



LEGAL SPEND WITH NO SURPRISES

Scale vs agility in private equity

Mid-sized PE firms are edging out their larger competitors with better management of legal expenses

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Executive summary

This report is a new analysis based on a specific data set from an independent survey of PE firms of all sizes published early in 2021. The purpose of this paper is to compare the management of legal expenses between mid-sized PE firms and large PE firms. We've classified mid-sized firms as those with assets under management (AUM) of between \$3 billion and \$10 billion – and large PE firms are identified as those with more than \$10 billion in AUM. A detailed methodology section is published at the end of this report.

Based on this analysis, we conclude mid-sized PE firms are generally outperforming their larger rivals when it comes to legal spend management:



Scale in legal spending has certain advantages. Large PE firms outspend mid-sized firms on legal services which provides some pricing advantages with legal service suppliers in certain matters such as merger and acquisition (M&A) transactions. Large PE firms spend less on legal as a percentage per transaction than mid-sized firms even as they tend to work on larger deals that cost more overall to execute.



One in five large PE firms are “often shocked” by the size of legal invoices. Twenty percent of large PE firms report they are often shocked by the size of their legal invoices. More than half (55%) say higher than expected invoices cause them to reforecast budgets, which leads to widespread internal friction among legal, finance and investment teams.



Some large PE firms make no effort to control legal costs.

About one in five large PE firms (22%) say they make no effort to actively manage legal costs compared to just 4% of mid-sized firms. Seven in ten large PE firms reported they were billed for legal work that was, in hindsight, considered unnecessary or redundant; fewer mid-sized PE firms (54%) report similar experiences.



Mid-sized PE firms place a sharper focus on spending.

The difference in legal spend management approaches between mid-sized and large PE firms becomes more pronounced in a comparison of processes. When asked about ten conventional processes for managing legal engagements, mid-sized firms edged out large firms by implementing seven out of the ten named processes. For example, 74% of mid-sized PE firms enforce a formal budget approval process for new matters, compared to just 55% of large PE firms.



Specialized legal spend technology gaining interest in private equity. The majority of both mid-sized (70%) and large PE firms (65%) are reliant on manual data collection and spreadsheets for managing millions in annual legal spend. However, that reliance is down from 91% compared to an earlier survey published in July 2020. Across PE firms of all sizes, most either have specialized legal spend management software in place or have plans to introduce it within their organization.

Legal spend characteristics by PE firm size

Larger PE firms naturally spend more per year on outside legal costs than mid-sized firms. Among our sample set, the majority of mid-sized PE firms (79%) spend between \$2 million and \$10 million annually on external legal counsel. By comparison, their larger competitors (70%) spend between \$10 million and \$25 million (figure 1). This includes group legal spend, fundraising, costs associated with M&A transactions, and any extraordinary legal costs such as for litigation and regulation.



The increased budget line item for legal expenses provides larger PE firms with some pricing advantages because of their scale. Merger and acquisition (M&A) transactions are a prime example. While larger firms typically work on larger deals that are more resource intensive, as a percentage, the costs associated with those deals are lower (figure 2).

Fig. 2. During a 'typical' acquisition, on average how much would you expect to spend on external legal counsel per deal?

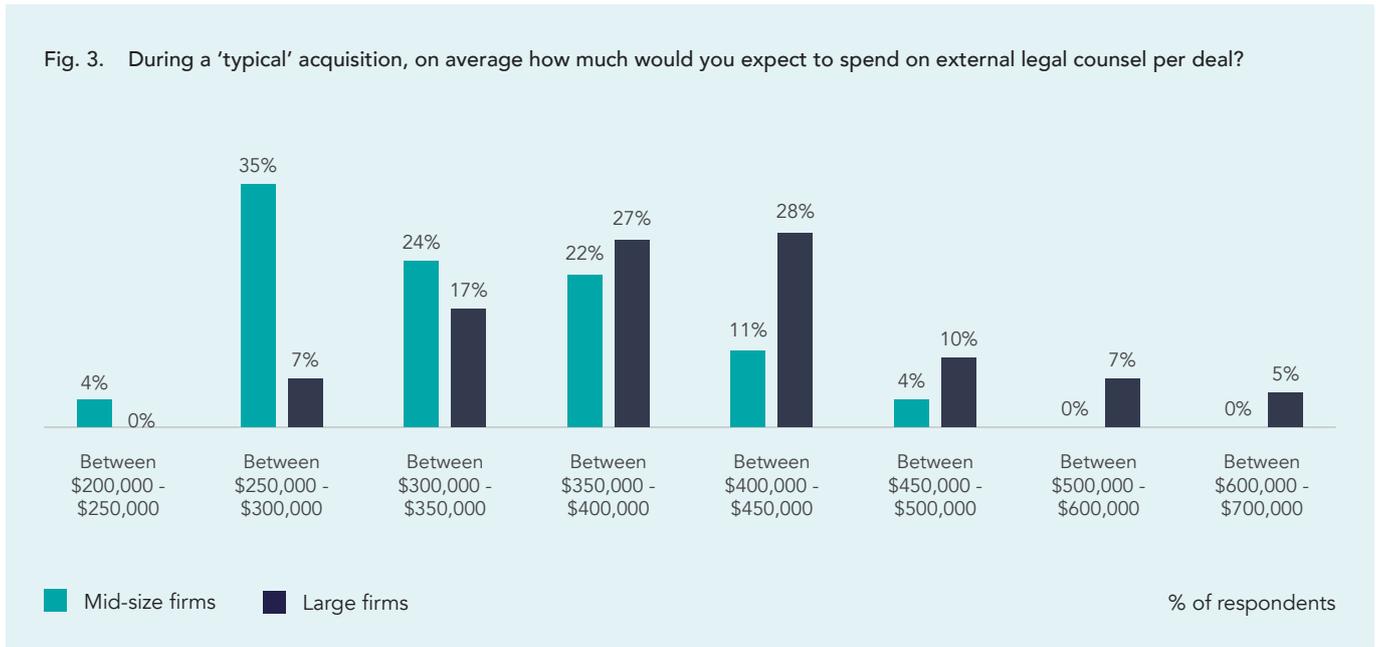


For example, a 'typical' acquisition deal for large PE firms averages \$724 million in value and costs an average of \$410,000 (.057%) on outside counsel to facilitate those deals. By contrast, mid-sized firms average \$455 million per acquisition and spend an average of \$331,000 (.073%) on legal advice for such a transaction (figure 3).

Legal costs can accumulate quickly in short periods, adding up to significant cost overruns. Across PE firms of all sizes, our prior research shows private capital firms are feeling pressured by increased scrutiny of all costs – and 77% say legal spend on individual transactions is a material concern.

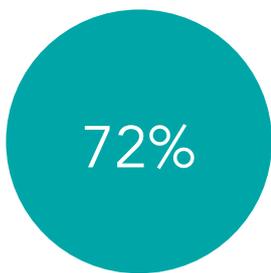


Fig. 3. During a 'typical' acquisition, on average how much would you expect to spend on external legal counsel per deal?

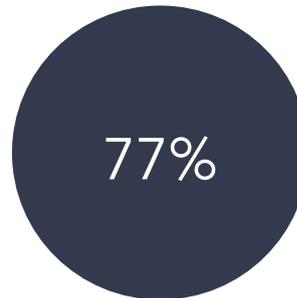


While PE firms aren't especially price-sensitive when it comes to legal costs, they also [don't want to buy the whole store](#), so to speak. Nearly three quarters of mid-sized PE firms (72%) and large firms (77%) say legal spend optimization is a priority for their organization in 2021.

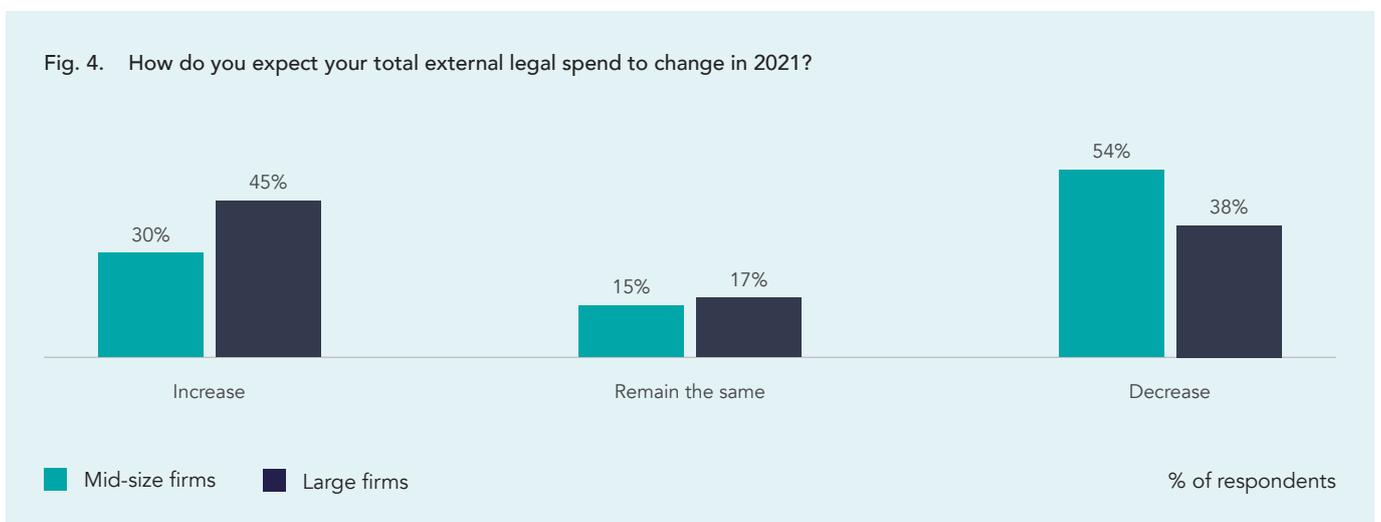
To that end, more than half of mid-sized PE firms (54%) expect their legal spend to decrease in 2021 compared to 38% of large PE houses. Inversely, about one in three mid-sized PE firms (30%) expect legal costs to grow this year while 45% of their larger competitors expect the legal line item to grow (figure 4).



Of mid-sized PE firms say legal spend optimization is a priority for their organization in 2021



Of large PE firms say legal spend optimization is a priority for their organization in 2021



Organizational effects of higher-than-expected legal invoices

Cost overruns adversely influence internal team dynamics across the PE organization. Our prior research has shown PE firms of all sizes say higher-than-expected legal invoices create friction among the lawyers in the legal department and the wider business (79%), including their peers on investment teams, and also with the finance department (78%).

Yet legal costs seem to exceed expectations with some frequency. For example, our previously published survey findings revealed that nine legal matters – from investment financing to M&A and litigation – go [over budget estimates 70% of the time](#) in some cases.

How can this happen? Legal expenses accrue quickly when matters are fluid, and the budget isn't being closely monitored. For example, 42% of large PE firms say they occasionally lose track of accrued legal costs as their law firms work on matters. When these firms receive invoices, one in five (20%) say they are often shocked by the size of the bill. Consequently, more than half (55%) are forced to reforecast budgets ([figure 5](#)).



By contrast, mid-sized PE firms are less likely to lose track of accrued legal costs (26%) but are also more likely to be surprised by the size of the legal invoice (33%). Mid-sized firms seem to be better prepared for this, however, as they are less likely to be forced to re-plan budgets (41%). However, the internal friction caused by higher-than-expected invoices is more prevalent (80%).

In aggregate, the responses to this question support a subtle theme that emerged in this analysis: mid-sized PE firms are edging out their larger rivals in terms of managing legal costs.



How EQT use Apperio to manage legal spend

Simply taking steps in the right direction can go a long way toward getting a handle on legal costs, as EQT, one of the world's largest private investment firms recently illustrated. In a [case study](#), EQT noted, before implementing legal spend management, there could be a gap of weeks between law firm status and time-entry updates – and fees would suddenly and unexpectedly jump in that period.

Now their legal spend management efforts enable them to see exactly what's happening without having to ask law firms for such granular updates. In turn, this provides the opportunity to prevent costs from mushrooming.

Read the full case study here: <https://www.apperio.com/stories/eqt>.

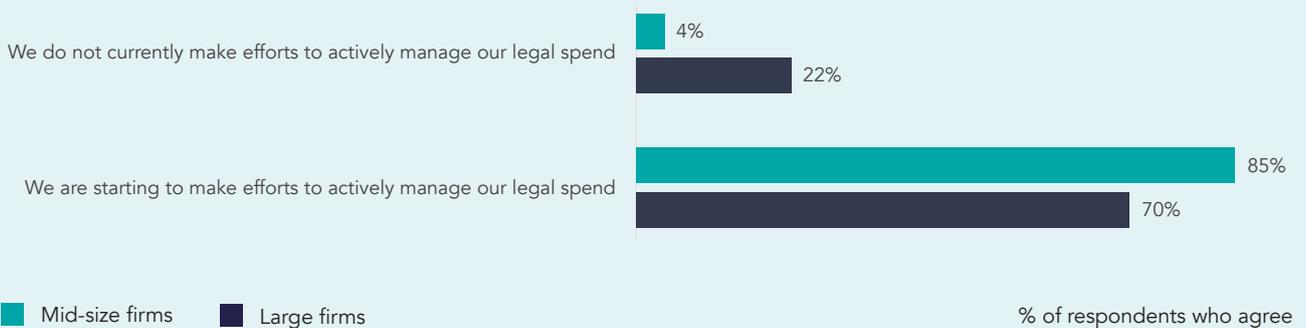
Efforts to manage legal spend

In terms of effort, mid-sized PE firms again seem more inclined to make efforts or plans to manage legal spend. For example, just 4% of mid-sized PE firms say they do not actively make any efforts to manage legal expenses. By contrast, about one in five large PE firms (22%) say they make no effort to actively manage legal costs (figure 6).

A similar theme shows up when asked about new initiatives for legal spend management. Some 85% of mid-sized firms say they are starting to take steps to manage legal spend where 70% of large PE firms are doing the same thing.

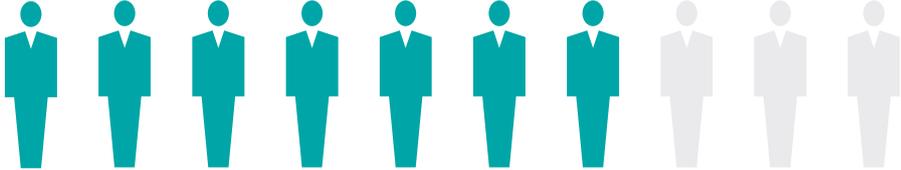


Fig. 6. Thinking about the management of your legal spend, to what extent do you agree or disagree with the following statements:



Merely applying more focus on actively managing legal spend could go a long way toward reigning in unnecessarily high costs. An unnerving seven in ten large PE firms reported they were billed for legal work that was, in hindsight, considered unnecessary or redundant. While mid-sized PE firms also experience this problem, it is somewhat less pervasive at 54% or about five in ten firms in this category (figure 7).

Both mid-sized and large PE firms indicate that having greater visibility into their law firms' work-in-progress (WIP) would enable them to get ahead of the problem before work is completed and law firm invoices are published. Indeed, the correlation is compelling: those PE firms with better visibility into accrued legal spend have fewer experiences with invoices for legal work that was unnecessary in hindsight.



Seven in ten large PE firms were billed for legal work that was, in hindsight, considered unnecessary or redundant

Fig. 7. Thinking about the management of your legal spend, to what extent do you agree or disagree with the following statements:



Processes PE firms use for effective legal spend management

A more prominent difference in approaches to legal spend management appears when it comes to business process management. When asked about ten conventional processes for managing engagements and costs with external legal advisors, mid-sized firms are outperforming their larger competitors.

Specifically, mid-sized firms are more likely than large firms to say they have implemented seven out of the ten named processes – and were tied for an eighth (figure 8). Some illustrations of these processes include:

- **Budget approval.** 74% of mid-sized PE firms require a formal budget approval process for new legal matters, compared to just 55% of large PE firms.
- **Legal accruals.** 37% of mid-sized firms say they perform a “regular calculation of accruals” compared to just 28% of large firms.
- **Retrospective analysis of cost overruns.** 26% of mid-size PE firms say they perform a retrospective analysis to understand why a particular matter went over budget, while just 15% of large PE firms are inclined to do the same.

When asked about plans to introduce legal spend management processes, the data shows larger firms are aiming to make up the gap. One point that stands out among plans is that 37% of large PE firms expect to implement a “formal process for authorization to instruct legal counsel.”

This is an important point because internal collaboration and transparency are just as important as managing outside spend. In private capital, business leaders often instruct law firms directly on new matters. This enables a PE firm to capitalize quickly on new investment opportunities. However, when different investment managers are working independently with various law firms, in-house lawyers don't have a comprehensive view of legal costs – and that's often when these expenses skyrocket.

Fig. 8. Which processes do you have in place, or are considering, to manage engagement with external legal advisors?



Legal spend management technology adoption

The majority of both mid-sized (70%) and large PE firms (65%) are highly reliant on manual data collection and conducting budget planning and analysis in spreadsheets (figure 9). However, this is down significantly from a survey fielded early in 2020 where 91% of the in-house legal teams working in PE said they were dependent on spreadsheets.

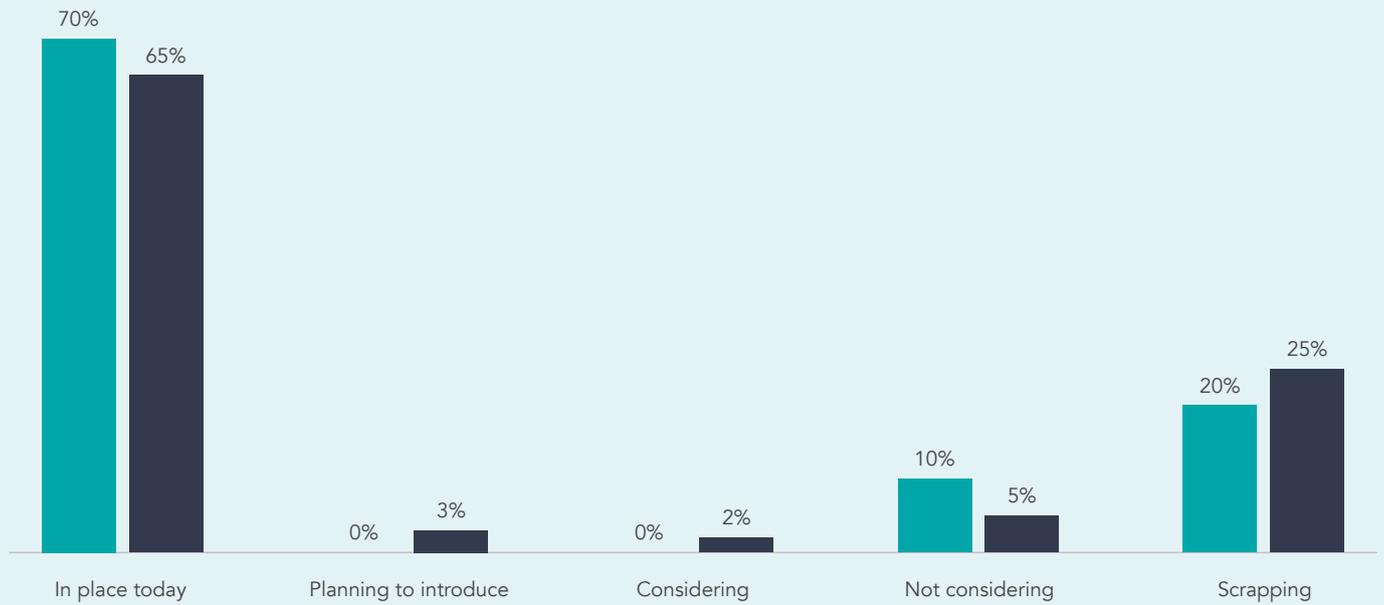
Simply stated, spreadsheets are not conducive to frugally managing an annual legal spend of between \$2 million and \$25 million – which in PE is often parsed out among a half-dozen law firms and potentially hundreds of legal matters.

Both mid-size and large PE firms seem to have a genuine interest in the emerging category of software dedicated to legal spend management. While only 13% of mid-size PE firms are using such technology today, more than six in ten (63%) are planning to introduce it soon – and another 15% are considering it.

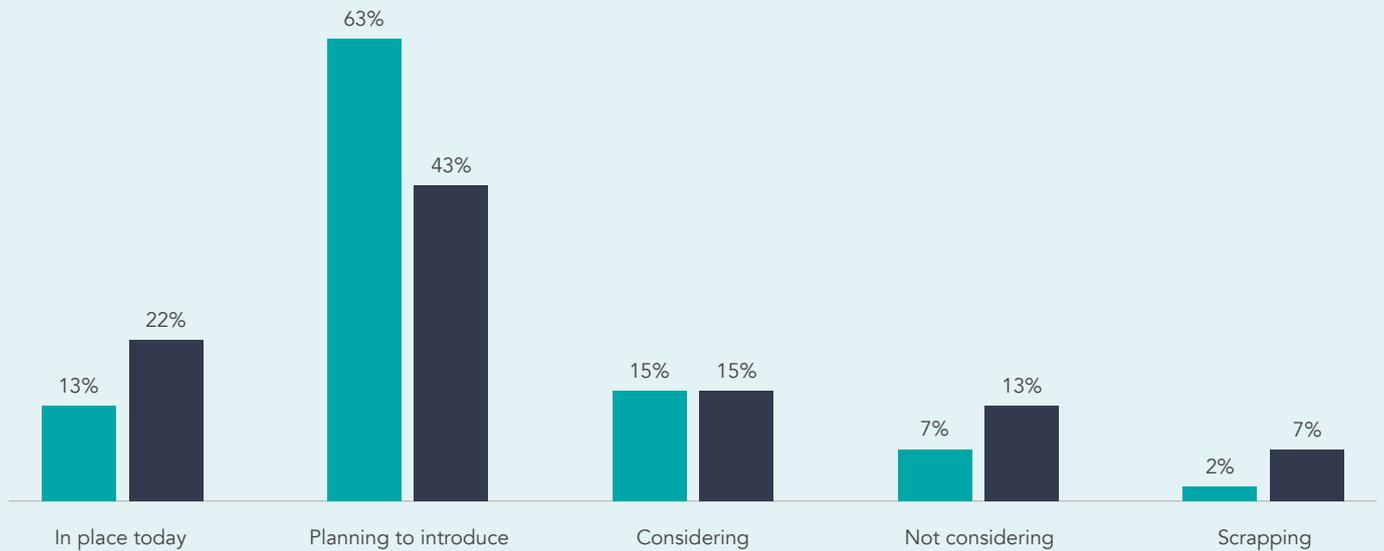
A slightly higher percentage of large PE firms already have spend management software in place today (22%), with another 43% planning to introduce it and a further 15% considering the technology.

Fig. 9. Which of the following tools do you use to manage your legal spend?

Manual data collection (e.g. in Excel)



Specialized spend management software (e.g. Apperio)



Mid-size firms Large firms

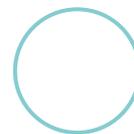
% of respondents

Conclusion

Mid-size PE firms, those with between \$3 billion and \$10 billion AUM, aim to reduce their legal expenses in 2021. They're well-positioned to achieve this by more actively managing their legal spend. These organizations have better visibility into the source of their legal costs but many still struggle with accruals and are sometimes surprised by the size of law firm invoices.

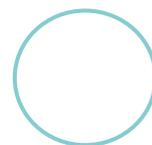
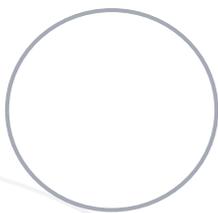
However, cost optimization is important to mid-sized firms and they are putting significant effort into process improvement. Mid-size firms also grasp the importance of technology. They intend to use data and analytics to drive better legal budget decisions – which in turn helps improve investment returns.

By contrast, large PE firms – those with more than \$10 billion in AUM – are significantly less likely to actively manage their legal spend than mid-size firms. They also have less visibility into legal spend across their organization and are more likely to be billed for unnecessary legal work.



Large PE houses are slightly behind mid-sized firms in terms of implementing processes and technology to effectively manage their legal spend. The effects cause widespread internal friction and add to the external pressure to keep costs low and improve margins. These investment organizations may have more to gain from effective legal spend management because their legal costs are higher overall.

Based on this analysis, we conclude mid-sized PE firms are generally outperforming their larger rivals when it comes to legal spend management. They are more actively managing legal spend and are outstripping both current and planned efforts of large PE firms. They have better visibility and are significantly less likely to be billed for unnecessary legal work.



Methodology

Over the last year or so, Apperio commissioned an independent research firm to conduct two separate surveys of in-house lawyers working for private equity firms. The results of the most recent survey – and source of the data set used in this analysis – were published in January 2021 in a report titled [Responsibility Without Control? Challenges Facing Private Equity Legal Leaders](#).

In terms of sample size for this analysis, the total number of respondents in this slice of the survey data was 106. Broken out by size, 46 respondents work for mid-sized firms and 60 work for large PE firms.

A previous study, which was not used in this data analysis, but is a source of comparison in the text, was derived from a separate survey that was also independently commissioned. That study polled 100 in-house lawyers working for PE firms across the US and UK with an average of \$10 billion AUM. The results of that survey were published in a July 2020 report titled [Rocketing Scrutiny, Eroding Trust: The Changing PE Legal Spend Landscape](#).

About Apperio

The Apperio legal spend management platform is specifically designed for in-house legal, deal and finance teams. With ever-increasing scrutiny over how clients' funds are spent, Apperio helps investment firms to track the ongoing costs associated with fundraising, oversee the investment matters currently in progress with external firms, improve the predictability and efficiency of legal spend, and safeguard regulatory compliance.

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



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