



AMERICAN BAR ASSOCIATION

Solo, Small Firm and
General Practice Division



Thomson Reuters Institute

2022 State of US Small Law Firms

Cause for cautious optimism



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“An optimist is one who makes opportunities out of their difficulties” – Harry Truman

Executive summary

The world looks decidedly different than it did just three years ago. On the surface, the landscape for small law firms may seem largely familiar — the legal work, clientele, day-to-day challenges of practicing law and managing a small business. But beneath the surface, much has changed.

As already nascent changes were catalyzed during 2020 and 2021, this year brought an additional level of complexity with the upheaval of the overall economy. Law firms of all sizes have not been immune. Yet smaller law firms have maintained a bullish outlook on their future prospects, and likely with good reason.

Evidence across the legal marketplace indicates that corporate clients are looking for ways to push work down to lower-cost legal service providers, creating new opportunities for smaller law firms to capitalize on their price advantages. At the same time, those small law firms that serve primarily individual clients continue to face pressure from alternative providers like *do it yourself* (DIY) legal sites. Yet, small law firms report that they are not facing an increasing degree of pressure from those competitors, with whom they have learned to cope over many years of competition.

This most recent edition of the *Report on the State of US Small Law Firms* once again explores the current state of the legal market through the eyes of leaders of small legal practices. In general, these leaders continue to characterize their practices as successful. However, some cracks may potentially be emerging due to increasing costs pressures for some firms. Increasing administrative burdens continue to place ever greater pressure on small firm leaders, most of whom one would suspect would rather be practicing law and serving their clients rather than managing the minutiae of the business side of their practices. Also, broader economic challenges could further increase pressures on small law firms.

Still, for those small law firm leaders who keep a weather eye on the potential storm in their path and who can take steps to not only deal with current challenges but avoid future ones, the current upheaval in the broader economy, and the legal market specifically, could provide fertile ground to turn difficulties into opportunities.

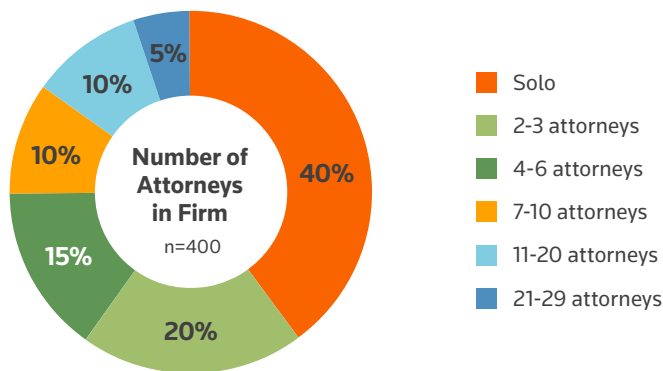
Key findings

- The outlook for small firms is increasingly positive
- Small firms by-and-large consider themselves to be successful
- The competitive landscape is shifting, and this provides both new opportunities and rising threats
- Small firms are demonstrating the ability and wherewithal to make changes and potentially take advantage of those opportunities

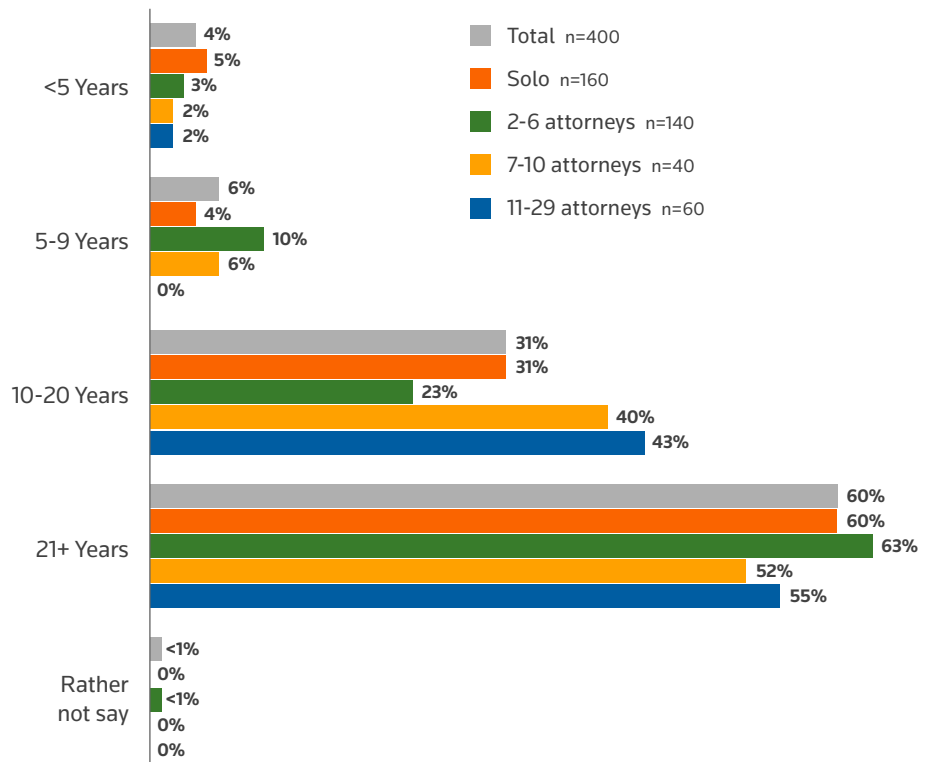
Methodology

The findings in this report are derived from a survey of lawyers within small law firms, defined as law practices with 29 or fewer attorneys. The survey was conducted in August and September 2022.

Figure 1: **Respondent demographics**



Years of Practice Experience



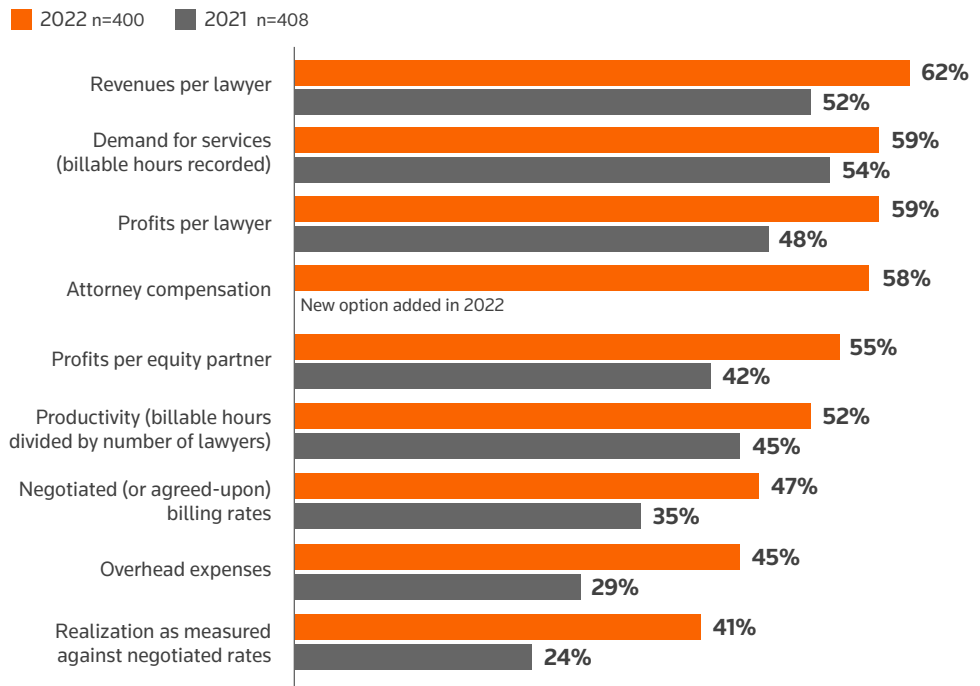
Source: Thomson Reuters 2022

Small law firm leaders as optimists

Lawyers are not typically known as optimists, and instead are far more often associated with risk aversion. Yet, small firm lawyers are optimistic about the outlook for their firms. Indeed, expectations are higher across the board for key financial metrics, both in the next 12 months and over the next three years.

Figure 2: **Expected changes in financial performance indicators in the next year**

Change in the next year (high/moderate growth)



What change do you expect to see in the following financial performance indicators for your firm...Over the next year?

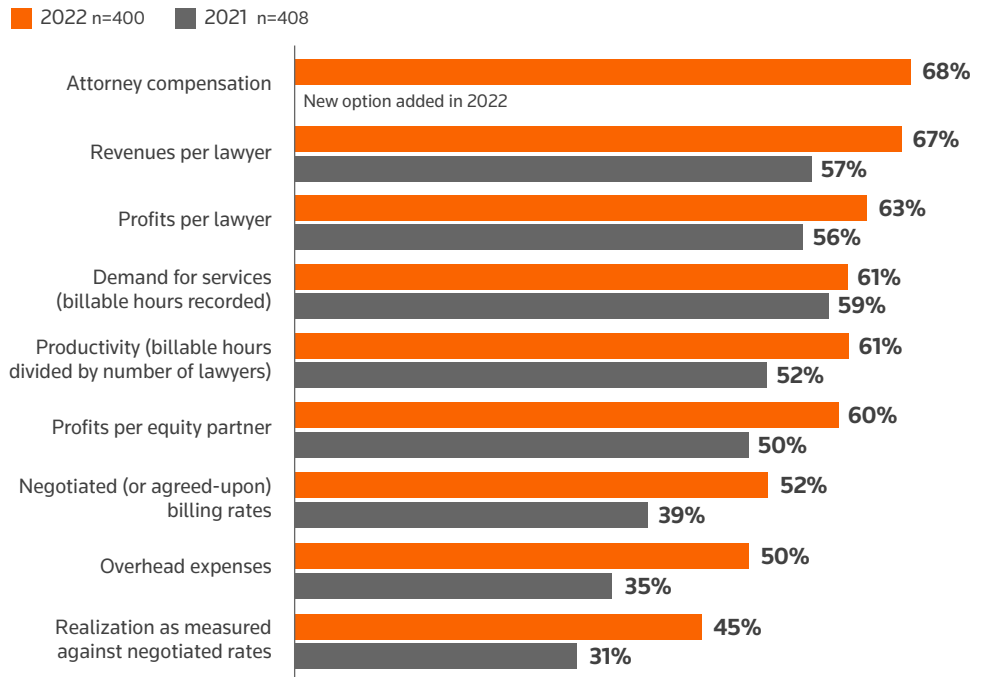
Source: Thomson Reuters 2022

Slightly more than 60% of small firm lawyers expect high-to-moderate growth over the next year in revenues per lawyer, billable hours, and profits per lawyer — all representing sizeable jumps from last year. In addition, the majority of lawyers expect higher attorney compensation, profits per equity partner, and productivity. Expectations for improved billing rates and realization are also significantly higher than last year.

Expectations are also higher looking out over the next three years. Lawyers expect high-to-moderate growth to continue across nearly all key metrics.

Figure 3: **Expected changes in financial performance indicators in the next three years**

Change in the next year (high/moderate growth)



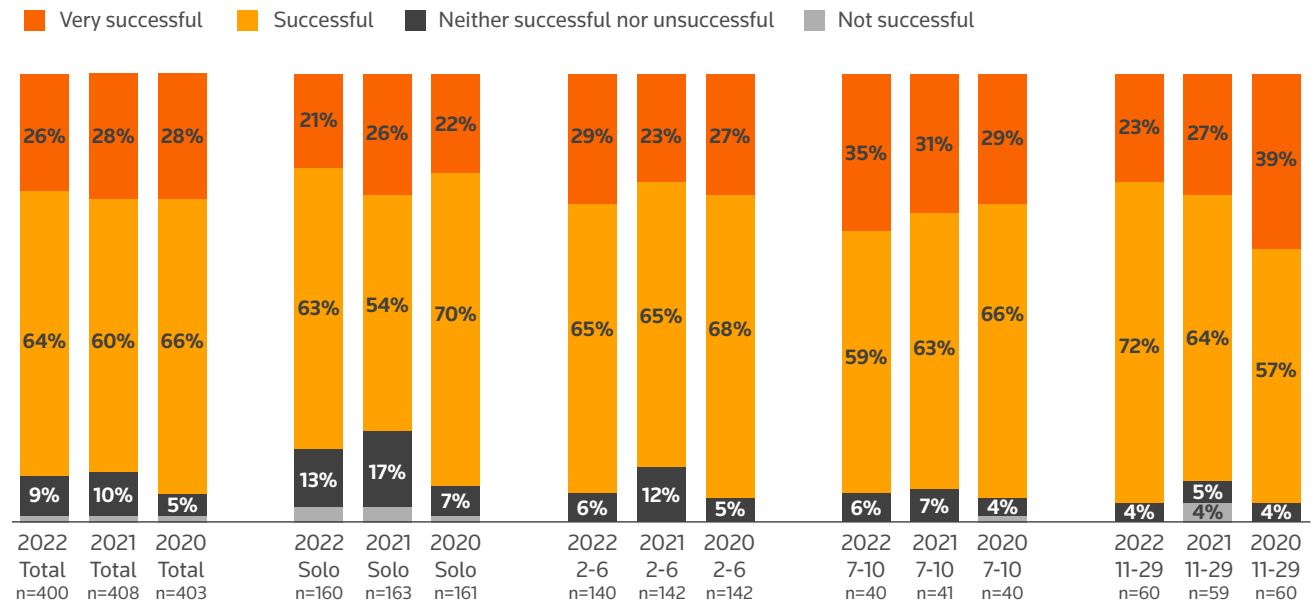
What change do you expect to see in the following financial performance indicators for your firm...Over the next three years?

Source: Thomson Reuters 2022

Success: defining it, measuring it

With such strong growth trajectories anticipated, it's not surprising that small firm lawyers overwhelmingly view their firms as being successful or even very successful.

Figure 4: **Success characterized**



Based on your above definition, how would you characterize your firm's success?

Source: Thomson Reuters 2022

Overall, 90% of small firm lawyers rate their firms as successful or very successful in this year's survey. That breaks down to 64% of respondents saying they consider their firm successful, while 26% give their firms even higher marks as being very successful. Remarkably, less than 1% of small firm lawyers feels that their firm is not successful. These sentiments are in-line with findings from previous years.

Digging a bit deeper reveals some nuances behind these sentiments, however.

Views of firm success took a dip in 2021 for solo firms and those with between 2 and 6 attorneys, but that sentiment rebounded in 2022. For firms with between 7 and 10 attorneys, the percentage of lawyers describing their firm as very successful has steadily risen over the last three years to 35%, from 29%. But for firms with between 11 and 29 attorneys, that percentage has dropped from 39% to 23%, falling from leading the market to a near tie for the lowest rating among small law firm subsegments. While still considering themselves successful overall, a bit of exuberance among these larger small firms may have faded slightly.

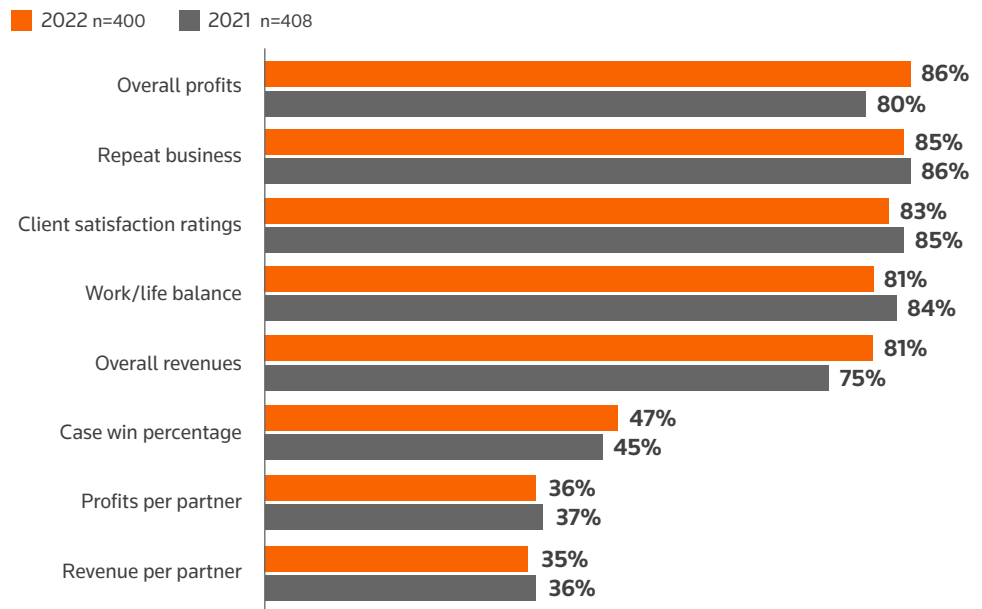
Defining success

Key to understanding *why* lawyers at small firms consider their firms successful is to understand *how* they define success – and how the factors of success have shifted slightly in the last year.

In 2021, repeat business was the most commonly cited definition of success, followed closely by client satisfaction ratings and work/life balance. This year, overall profits leapfrogged those factors to become the most frequently mentioned measure of success. Overall revenues rounds out the top five responses.

Figure 5 : **Measures of success**

Define success



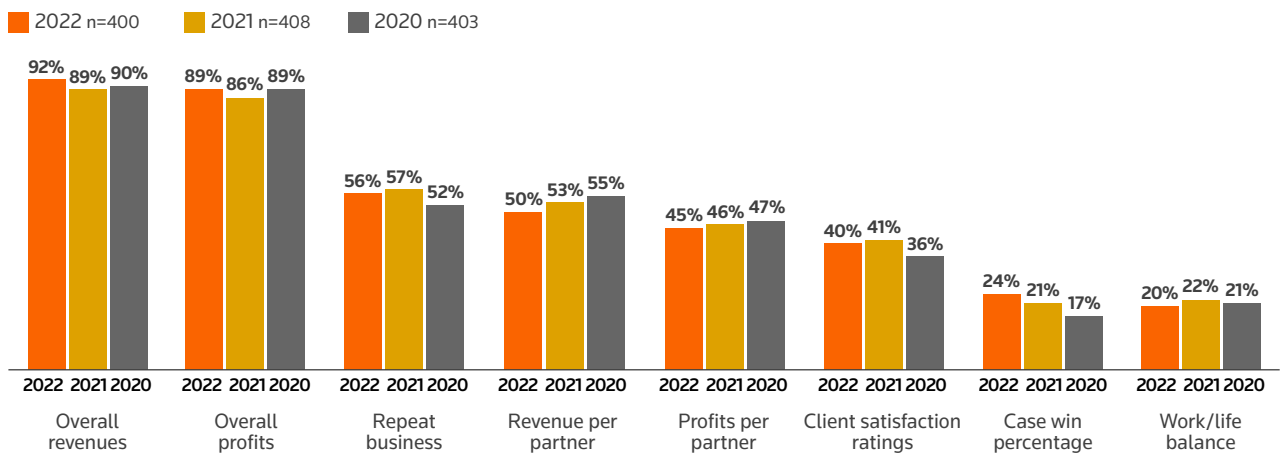
How do you define "success" as it relates to your law firm?

Source: Thomson Reuters 2022

Measuring success

An old business adage credited to management theorist Peter Drucker says, “What gets measured, gets improved.” That being the case, it’s interesting to see what aspects of their business small law firms are measuring.

Figure 6: **Metric tracking**



Do you track any of the following metrics within your firm?

Source: Thomson Reuters 2022

With regard to which particular performance metrics are being tracked, little has changed over the past few years. Attention paid to overall revenues and profits — still far-and-away the most-tracked metrics — has mostly held steady, while focus on revenues per partner and profits per partner has declined slightly.

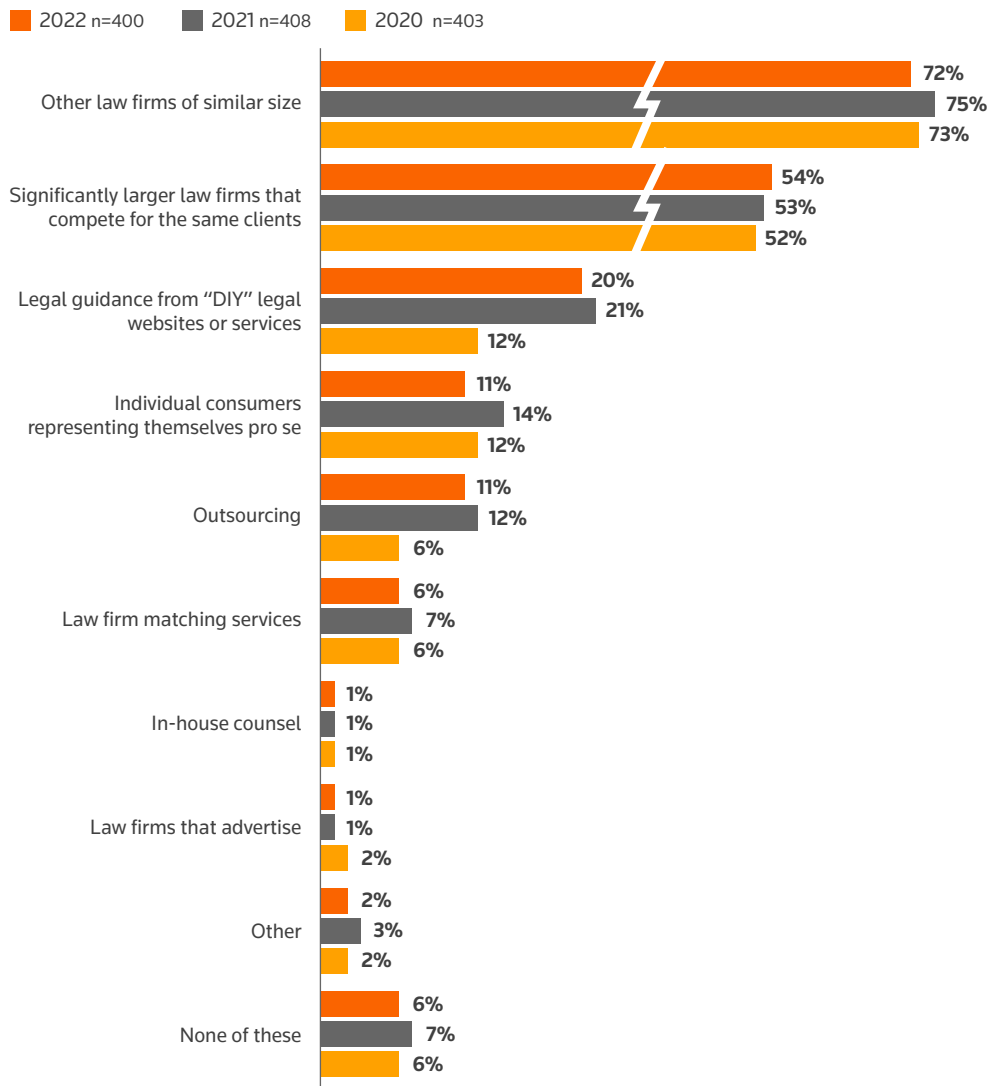
At the same time, slightly more small law firms seem to be paying attention to client-facing metrics. Tracking of both repeat business and high client satisfaction ratings has grown over the last three years.

Greater focus on client-facing factors may be increasingly important for small firms as they simultaneously try to address challenges like rising competition and to grow revenues and clients served.

Competition

Small law firms sit squarely at the intersection of two significant competitive forces — DIY services competing ostensibly from below, and larger law firms competing from above.

Figure 7: **Sources of competition**



From which of the following do you experience the most competition in the market?

Source: Thomson Reuters 2022

The growing popularity of DIY legal websites continues to encroach upon small firms' clientele. The percentage of small firm lawyers who view such websites as major competitors took a significant jump in 2021 and has remained elevated in 2022. Such competition — readily accessible via computers and smartphones and viewed by consumers as a less expensive alternative to law firms — is putting the onus on small law firms to improve efficiency and client service.

The threat is likely to continue to increase as websites aimed at consumers and businesses proliferate and add increasingly sophisticated technologies. Particularly for small law firms in practices where DIY sites are making the biggest inroads — estate planning, small business formation, etc. — these sites may even present a potential existential threat to firms that cannot formulate a plan to compete effectively. Regardless, small firms that cater to individual consumer clients need to continue focusing on efficiency and client service to better ensure they are providing a high level of value.

When it comes to competing against other law firms, the percentage of lawyers who say they are concerned about other firms of similar size has held relatively steady.

However, the percentage of lawyers who view significantly larger firms as competition for the same clients has been creeping upwards over the last few years.

This may be a result of both shifts in what clients are looking for within a law firm, as well as larger firms seeking opportunities to take work from smaller competitors. Through the decade from 2010-'19, the large firm and midsize legal markets saw mainly flat-to-minimal organic growth. Many of these firms may today be looking for new growth opportunities in areas more traditionally served by smaller law firms. While there may be less high-ticket work available, they may be looking to make up for it through greater volume.

More significantly, clients across the legal market are more open to seeing how they can maintain quality legal services while paying less, whether this means moving to progressively smaller firms or shifting from national to regional firms and so on. And such shifts may be occurring to some degree across a broad spectrum of client sizes as well.

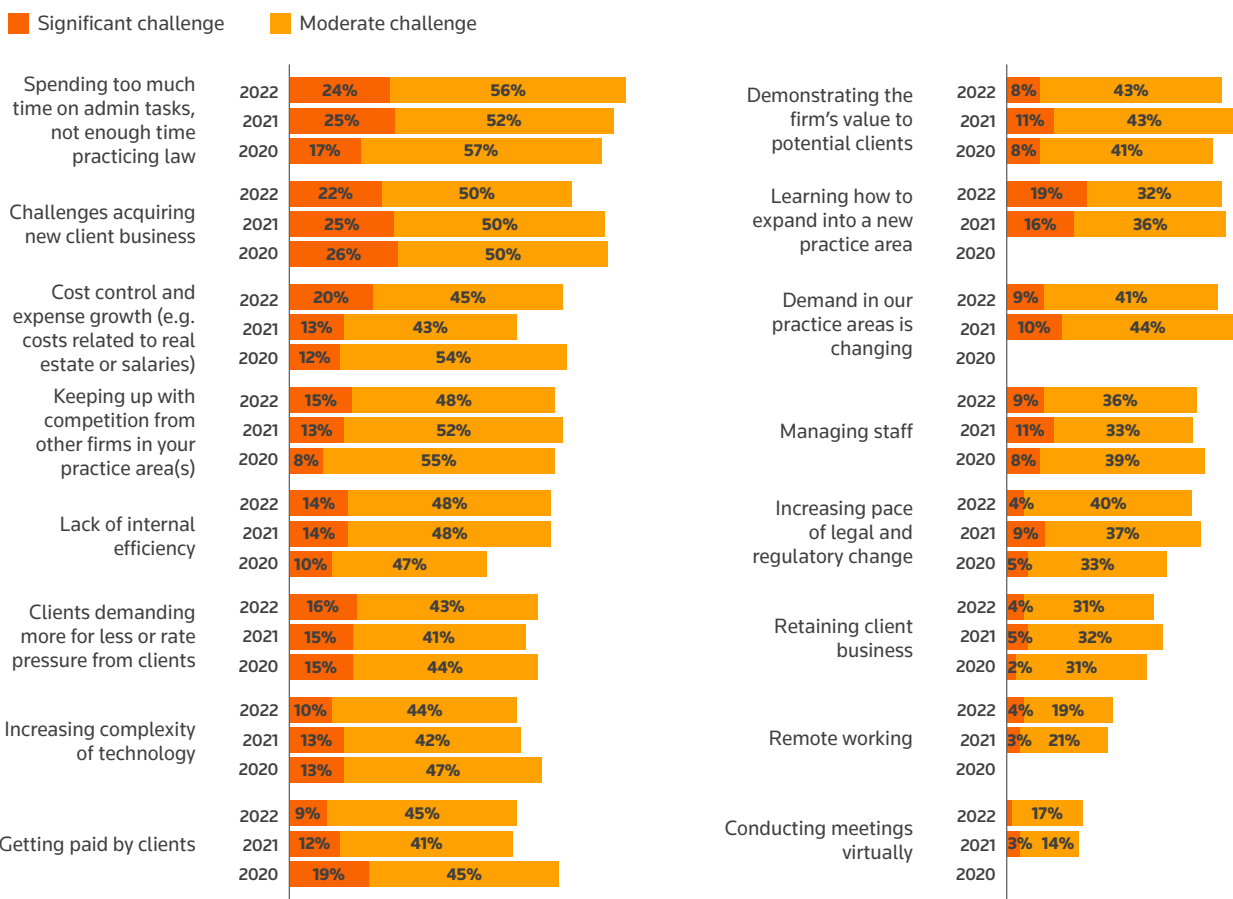
Shifting market dynamics may mean more opportunities for small firms to poach business away from significantly larger firms, even as those larger firms look to outcompete their smaller counterparts. Growing economic concerns, including inflation and economic slowdowns, may induce all types of clients to seek out more cost-effective options for quality legal work. This could include potentially lucrative work from businesses as well as high net-worth individuals.

Small law firms who are able to deliver quality work while offering more client friendly rates and personalized service are likely to be an attractive option for clients who are shopping for more cost-effective legal work.

Challenges

Despite a generally optimistic outlook, the challenges facing small law firms should not be overlooked. Indeed, keeping up with competition remains just one of the many challenges that small firm lawyers have identified.

Figure 8: **Small law firm challenges**



Please indicate the degree to which the following issues are a challenge for your firm.

Source: Thomson Reuters 2022

Spending too much time on administrative tasks and not enough time practicing law remains the top challenge for small firms, as it has for the last several years. And the level of concern has crept even higher over the last three years. This year, fully 80% of respondents said they saw at least a moderate challenge from spending too much time on administrative tasks. And this administrative burden is cutting into what most small law firm lawyers went into the legal profession to do — practice law and serve clients. In fact, the average small firm

attorney now spends only 56% of their time practicing law, down from 58% in 2020. While this may seem an insignificant shift, two percentage points represents about 12 minutes per day, or roughly two-tenths of a billable hour. That comes out to nearly 50 hours for a lawyer who's working 50-hour weeks, 50 weeks per year.

While concerns over acquiring new client business appear to have dropped slightly in the past three years, business development remains the number two challenge faced by small law firms. Although the evidence is unclear if the decline is a result of small firm lawyers getting better at finding new matters, or if their level of concern has dropped as other challenge areas have arisen; the latter indicating that there may not be any real improvement in business development but rather a simple matter of shifting priorities.



Time spent practicing law has dipped to 56% of each day.

For example, cost control and expense growth unsurprisingly jumped to the fore in 2022, consuming a greater share of small firm leaders' attention. The percentage of small firms that consider expenses, especially those tied to salaries and real estate, as being a significant challenge shot up to 20% in 2022, after holding steady in the 12% to 13% range in 2020 and 2021. Expense concerns are now the third highest-ranked significant challenge after the aforementioned challenges of time spent on administrative tasks and acquiring new client business.

The pressure to reduce costs is especially being felt among firms with between 11 and 29 attorneys. The percentage of these larger small law firms identifying cost controls as either a moderate or significant challenge rose to 92% in 2022, from 74% in 2021.

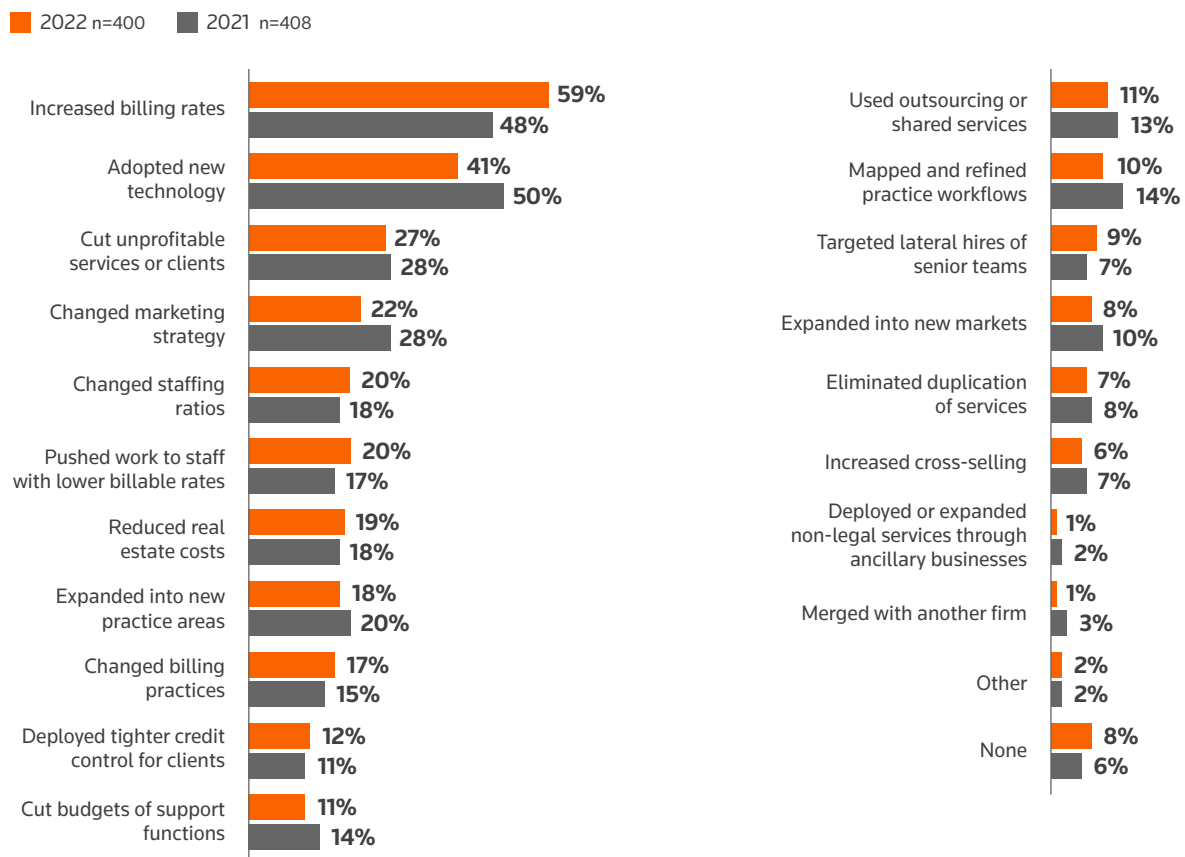
Taking action

As has persistently been the case for as long as this report has been published, the identification of a challenge is not necessarily enough to spark small firm lawyers into action, although this year (as has been the case in some circumstances in the past), certain challenges seem to spark more motivation for change than others.

Despite being the top two challenges small firms face, very few small firm lawyers report taking action to address either their administrative burden, with 82% saying they are not addressing the challenge; or their problems with business development, with 74% not addressing.

Small firm lawyers appear to be taking a different tack with regard to cost control, however. Fully one-third of respondents report taking at least some steps to address the challenges posed by rising costs. Some of these steps are reflected in the changes that respondents report making to their firms within the past year.

Figure 9: Firm changes



Which, if any, of the following changes has your firm made in the past two years?

Source: Thomson Reuters 2022

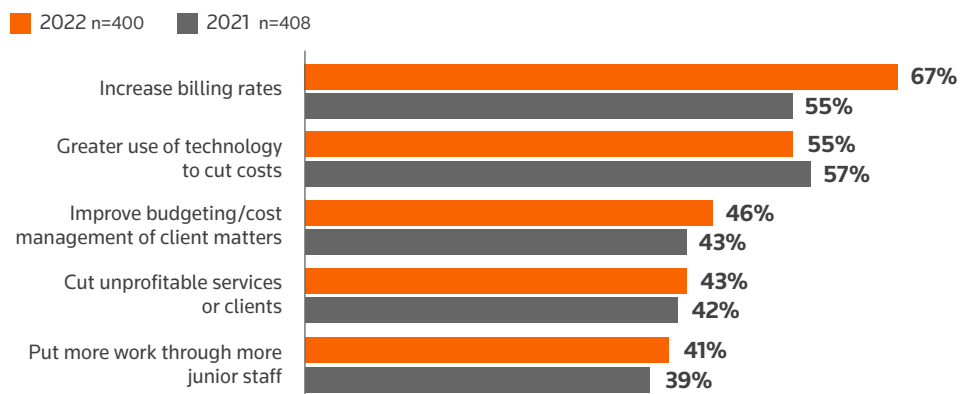
In 2022, the most significant widespread change small firms made was increasing billing rates. Fully 59% of small firms raised rates, a significant increase after only 48% instituted higher rates in 2021. Whether because they felt clients were more willing to accept higher rates in 2022 or in response to rising inflation — or both — raising rates was the most widely-adopted change in 2022, more so than such actions as cutting unprofitable services or clients, reducing real estate costs, or expanding into new practice areas.

There was also a noticeable decline in small firms that reported adopting new technology in 2022, but this is undoubtedly not because technology is playing a smaller role in the average small firm lawyer’s daily life. Rather, both 2020 and 2021 saw larger percentages of respondents report having adopted new technology in the prior two years; so in 2022, the focus may well have shifted toward improving adoption and implementation of new tech instead of making new purchases.

Similarly, increasing billing rates tops the list of steps that firms are likely to take in the next year to drive performance improvement, with 67% of firms saying they likely will or probably will raise rates over the next year. This makes it by far the most common tactic that firms will be using to improve firm performance.

Lending credence to the importance of technology to the lawyer’s daily workflow is the fact that increasing use of technology as a means to cut costs appears as the second most likely performance-improving step law firms plan to take in the next year.

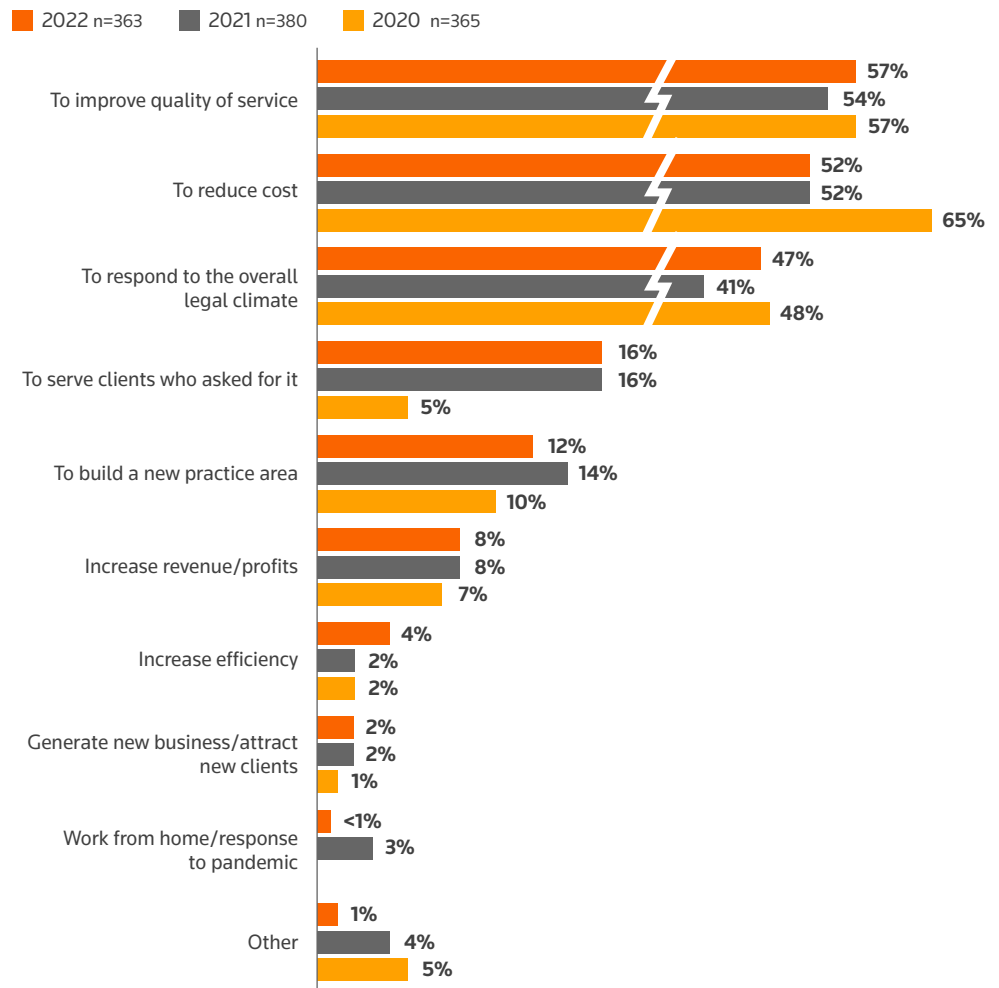
Figure 10: **Top 5 steps to improve firm performance**



Over the next year, how likely are you to take the following steps in order to improve your firm’s performance? Response either “likely will” or “definitely will.”

Source: Thomson Reuters 2022

Beyond digging into which steps firms plan to take to improve performance, it’s also beneficial to understand *why* they are making changes. When it comes to deciding what issues warrant making major changes, fewer firms are seeing costs as a driver for making major changes, even as concerns about costs are rising.

Figure 11: **Reasons for major changes**

Please select the two most important reasons that your firm made the change(s) in the past two years.

Source: Thomson Reuters 2022

The primary focus at the moment continues to be improving quality of service, just as it was last year. In 2020, reducing costs was viewed as the primary reason to make major changes. This is understandable given the huge uncertainties in the market during the first year of the pandemic, although it is perhaps a bit puzzling why it has not seen another rise given today's overall economic climate. Perhaps this is due to the generally positive outlook small firm lawyers have regarding the health of their businesses.

Another noteworthy jump in the past two years is the number of small firms making changes because the clients asked for it, again reflecting greater emphasis on improving responsiveness to clients' needs and desires.

Firm changes: setting and meeting goals

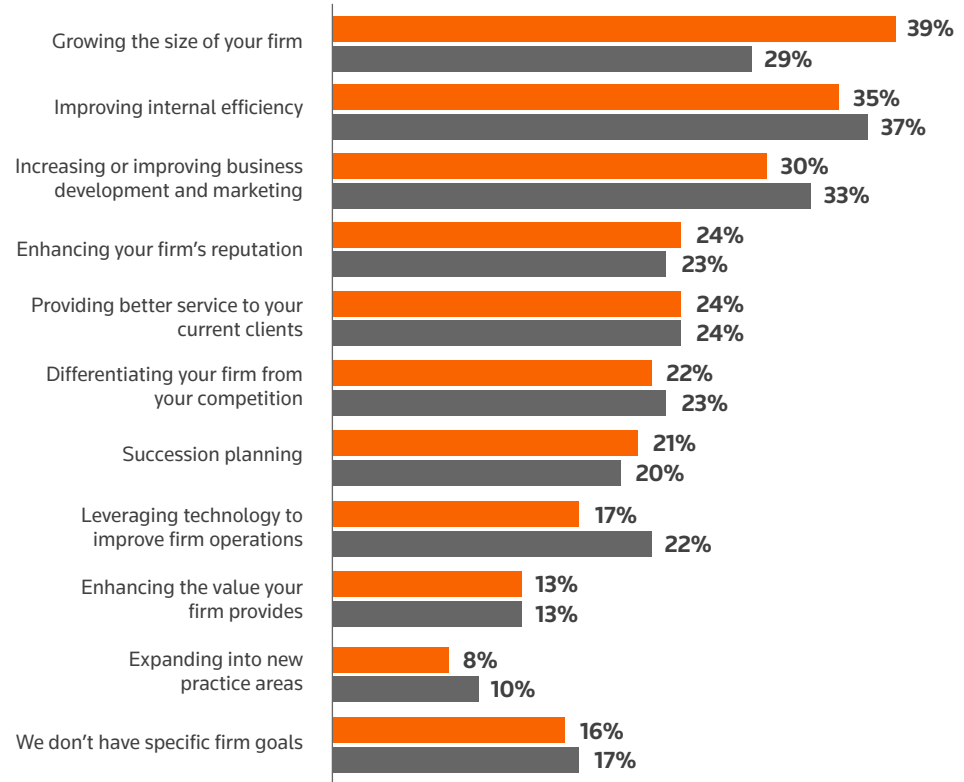
As small law firms seek to reconcile their optimistic outlook with their challenges and recent changes, their goals are shifting accordingly. When looking ahead at their goals, small firms are clearly setting their sights on maintaining strong growth modes.

Figure 12: **Goals and priorities**

Top three goals/priorities

2022 n=400

2021 n=408



What are the top three goals/priorities that you have for your firm?

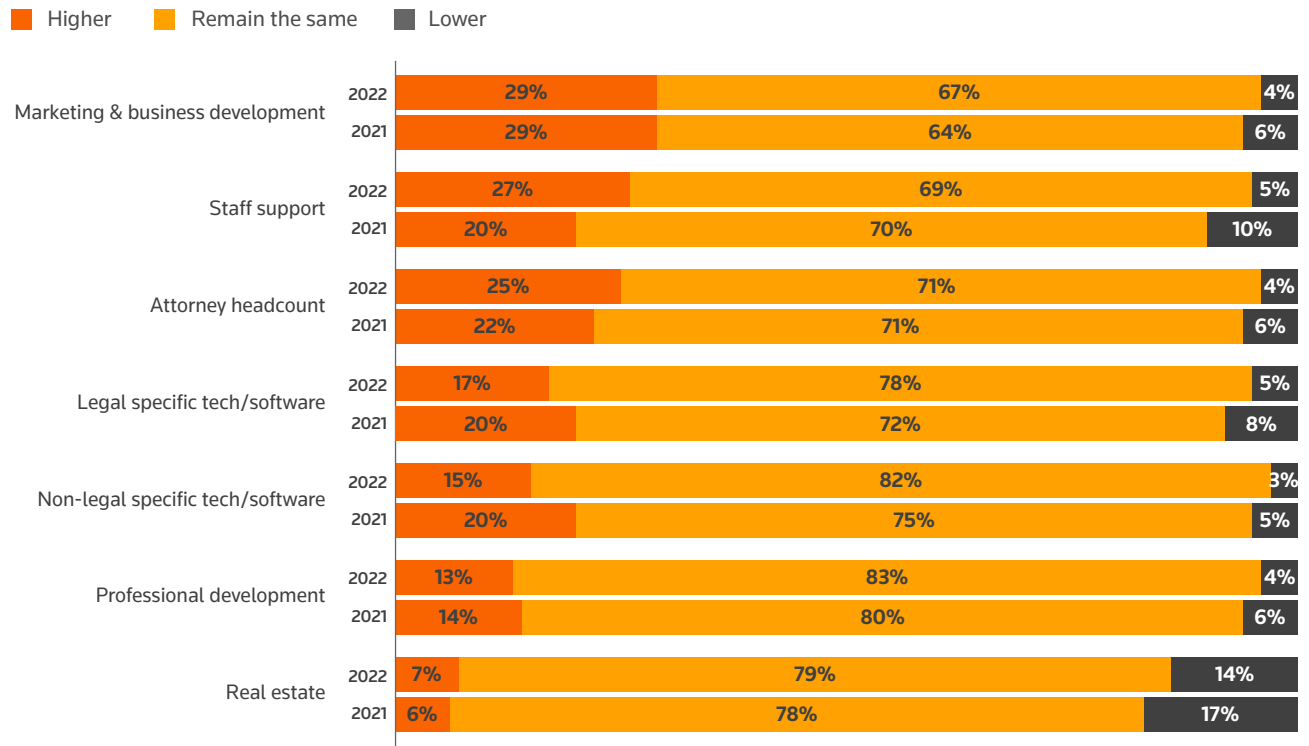
Source: Thomson Reuters 2022

Growing the size of the firm rocketed to the top spot in 2022, with 39% of firms saying it is one of their top three goals. It should be noted, "growing the size of your firm" in this context does not carry with it the traditional connotation of attorney headcount, the way many lawyers might think when discussing firm size. Rather, this question was framed around growing the size of the firm with respect to *number of clients* served and revenue.

Improving internal efficiency and increasing or improving business development and marketing are the second and third top goals, respectively, although they both dropped slightly in priority this year.

Setting goals is one thing; meeting them is another. And meeting goals requires intentionality and focus. A good reflection of how serious any organization is about its stated priorities is how it plans to spend its money. In that regard, small law firms generally appear well positioned to see through on many of their goals.

Figure 13: **Investment areas in the next 12 months**



For each of the following areas, please indicate whether your investment in that area in the next 12 months will be higher, lower or remain the same as the previous 12 months. (2021 n=408, 2022 n=400)

Source: Thomson Reuters 2022

Nearly no small law firms plan to cut their marketing and business development budget, which is likely wise, given the competitive nature of the market in which small law firms operate and their client-growth aspirations. In fact, almost 30% plan for an increase to that particular budget area. The same trends hold true regarding both legal-specific and non-legal-specific technology and software. In fact, planned budget cuts among small law firms appear exceedingly rare across the board.

Moreover, firms plan to continue to maintain or strengthen staff support. The percentage of firms planning to increase their investment in staff support has been growing steadily over the last three years to 27% in 2022 – more than doubling the 12% we reported in 2020. Meanwhile, the percentage of firms that plan to decrease their staff support spend, even in the face of rising inflation and an uncertain economy, continues to decline. While nearly one in eight firms (13%) shrank their plans for spend on staff support in 2020, that percentage fell to 10% in 2021, with an even bigger drop in 2022 to only 5%.

The same appears to be true regarding attorney headcount. Some 25% of respondents report an increase in budget dedicated to attorney headcount, while only 4% report an anticipated budget decrease. Part of this planned increase may be due to the rising cost of attorney talent, but it may also be a reflection that at least some small law firms plan to bring on additional lawyers in the coming year.

Both of these talent investment areas would tie into the reported 43% of respondents from Figure 10 who reported planning to put more work through to junior staff.

A closer look at technology

In terms of technology spend, small law firms are either increasing their tech spend or at least holding the line. This is particularly the case for firms with 11-29 attorneys, in which the percentage of those firms increasing their investment nearly doubled in 2022 to 38%, from 20% last year.

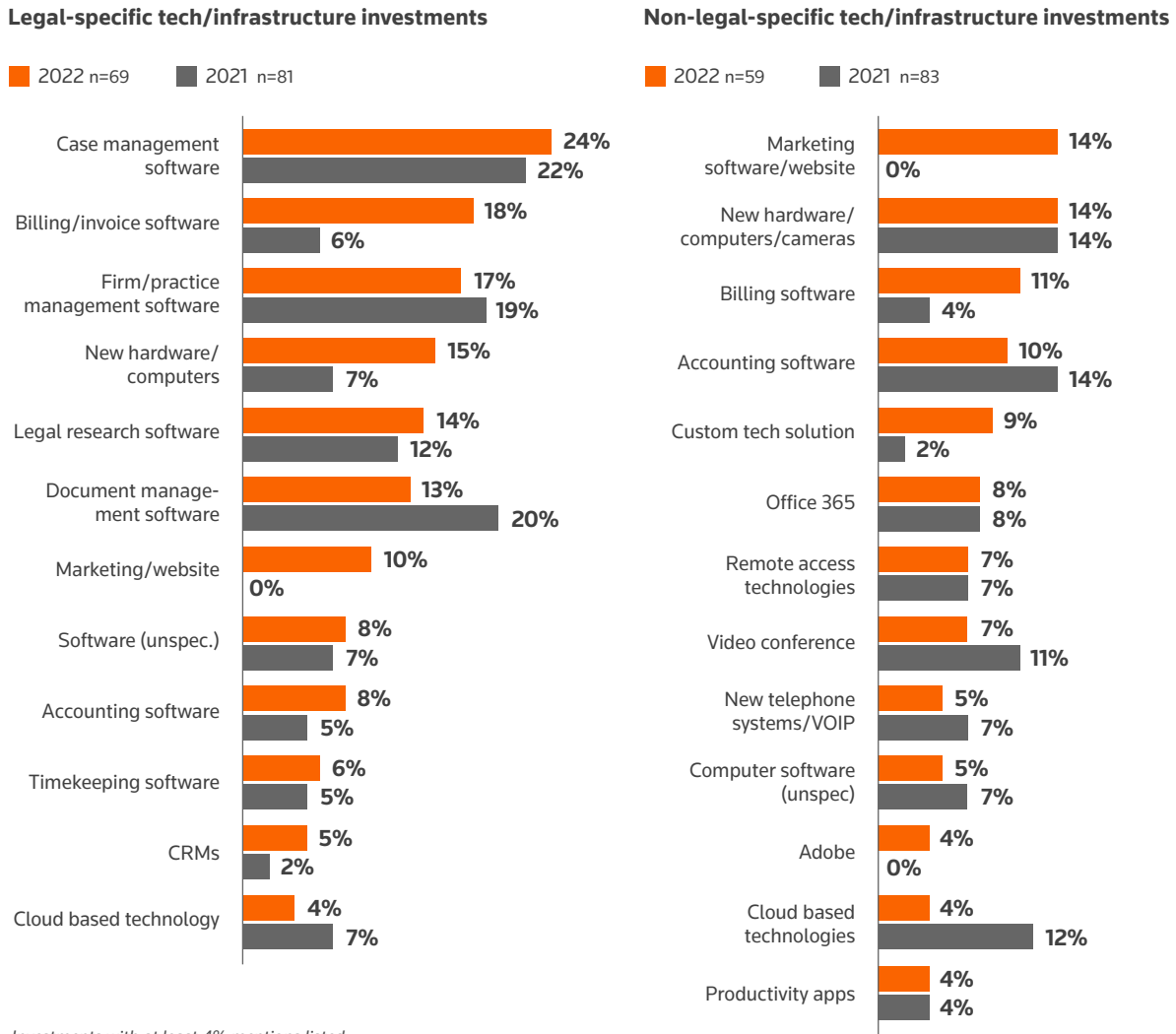
Meanwhile, the percentage of firms planning to *decrease* their tech spend is both miniscule and dwindling. The percentage of firms reducing their investment in legal-specific technology and software fell from 8% in 2021 to only 5% in 2022.

When it comes to non-legal-specific tech, that figure is even smaller. The percentage of firms reducing their investment fell from 5% to only 3%. In other words, 97% of small firms are planning to either increase their investment in such technology or hold it steady over the next year.

At a time when many firms are searching for opportunities to trim every possible dollar of spend, this trend is a clear bet by small firms that the efficiency gains from technology and software will outweigh initial investment costs and prove a prudent investment.

And similar to staff support, this is consistent with firms' goals to improve efficiency and reduce time spent on administrative tasks that take away lawyers' attention from practicing law.

Figure 14: **Technology/infrastructure investments**



Investments with at least 4% mentions listed.

What types of Legal specific technology/infrastructure does your firm plan to invest in?
 What types of NON-Legal specific technology/infrastructure does your firm plan to invest in?

Source: Thomson Reuters 2022

When it comes to specific tech investments that firms are looking to make, one of the biggest jumps has been in billing-invoice software. Only 6% of small firms projected investing in this area in 2021, yet that shot up to 18% in 2022, rising all the way to the number two priority. This is consistent with trends we are seeing even at significantly larger firms. *Financial hygiene*, or greater billing discipline, is being seen across the board as a means to support revenue in a period of economy uncertainty.

Collecting a higher percentage of billed invoices increasingly is seen as potentially low-hanging fruit that can bring in more dollars on work that’s already been completed and invoiced.

Rising to the challenges

Prior versions of this report have spent much time discussing a persistent lack of action by small law firms in tackling their self-identified most significant challenges.

Some of this may be attributable to small law firm lawyers generally viewing their firms as being successful, muting any sense of urgency to make significant changes or consider new strategies. However, this also meant that firms were not taking many of the steps that could have further accelerated growth, improved competitive positioning, increased efficiency, or addressed bottlenecks and other problem areas.

We also have seen at least one example of a past challenge that a larger proportion of small firms did proactively confront — getting paid by clients — and now, those efforts appear to be bearing fruit.

In 2020, getting paid by clients was one of the top concerns among small law firms. That year, concern over getting paid, or rather, potentially not getting paid, jumped sharply as firms were facing increased uncertainty about clients' ability and willingness to pay their legal fees as the pandemic took hold. Nearly two-thirds (64%) of firms viewed it as a significant or moderate challenge.

But even at that time, as reported in the *2021 State of U.S. Small Law Firms*, more than 40% of small firms reported that not only did they have a plan to address the problem, but they also had already implemented changes to address the issue.

The most common changes that firms reported making included: increasing retainers, improving payment collections, and accepting electronic payments such as ACH payments and debit or credit cards. Each of these steps directly addressed the problem of not getting paid by clients by either improving transparency and accountability for billing or making it easier for clients to do business with the firm.

Fast forward two years and the percentage of firms who view getting paid by clients as a significant or moderate challenge has fallen to 54%. And the portion of firms with the greatest urgency around this issue, those who rated it as a significant challenge, has been cut by more than half to just 9% from 19% in 2020.

Ranked among the overall top challenges for small law firms, getting paid by clients has dropped from fourth on the list down to a tie for eighth, suggesting that firms now see less urgency around the issue and are moving on to hopefully address other priorities.

This may be an example of only one out of a plethora of remaining challenges, yet it demonstrates that small firms can make marked improvements against some of their most significant challenges. However, it requires not only setting goals, but also making strategic decisions to address specific challenges, identify appropriate steps, and measure progress.

The road ahead

While small law firms are very positive in their outlook, they are also very much aware of the ongoing challenges that they face.

Small firms not only provide legal counsel, but are also small independent businesses, and firm leaders must continually strive to keep the two in balance. And while current economic conditions are becoming challenging, small firm lawyers overwhelmingly consider their firms to be successful. Hopefully, this is an indication that they know what continues to work well for them in terms of managing workflow, business development, operations, and more. However, there is always additional room to track and measure key metrics that can help determine whether the firm is improving in key areas or needs to re-evaluate current strategies.

Meanwhile, competitors of all stripes continue to look to take a greater share of market from the small law firm space. Fortunately, this increasing competition also means increasing opportunities for small firms to solidify their position as providers of quality legal service that is cost-effective for clients and offers outstanding customer service.

As this report details, there is emerging evidence that suggests small law firms are demonstrating their ability to rise to the challenge and address some of their most pressing needs. Continuing to strategically focus on their goals and the challenges that could stand in their way will enable them to fully capitalize on the growth opportunities that they are foreseeing.

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