

Will the Slump in Demand for Law Firms at the End of 2022 be Followed by a Rebound?



U.S. law firms experienced a sharp drop in client demand, declining productivity, and rising expenses, leading to a slump at the end of 2022, according to a report by the Thomson Reuters Institute's Law Firm Financial Index. The report, which tracks key financial metrics across 170 large and midsize law firms, found that demand was down by 3.9% in the fourth quarter of 2022. Productivity also fell more than 7% year-over-year, and lawyers billed an average of 112 hours per month in the fourth quarter of 2022, down from 121 hours the previous year. Every practice area tracked by the index saw a decline in client demand over the fourth quarter of 2021.

The demand for M&A work was down by almost 17%, followed by real estate, which was down 11.5%. Demand was also down by 10% for both bankruptcy and tax practices. According to the index, profit per partner declined by 4.5% over the past 12 months.

The report found that law firms now face an "unsustainable" situation in which there is not enough work to occupy the attorneys they raced to hire in 2021. William Josten, manager for enterprise legal content at the Thomson Reuters Institute, which shares the same parent company as Reuters, said that firms are going through a rough quarter.

However, he pointed out that demand for legal services fell by just 0.6% in total throughout 2022, meaning that the most dramatic declines came toward the end of the year. Josten also noted that law firm finances have been like a pendulum, swinging dramatically between a dismal 2020, record-breaking profitability in 2021, and a challenging 2022.

According to the report, despite the challenging environment, there are concrete signs that the pendulum could be already swinging in a positive direction. Increases in direct and overhead expenses are slowing, primarily due to lawyer pay remaining stable after a year of significant increases in 2021. Billing rates continue to climb steadily, and transactional work is poised to pick up as interest rates stabilize and inflation moderates.

Josten added that law firms know more about the challenges they face, and they are coming into focus so firms can more effectively plan for those impacts. The report suggests that law firms may mitigate the slump's effects by focusing on efficiency and cost-cutting measures while continuing to develop their transactional practices.

Despite the challenges, the legal industry remains a significant contributor to the U.S. economy, and law firms are a critical component of that industry. While the latest report suggests that law firms may face a challenging environment in the short term, it also offers reasons for optimism about the future. With the right strategies and a continued focus on efficiency and cost-cutting, law firms may be able to weather the current storm and emerge more robust in the years to come.

REFERENCES:

Law firms' demand slump deepened at the end of 2022. Is a rebound coming?