PEER MONITOR INDEX

THOMSON REUTERS INSTITUTE

Q4 2020 EXECUTIVE REPORT
ISSUED 02.02.2021

LEGAL INDUSTRY SHOWCASES RESILIENCY

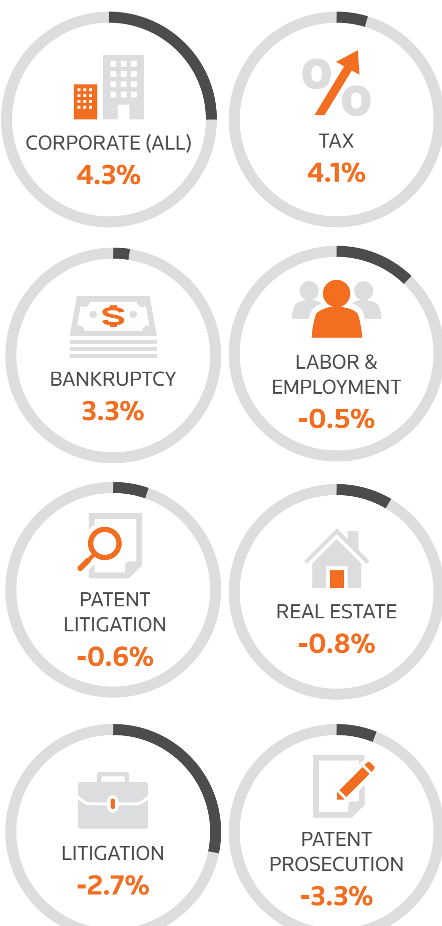
The fourth quarter provided quite the capstone on an otherwise tumultuous year. Businesses of many industries struggled to transition to new working environments because of the COVID-19 pandemic, and the legal industry was no different. Firms have seen their workloads fall short of the year prior as their clients have been faced with their own hardships. Demand fell for the third straight quarter, albeit to a lesser extent, and the average firm in the U.S. worked 0.3% less hours in the quarter than they did in Q4'19.

Despite this, the Peer Monitor Economic Index score reached the highest point since 2006, which also happened to be the second highest quarterly mark ever. The PMI rose to 69, or by 11 points in the fourth quarter, highlighting the resiliency of the legal industry and traditional law firm model.

It may come as a surprise how the legal industry finds itself in many ways in the best health it has been in years with what is happening in the world around it. Demand was down, but there were positive signs emerging when one looked closer. Corporate and tax work both saw growth of more than 4.0% in the quarter, with bankruptcy slightly behind that pace. While welcome news, this was not quite enough to overcome contractions in other areas, such as litigation which made up 29% of all hours worked in 2020 and declined by 2.7%.

PRACTICE DEMAND GROWTH

Y/Y Change | **Q4 '20 v Q4 '19**

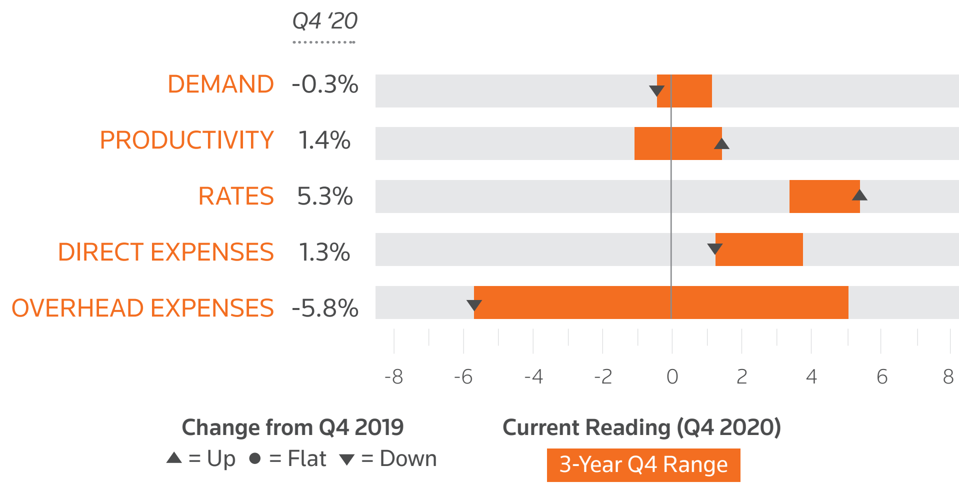


**Circular band surrounding practice is equal to Proportion of Hours Worked in 2020.*

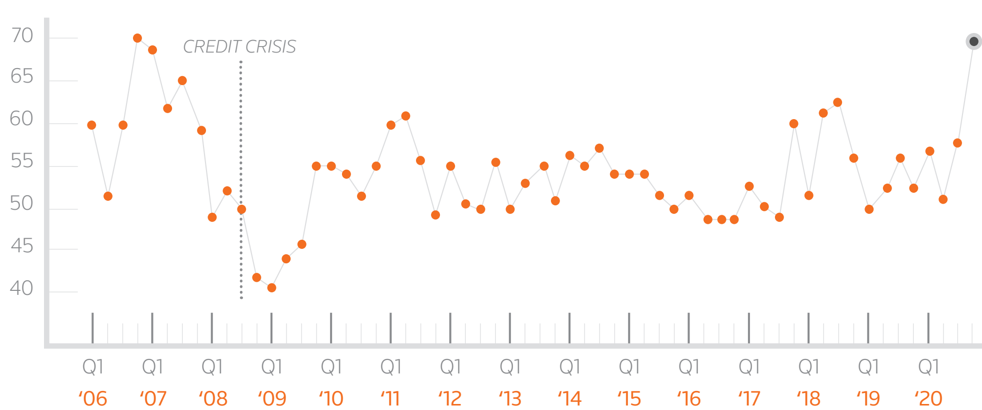
KEY FACTORS Q4 2020 ANALYSIS

Year-Over-Year | **Q4 '20 v Q4 '19**

PMI SCORE: 69 ⬆ 11



PEER MONITOR ECONOMIC INDEX (PMI)



[1] The PMI is a composite index score, representing the quarter-over-quarter change in drivers of law firm profitability, including demand, rates, productivity, and expenses. Positive factors driving firm profitability will produce a higher score.

Higher Rates and Overhead Savings Deliver Strong Profits

One of the main drivers of industry health has been worked rates, which have remained sky-high. Worked rates in the fourth quarter were 5.3% higher at the average U.S. based law firm than they were last year. As a result, despite the demand decline, fees worked (a proxy for revenue) grew by 5.3% on average in the quarter. Fees worked growth in the market occured at a pace that was more than double the rate of inflation by December's end.

Firms have been aggressively cutting overhead expenditure for the majority of 2020. This has been done to essentially firewall profitability, and it has been quite effective. Marketing and business development, recruiting, and office expenses remained the hardest hit by spend reductions by year's end. One interesting development was a return to spending in technology in the fourth quarter, as firms have discovered and adopted more efficient remote work strategies. Despite the late increase in tech spend, overhead expenditure was 5.8% less by year's end.

Direct expenses were slower to follow overhead's lead in terms of contraction but have begun to be reduced by firms as well. While non-lawyer support staff were the initial targets of layoffs and furloughs, lawyers began to see headcount reductions in their ranks by the third quarter. The primary targets of reductions amongst lawyers were associates, and by the end of the fourth quarter the average law firm employed 1.6% less attorneys than in 2019, a pace reminiscent of 2009 and the great recession. The contraction in lawyers may have been for good reason, and firms may have simply found their balance of supply and demand out of sync. Directly resulting from the reductions was an increase in productivity for the first time in 2020, up 1.4% on average.

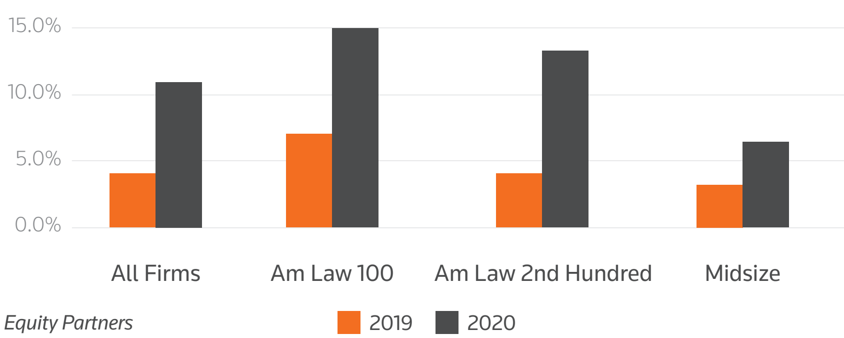
With the year ending came partner distributions. As demand ended in "not as bad as it could have been" territory, worked rates higher than they had ever been, and expenses significantly reduced, the result was profit per equity partner growth nearly triple what it was by the end of 2019. When you consider all of these factors, and when the average equity partner at a law firm's share has increased by 11.5%, it becomes clear how the PMI score can rise so dramatically while the broader economy continues to struggle.

For more information on the PMI, and how the Peer Monitor platform can provide you more granular, timely, and narrowly tailored competitive intelligence, please contact Brent Turner at **763 326 6625** or **brent.turner@thomsonreuters.com**, or visit the Peer Monitor website **here.**

LAWYER (FTE) GROWTH

Lawyers (contractors excluded)

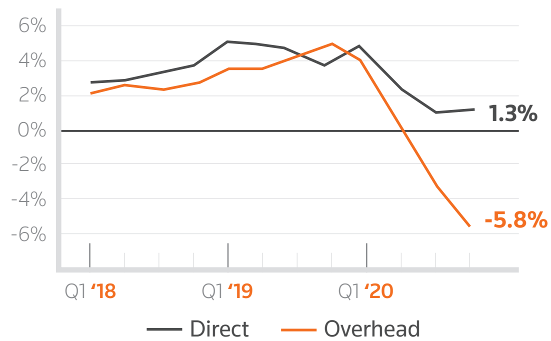
PROFIT PER EQUITY PARTNER GROWTH



Equity Partners

EXPENSE GROWTH

Rolling 12-Month Y/Y Change



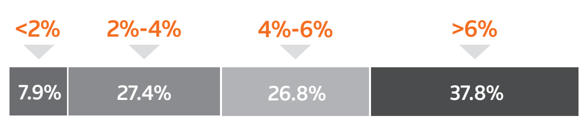
OVERHEAD HIGHLIGHTS

Rolling 12-Month Y/Y Change | Q4 '20

**Circular band surrounding expense is equal to Proportion of Overhead Spend in 2020.*

WORKED RATE GROWTH

Proportion of Firms | Q4 '20 v Q4 '19



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