

Acritas

LEGAL EXECUTIVE
INSTITUTE



2019

State of the Legal
Market in China



the answer company™

THOMSON REUTERS®

INTRODUCTION

As trade tensions between the US and China heat up, the accusation is frequently made that Chinese business success is based on copying Western innovation. “The legal market in the China is evolving rapidly”, says Li Steven Wang – Head of Corporate Segment for Asia & Emerging Markets at Thomson Reuters, “and adoption of the US/European model of law firms as private and commercial businesses is a relatively recent development there. Because the China legal market is only about forty years old, one might assume they lag behind their Western counterparts in many areas – but our latest research suggests that this is not necessarily the case.”

In fact, our most recent research into the Chinese legal market indicates that the West may have a few lessons to learn from the Chinese. The Chinese market is changing much more rapidly than Western markets, and is less bound by institutional inertia and tradition. Consequently, the Chinese are more likely to try different methods and strategies, and to utilise technologies that make these alternative approaches possible.

KEY TAKEAWAYS

What the West might learn from the East

Clients the world over hate hourly billing. In China, alternative fee arrangements (AFAs) are used in 55% of matters. In the US, it's 17%. (Acritas Sharplegal research)

93% of Chinese companies need legal advice elsewhere in the world, whereas only 78% in the US do, and 85% in the UK. (Acritas Sharplegal research) And despite a slowdown, economic growth in China this year is still forecast to be 6.2%. (*IMF's World Economic Outlook Projections*)

What the East might learn from the West

Chinese law firms should develop closer relationships with clients in order to enhance partners' knowledge of their client's businesses. Closer client relations and deeper business knowledge allows partners to provide more business-savvy advice and better service.

What both East and West need to recognise

Not enough clients think their firms are innovative. Law departments in the West are making headway in innovation, but adoption of new technologies is relatively slow. Meanwhile, the Chinese are rapidly adopting software to drive efficiencies in case management and workflow automation.

If law firms don't innovate, clients in search of alternatives will find firms that do. Furthermore, the march toward alternative representation is all too evident in China and elsewhere in the world, especially with regard to the Big Four.

The data in this report comes from Acritas' ongoing research with senior in-house counsel and law firm partners across the world. Data is drawn from Sharplegal interviews with respondents based in Mainland China and those outside of China relating to their legal needs within China.

OVERVIEW

Organizations within China are growing their legal spend at a much higher rate than in Western markets, though amounts still have not reached typical global levels. Price points are now aligned to global norms, however, and China's use of alternative fee models is notably high.

China's businesses are extremely dynamic and international: More than nine out of ten businesses we spoke to have requirements for international legal advice, and that demand is growing faster in China than anywhere else in the world. Interest in Europe in particular, has seen significant growth. At the same time, multinationals over the past three years have increased their legal spend in China more than any other market in the world.

The legal needs of Chinese companies are also growing in range and sophistication. But to deliver these more robust services effectively, external law firms need to develop closer relationships with their clients, offer more consistent quality and service, and provide more business-savvy legal advice. Key to achieving this is effective communication and feedback in both directions.

In general, external law firms around the world innovate slowly and cautiously, whereas Chinese legal departments are driving innovation relatively quickly through legal tech. And because law firms are not always the first to innovate, alternative providers are gaining ground. This is a dynamic market, and the demand to "work smarter" is growing internationally.

"The legal market in the China is evolving rapidly, and adoption of the US/European model of law firms as private and commercial businesses is a relatively recent development there. Because the China's legal market is only about forty years old, one might assume they lag behind their Western counterparts in many areas – but our latest research suggests that this is not necessarily the case."

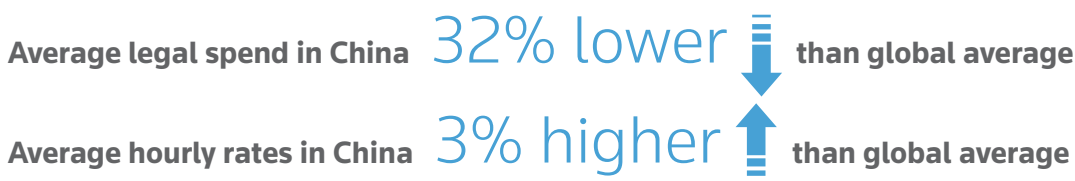
Macroeconomic context

In just four decades, China has transformed itself from one of the poorest nations in the world to the second richest, and its climb is far from complete.

In 2010, China's GDP growth was 10.6%. However, that rate of growth is slowing as the decade progresses, down to 6.6% in 2018, with a forecast of 6.3% for 2019 and 6.2% in 2020. (Source: UN World Economic Situation and Prospects 2019.) This gradual decline in speed of growth has prompted the Chinese government to turn its attention to growth quality. This shift toward quality, combined with a focus on speeding the reform process to accelerate sustainable growth, leads the IMF to predict that China will be the dominant world economy by the end of the next decade.

For the global corporate legal market, China's period of exponential growth continues to represent massive opportunity. In 2017, China benefited from just over \$168,000M inward direct foreign investment and, in turn, made \$102,000M outward direct foreign investment. (Source: OECD.)

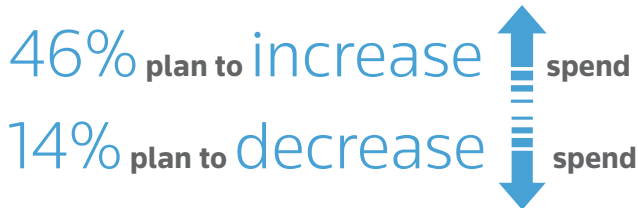
Impact on legal spend



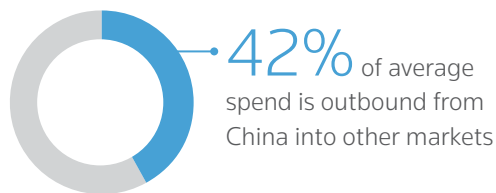
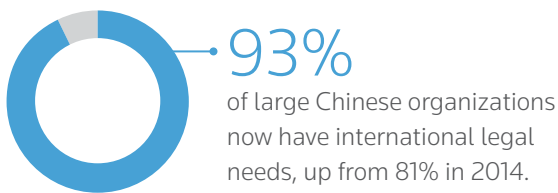
Source: Acritas Sharplegal research

Acritas data collected over the last decade reveals that law departments in China have significantly increased both their legal spend and the average hourly rates they pay to firms. Whilst the average spend is still a third less than the global average, hourly rates are now 3% higher than the global average.

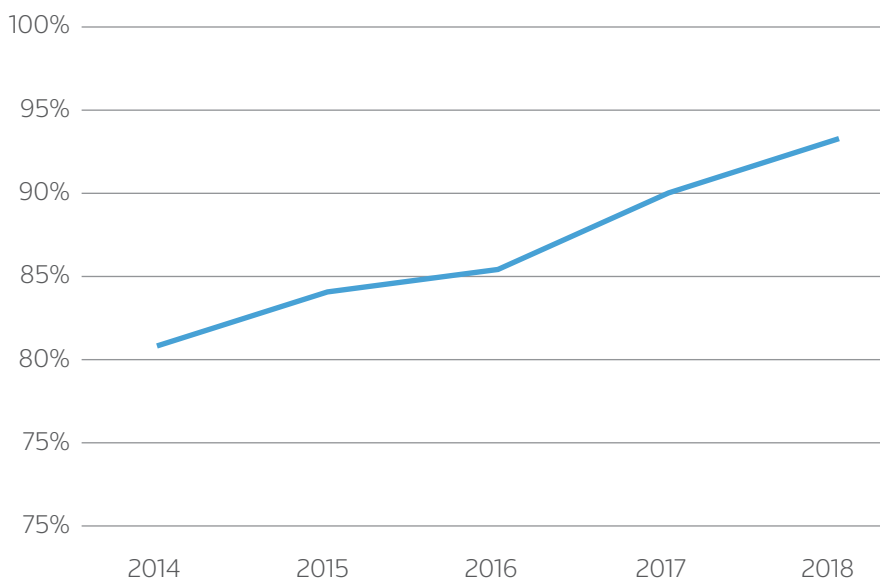
Most work in China is conducted under alternative fee arrangements (AFA). Hourly rates are only used 45% of the time. In the US, by contrast, hourly rates are the primary pricing model, adopted nearly 90% of the time. In long-established jurisdictions, any pricing model that moves away from hourly billing is regarded as “new”, but alternative models are the historic norm in China. Globally, sophisticated clients express a strong desire for movement away from hourly rates, and international firms are struggling to effectively transition sufficient work to AFAs. Therefore, China’s approach to pricing could give its law firms several competitive advantages. These alternative approaches could also present an opportunity for both firms and clients to take a leading role in developing the global market.



Looking ahead, Chinese law departments forecast continued growth in legal spend, both domestically and internationally. 46% of departments plan to increase their overall legal spend in the next year, compared with only 14% planning to decrease spend. The rest expect spend levels to remain static. Growth in international spend is even higher, with only 6% planning to decrease spend.



% OF ORGANIZATIONS IN CHINA WITH INTERNATIONAL LEGAL NEEDS

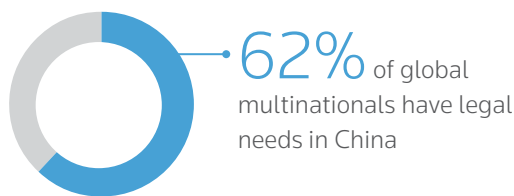


Source: Acritas Sharplegal research

Law departments in China have steadily internationalised over the last five years, to the point where 93% now have some need for legal advice at an international level, up from 81% in 2014. This is perhaps unsurprising, since it parallels broader economic trends of increased investment in foreign countries (for example, through the Belt and Road strategy) and the normalisation of China's currency across global financial markets.

Needs in almost all major legal markets have grown over the last five years. Special Administrative Region Hong Kong retains its place as the main international market for Chinese legal buyers, with 83% stating they have needs in the territory. More widely, 66% have legal needs in the US. However, Europe has seen the greatest increase in inbound legal needs from Chinese clients across a range of countries, including the UK, Italy, Russia and Spain. This is an optimistic trend for the UK, where hopes for a "golden era" economic partnership between the two nations are high. Chinese clients' spend in geographically closer markets such as India, Singapore and Japan remain largely unchanged, with just under half having legal needs in these jurisdictions.

Foreign multinational interest in China



Source: Acritas Sharplegal research

In line with increasing foreign direct investment, the proportion of global multinationals with legal needs in China has risen over the last decade. Approximately six in ten multinationals now have legal needs in China. The average value of spend into China is also increasing, and multinationals predict this will continue to grow in the year ahead, although there is a small proportion, 14%, who intend to decrease spend.

The types of work international clients need has generally remained consistent over time, but there are some notable shifts. In 2014, Corporate was the most required work-type in China for foreign multinationals. Regulatory has now overtaken Corporate as the main area of legal need in China for international companies. The proportion with a need for banking and finance advice has also increased, albeit to a lesser extent. These two trends may indicate further potential for growth following the China Banking and Insurance Regulatory Commission's recently announced plans to allow foreign banks to set up wholly-owned banks and branches in China.

How the Chinese market differs from other markets

Compared to Western markets, where a high level of professionalism is expected, China-based clients are less likely to take expertise and professionalism as a given in the firms they hire. China's clients cite specialised knowledge and professionalism as the two strongest drivers of attraction to favoured law firms.

MAIN REASONS CHINA'S CLIENTS LIKE THEIR FIRMS



International

firms – global footprint and brand



Local

firms – historical client relationship and understanding of their business

Source: Acritas Sharplegal research

International firms are admired, not surprisingly, for their global capabilities and associated reputations, whereas local firms are more likely to be favoured for the historical relationship they have with a client and related knowledge of the client's business. An emphasis on historical relationships and demonstrated business understanding highlight the importance of trust, rapport and compatibility of values for Chinese buyers. On average, the professionalism of lawyers in international firms is cited more frequently as a key quality than in domestic firms, whereas domestic firm lawyers are more often complimented for their experience.

China's private legal profession has only emerged over the last forty years, so it is still in the early stages of development compared to the well-established US and UK markets. Fifteen to twenty years ago, Acritas' research in the US and UK frequently found professionalism to be a top driver of selection and favourability; only in the last decade has professionalism come to be taken as a given, shifting its status to more of a hygiene factor. It seems likely that as the Chinese legal market continues to develop, professionalism will become the norm and its importance in driving favourability can be expected to recede to a level more in line with the global average. In the meantime, professionalism can be pursued and exploited as a source of short-term competitive advantage.

The Chinese cultural value of "giving face" (thereby preserving dignity and respect) drives higher-than-average scoring on research rating scales, yet clients in China also report below-average overall satisfaction levels, which are related to poorer performance ratings across all attributes. The Chinese are not significantly behind in core elements of service delivery, such as efficiency and speed of response. But there is a greater disparity when it come to more sophisticated service attributes (e.g., legal quality and business acumen) developed in longer-established markets.

Because Chinese law firms still lag in performance against global benchmarks for business acumen and quality of legal advice, our research suggests that firms working in China should make these client-centered attributes a higher priority. Most global firms have employed Key Account Management (KAM) techniques—often combined with a sector strategy—to develop and sustain better relationships with their most important clients. These approaches need to be adopted in Chinese markets in order to ensure that firms really understand the business challenges of their Chinese clients.

When asked how their overall satisfaction could best be improved, clients in China offer a broader range of suggestions than the global average. They are particularly likely to cite better – and specifically, more frequent – communication as a desirable attribute. That's an open invitation to listen more closely in order to understand how the needs of Chinese business clients are shifting.

LEGAL SERVICES INDUSTRY LIFE CYCLE



Innovation in law firms



Source: Acritas Sharplegal research

Only 18% of Chinese buyers feel that their legal service providers are using innovative solutions, whereas the global average for perceived innovation is 35%. Use of technology is typically the most prevalent form of innovation, specifically online information and communication resources that enhance speed and efficiency.

Innovation in law departments

Technology and software are the most common forms of innovation seen in Chinese law departments, and their levels of adoption are reasonable. The Chinese are particularly adept at using searchable knowledge databases and case-management software to reduce workflow friction. They are also above-average adopters of workflow automation and metrics/dashboards technologies, as well as document, contract, internal matter and subsidiary-management software. On the other hand, Chinese law departments lag behind global averages in their use of virtual deal rooms, electronic signatures and compliance tools, all of which offer opportunities to enhance performance. Globally, adoption of artificial intelligence is currently low but anticipated to grow (China is somewhat behind other jurisdictions in this area). The opportunity here is not simply to play catch up, but to focus investment and resources wisely in an effort to overtake other legal markets around the world.

Use of Alternative Legal Services Providers

In keeping with the global trend toward Alternative Legal Services Providers, a significant share of clients in China are utilising these new and fast-growing services to conduct portions of their legal business. For example, just over a quarter of Chinese clients had used the Big Four for legal services, which is 5% lower than the global average. ALSPs are quickly becoming a genuine competitive force, and they are offering valid options for corporate legal departments to consider.

Maximising performance

China's rapidly developing legal-services market presents a wide range of opportunities: for international law firms seeking to expand into the world's fastest-growing major economy; for local law firms wishing to grow domestically and/or export their expertise; for a host of alternative legal service providers to build their businesses; for Chinese law departments looking to enhance their contribution to shareholder value; and for all these groups collectively to play a significant role in further development of the global legal-services industry.

Acritas' extensive research with global law firms and departments has revealed that when all parties in the legal ecosystem work together in genuine, close collaboration, everyone benefits. If such an approach is cultivated in China at this relatively early stage of the market's development, the opportunity to create a world-leading legal market is within reach. Collaborative partnerships between law departments and law firms can be built on these five key cornerstones:

FIVE WAYS TO CREATE THE IDEAL COLLABORATIVE RELATIONSHIP



Source: Acritas Stars – Appraising Clients survey, September 2018

LEGAL EXECUTIVE INSTITUTE

The Thomson Reuters Legal Executive Institute brings together people from across the legal industry to ignite conversation and debate, make sense of the latest events and trends, and provide guidance as you confront the opportunities and challenges that these changes present.

Through live events, blog commentary, legal news analysis, and interviews with industry leaders, the Legal Executive Institute offers keen insight into the profession of law and the legal marketplace from members of law firms, corporate legal departments, government, and academia.

For more information, go to legalexecutiveinstitute.com

Acritas

Acritas is the world's leading provider of global legal market intelligence. We know that your success depends on the quality of your decisions. Empirical data provides the best foundation for informed decision-making and successful strategy development. That is why our experts only make recommendations to clients based on the most robust research insights. With Acritas you can be sure to find the information you need to improve business performance and sharpen your competitive edge.

For more information, go to www.acritas.com

Visit legalexecutiveinstitute.com

