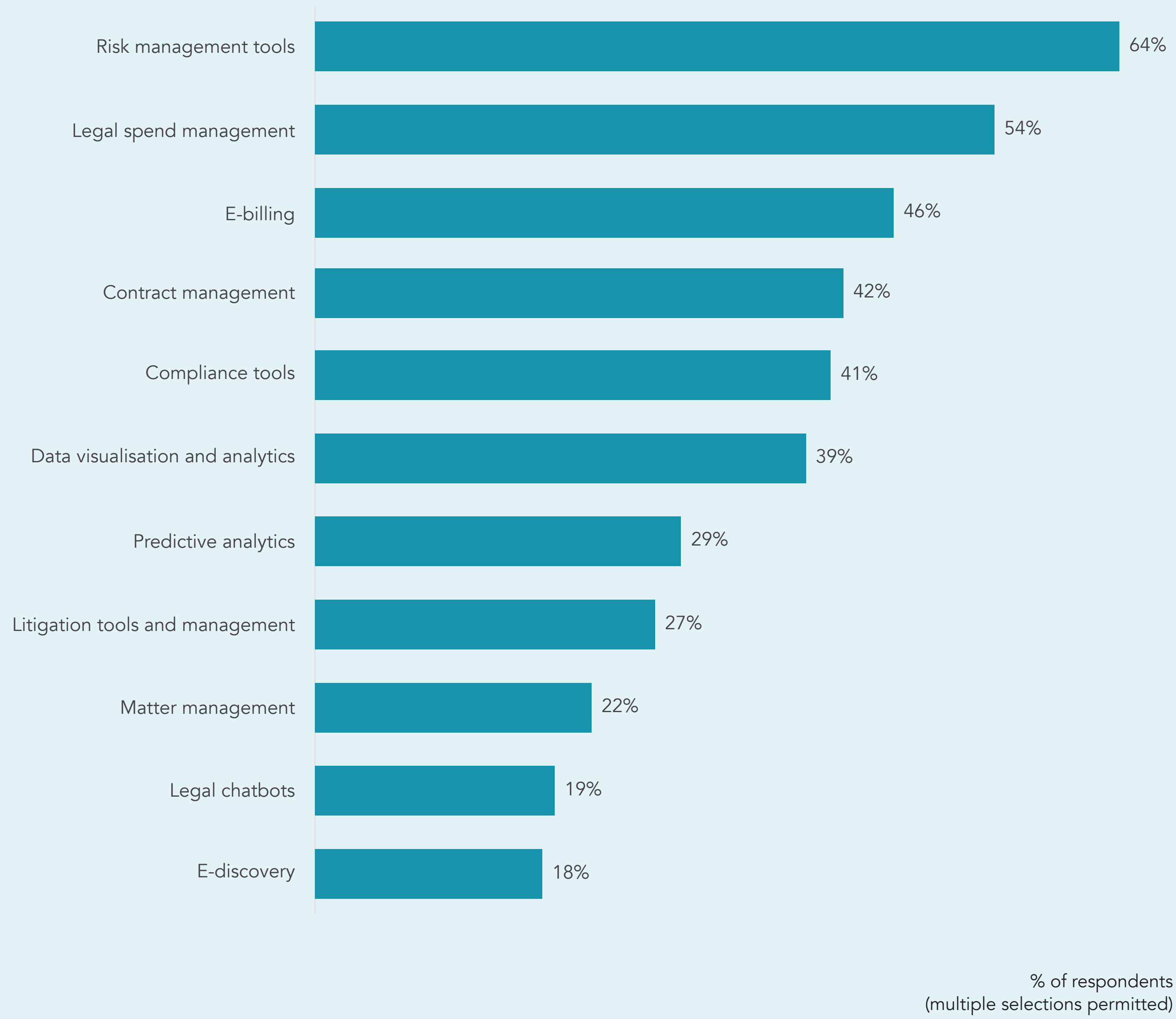


Fig. 9. Which of the following types of legal and compliance technologies would your organization consider implementing in the next 12 months?



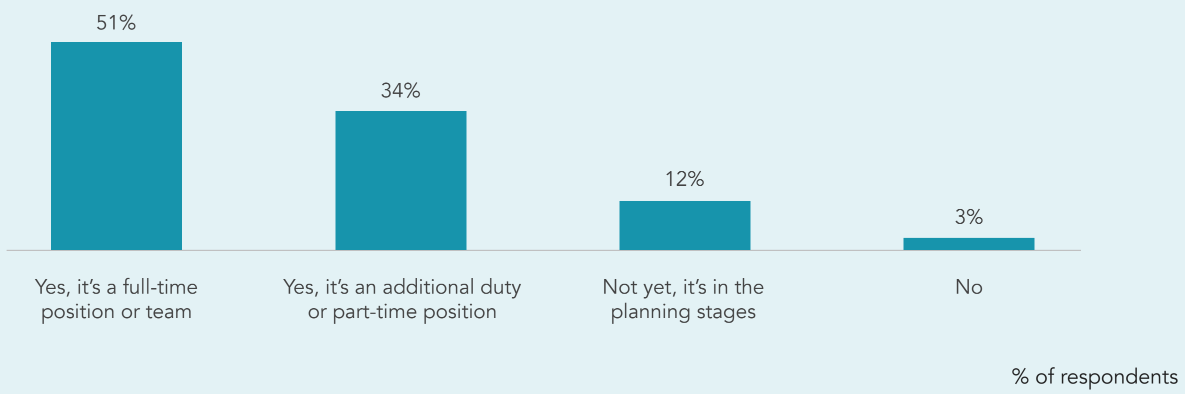
Law department resources dedicated to innovation

Most respondents (85%) say their department has a person or team charged with leading innovation. Just over half (51%) of respondents said this was a full-time responsibility while 34% said it was part-time. Another 12% said they didn't have a designated resource charged with innovation, but such a position was in the planning stages.

All in all, just 3% of respondents did not have a person or team charged with innovation – at least as an additional duty.

When analyzing the geographical split of answers to this question among the larger survey data set – that is across financial services – attitudes toward innovation in the US may be more advanced than in the UK. More than half (58%) of US respondents reported having a full-time person or team responsible for innovation, compared with 37% in the UK.

Fig. 10. Does your legal department have a person or team charged with innovation?



The top legal metrics PE firms are tracking

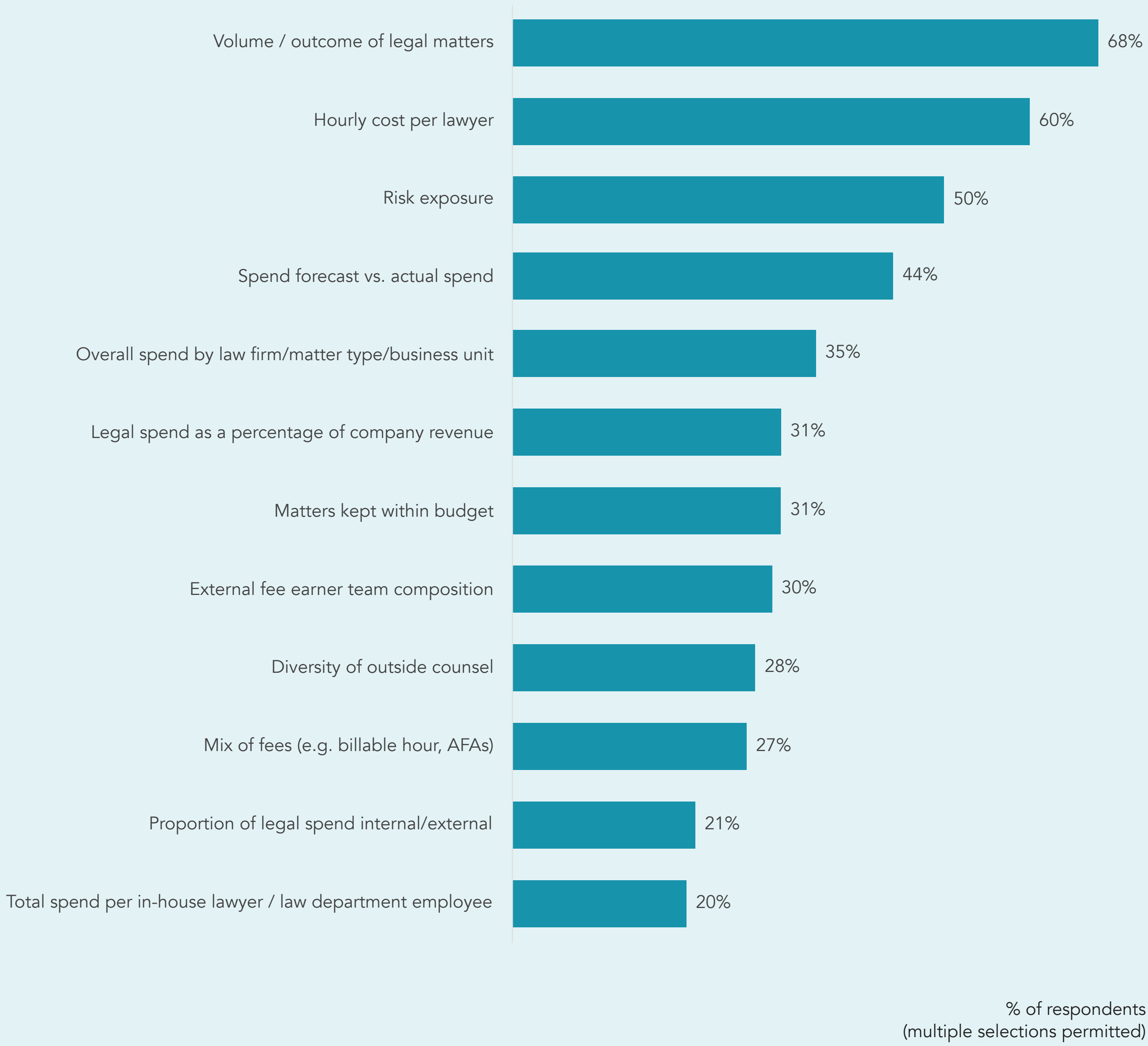
Most legal departments in private equity (62%) are measuring the value they contribute to the business "always" (32%) or "often" (30%). A further 30% say they only measure value "sometimes."

When asked specifically on how they measure value, the "outcome of legal matters" (68%), the "hourly cost per lawyer" (60%) and "risk exposure" (50%) were at the top of the list. These three measures were also the only metrics out of a list of 12 options to accumulate at least 50% of responses.

Rounding out the top five metrics were "spend forecast vs. actual spend" (44%), "overall spend by law firm, matter type or business unit" (35%), and "legal spend as a percentage of company revenue (31%), which was tied for fifth place with "matters kept within budget" (31%).

It's worth noting that further down the list, 28% of respondents say they track the "diversity of outside counsel." Previous research we've also commissioned shows that diversity is among the top factors in selecting outside counsel, so it makes sense the community is keen to monitor it.

Fig. 11. Which of the following performance metrics does your legal department track and monitor?



Conclusion

The uncertainty brought on by the global pandemic has cast a sharp focus on the value legal departments provide to private equity firms. As the resulting volume of work has grown, PE firms have willingly invested in legal department headcount and technology alike.

Legal departments too have stepped up. They've largely charged someone with responsibility for innovation and worked to improve their data collection and reporting. Even so, legal costs are growing, and challenges remain in obtaining a comprehensive understanding of their sizeable spending on legal services.

In-house leaders in private equity have a unique opportunity. Their legal departments are well-positioned to parlay the goodwill their teams have earned and the willingness of their organizations to continue to invest in the department. This will allow in-house teams to take legal spend management process maturity to the next level.

Survey methodology

The overall survey was commissioned by Apperio and conducted by the independent research firm Coleman Parkes. The researchers randomly polled 300 respondents in September and October of 2021 working in financial services, including private equity, asset management, investment banking, retail banking and venture capital, among others. An executive summary of the overall survey results and a link to download the full report can be found here.

This report is based on just those 100 senior legal (63%) and finance (37%) professionals who identified as working in private equity. On the legal side, respondents held positions with titles such as general counsel, associate general counsel, chief counsel, legal partner and senior legal counsel, among others. On the finance side, respondents reported titles including CFO, vice president of finance or accounting, finance director and controller.

These 100 respondents work for PE firms based in the US (71%) and UK (29%) with between $3 billion and $15 billion in assets under management (AUM). Most respondents (63%) reported they were the decision-maker around legal spending, while the remaining 37% said they were part of a team of decision-makers.

Collectively, respondents work for, or with, legal departments that employ an average of 11 lawyers and allied professionals. These teams oversee between $3 million and $20 million in annual outside legal counsel spend.

About Apperio

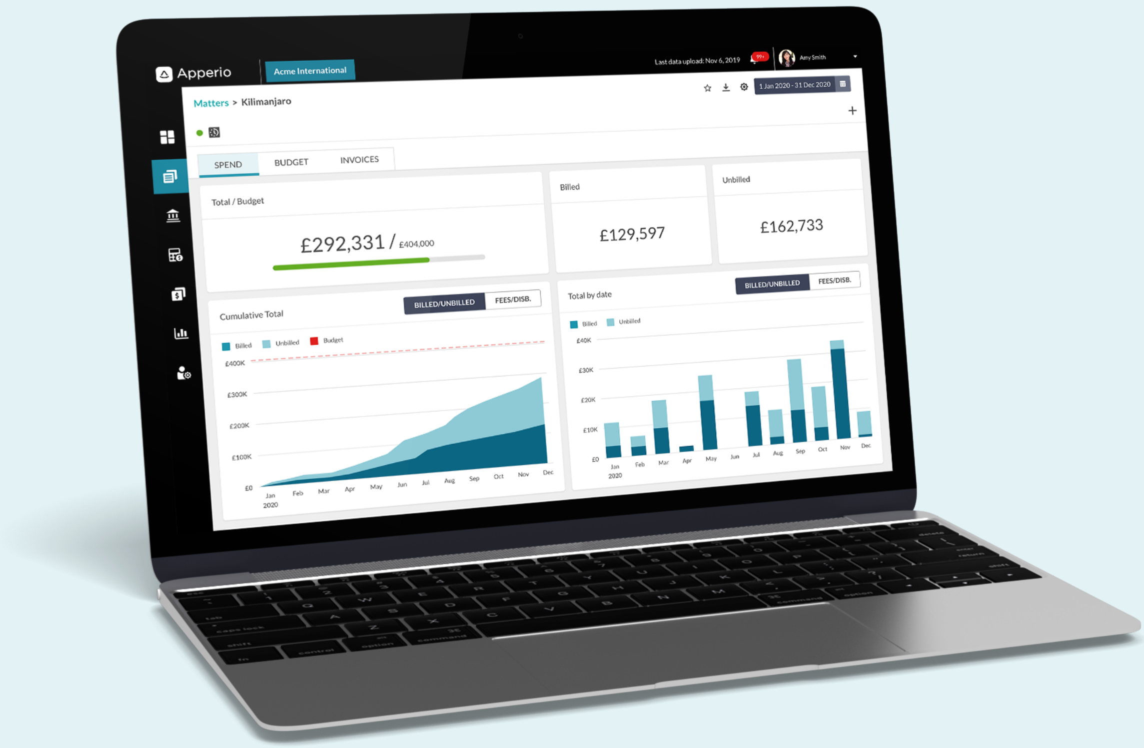
Apperio's legal spend management software is designed specifically for in-house legal, finance and investment teams. Apperio helps companies to stay in control of their external legal spend and drive efficiencies in their legal department.

Apperio uniquely connects directly to law firms' practice management systems to provide a live view of all matters and associated spend. This is an automated process that does not rely on spreadsheets or manual updates. The data is collected, structured consistently and presented simply for analysis to help our customers make informed business decisions.

Unlike e-billing solutions, which only provide visibility of invoiced matters that may have a lag of several weeks, Apperio provides an instant view of both historical and unbilled legal spend data.

Apperio helps PE legal departments to stay in control of their spend and build trust with external counsel by offering a collaborative, rather than adversarial approach to legal spend management. Currently, the platform is used daily by more than 50 in-house legal teams including Epiris, EQT, FSCS, Marex, Monzo, Finastra and Royal London.

To book a demonstration or find out more, visit www.apperio.com or simply email us at info@apperio.com.



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