

CommBank Legal Market Pulse.

November 2019



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Foreword

Welcome to the 2019 edition of the CommBank Legal Market Pulse, our annual analysis of the trends shaping the legal services market in Australia.

This year's edition shows that firms' confidence in the economy and outlook for business conditions has softened from the record highs reported in 2018.

At that time, firms were busy recruiting staff to service heightened client demand supported by regulatory activity in the Banking and Aged Care sectors and a strong pipeline of corporate deals.

The beneficiaries of this higher-margin work were mostly top-tier firms generating substantially higher profits. Today, however, top-tier firms are predicting business conditions to deteriorate at a faster rate than their mid-tier counterparts as this peak subsides.

Despite firms' more subdued outlook, confidence in the legal services sector still remains well above its five-year average and profits are growing at healthy levels. Finding quality staff also remains the top challenge and utilisation issues are starting to return.

But as firms grapple with fluctuations in client demand, striking a balance between efficient delivery and quality, sustainable client service has come into sharper focus.

As such, this report put firms' operational and staffing strategies under the microscope.

The question for many firms is how to efficiently and flexibly resource work while meeting the needs of value-conscious clients. This has led to changes not only in staffing levels for different roles, but increased engagement of contractors and outsourced service providers.

In terms of staffing, firms have increased their focus on recruiting across all positions over the past three years. The exceptions are shared services such as accountants, marketers and IT professionals, along with admin and secretarial staff, although the drive to reduce headcount appears to have run its course.

Instead, firms appear to be using more contractors, most notably in secretarial and admin roles. There has also been a marginal uplift in contracted senior and junior lawyers.

Firms are also seeking to manage workforce costs and efficiencies through increased usage of Legal Process Outsourcing (LPO) and Legal Services Outsourcing (LSO) partners. Just over half of all firms have either recently worked with an LPO or LSO or plan to do so. This is led by the top-tier firms.

Aside from fine-tuning their service delivery models, firms are also looking at other ways to meet changing client demand and diversify revenue streams. Firms indicated that they are planning to enter or grow into a range of new service areas but none more than corporate advisory.

This diversification is not limited to legal work. Most firms now offer non-legal services and rising revenues from these sources is set to continue over the next two years.

We hope you find this year's edition of the CommBank Legal Market Pulse useful within your firm's planning and benchmarking activities. We look forward to discussing these insights and hearing from you first-hand about your experiences in a dynamic and ever-changing market.

Marc Totaro

National Manager, Professional Services
Business and Private Banking
Commonwealth Bank of Australia

About the CommBank Legal Market Pulse Report

CommBank Legal Market Pulse is a wide-ranging analysis of the Australian legal sector. The report is based on a quantitative survey of CEOs, Managing Partners and other senior leaders. Forty-one law firms participated in the survey for this edition, carried out in July and August 2019 by Beaton Research + Consulting. Participants include 10 respondents classified as top-tier firms and 31 respondents classified as mid-tier firms. When results are split by tier of firm, counts are shown due to small sample sizes. Where a 'don't know' response was given it is excluded from the chart.

The state of the market

Sentiment dips from record highs

Firms' forecasts for economic performance and business conditions have moderated since last year, but above-average positivity remains.



Confidence in the economy dips

Law firms' forecasts for the Australian economy's performance in the coming 12 months have come off the all-time highs recorded last year. With the number of firms taking a benign stance on future economic conditions more than doubling, confidence in the economy over the coming year returned to levels seen towards the end of the 2017 financial year.

The more moderate outlook emerged against a backdrop of intensifying global market tension around issues such as Brexit and the US-China Trade War. The market was also busy speculating on the implications of the inversion of the bond yield curve, which has historically signalled that recessionary conditions lie ahead.

Law firms don't necessarily believe that is the case. The percentage of firms expecting a negative economic performance is unchanged for the previous two years. Rather, far fewer firms now expect a positive performance.

The more cautious outlook for the economy is evident across both top- and mid-tier firms, however top-tier firms are now more likely to have a negative view on future economic conditions.

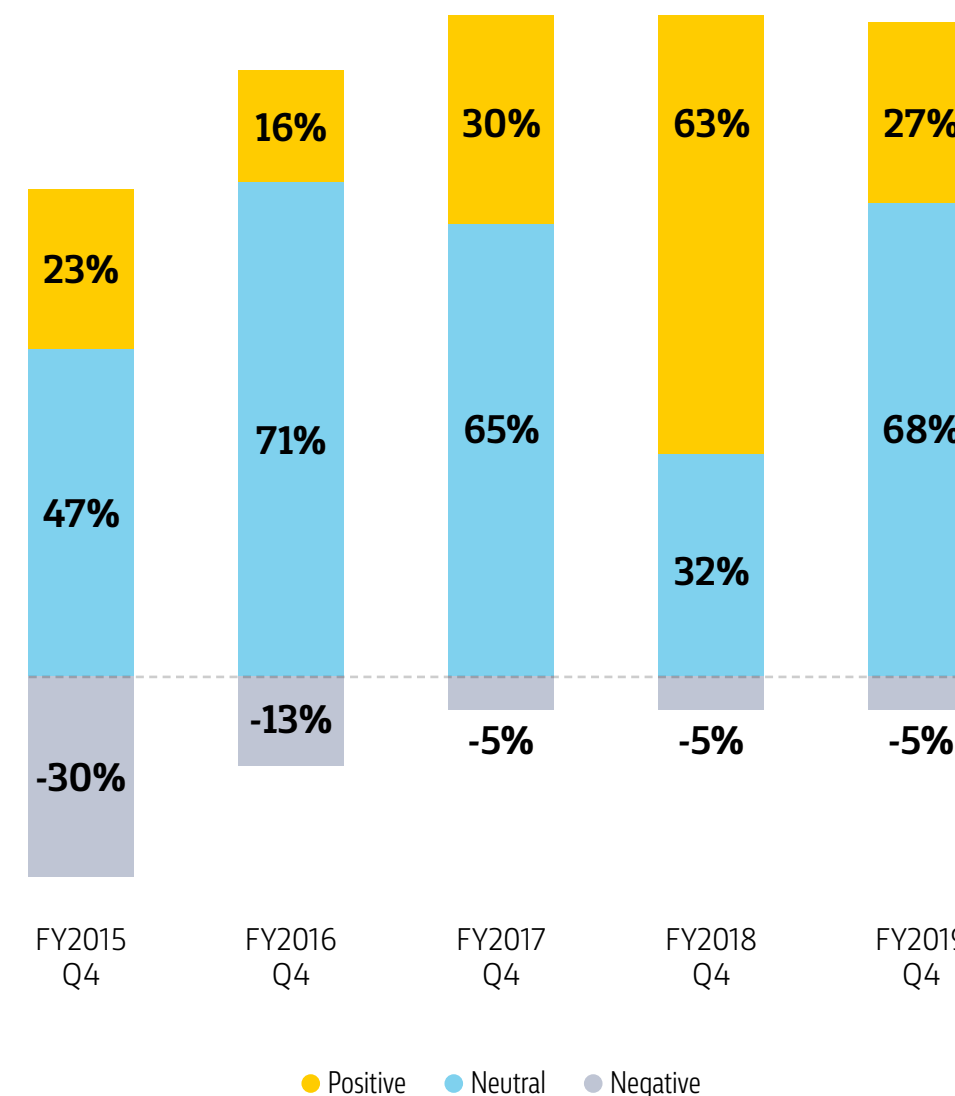
“Most firms are now taking a cautious view of future economic performance, but the anticipated pipeline of corporate deal activity, infrastructure projects and strong foreign investment volumes continue to buoy demand for legal services.”

Marc Totaro

National Manager, Professional Services Business & Private Banking
Commonwealth Bank of Australia

Firms downgrade economic outlook

How do you believe the broader economy in Australia will perform over the next 12 months?



Top-tier firms lead confidence lower

In line with fewer firms taking a positive view of short-term economic conditions, perceptions of current and prospective business conditions have also eased from last year's record levels.

Both top and mid-tier firms foreshadowed a softening of business conditions from its peak in the 2018 CommBank Legal Market Pulse Report. At that time, client demand relating to dispute resolutions, regulatory compliance and commercial litigation had provided the sector with significant tailwinds.

This year's edition shows that firms have further downgraded their outlook for current business conditions both currently and over 12 and 24-month horizons. Despite net confidence of current conditions falling to 54% from the previous peak of 85% last year, it is still the second highest net reading since 2010.

This overall subdued outlook is driven primarily by the top-tier firms, whose one-off uplift in activity during the Banking Royal Commission is now behind them. Larger firms are predicting a sharp deterioration in the market for corporate and commercial firms in two years' time, with nine of the 10 firms surveyed taking a neutral or negative stance.

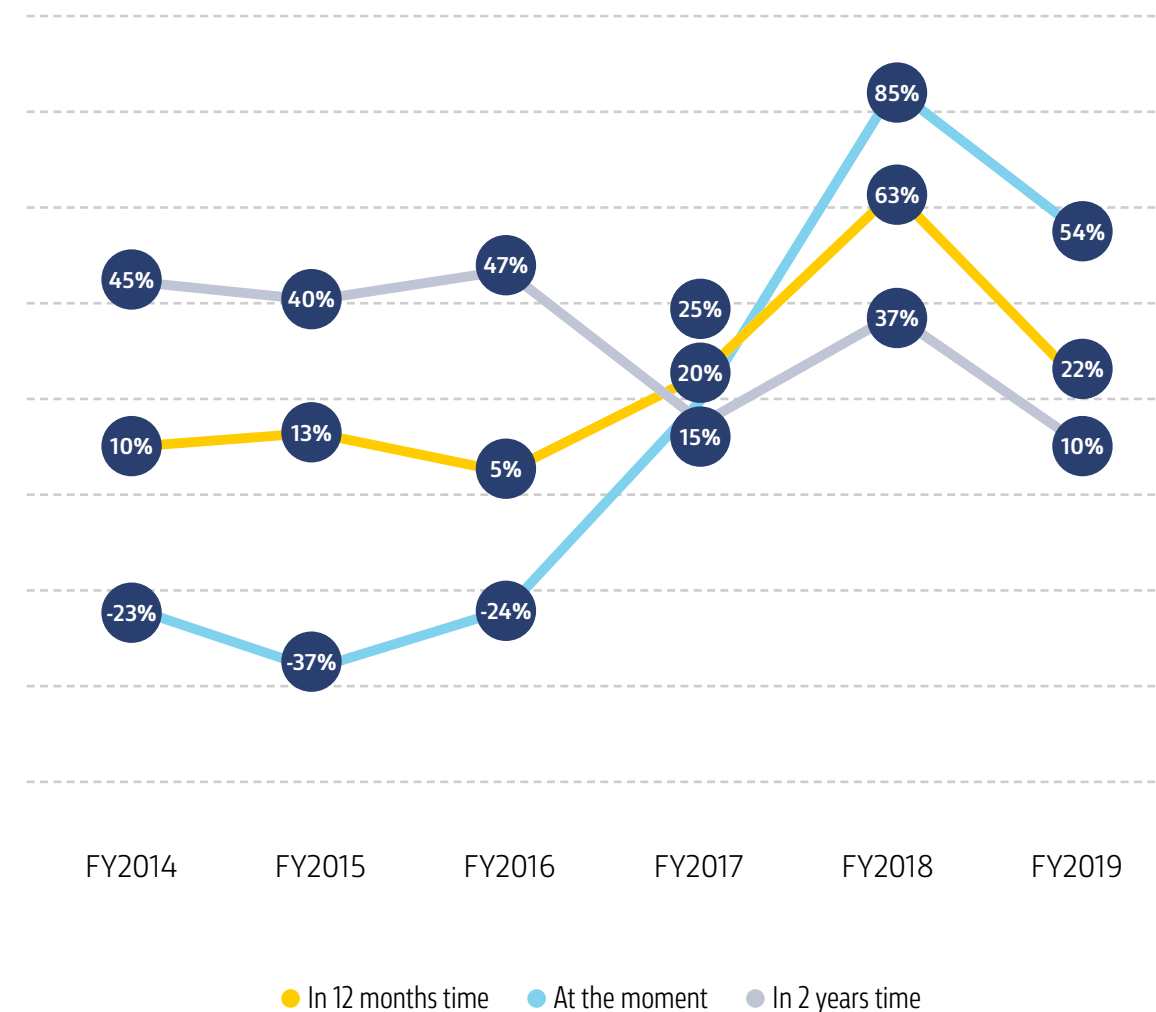
Mid-tier firms, many of whom didn't enjoy the same bonanza of high-margin work as that of the top-tier firms during the past financial year, are forecasting a more moderate decline in business conditions over the next two years.

“Competition will continue to remain tough due to the wide range of quality choices for clients in Australia. Clarity on value and a relentless focus on solutions for clients across a broad spectrum of their business challenges are the key to success.”

CEO/Managing Partner
International top-tier firm

Confidence falls, but short-term optimism remains

How do you rate overall business conditions for Australian corporate and commercial law firms?



Healthy profit growth continues

Both top and mid-tier firms surveyed reported year-on-year profit growth that is considerably above the inflation rate, recording a mean rate of 6.3% growth. While firms' profits may not be growing at the previous year's elevated rate of 8.2%, efforts to drive the top line and bottom line are evidently bearing fruit across both top-tier and mid-tier firms.

Partners therefore continue to prosper. Overall, the net change in Profit Per Equity Partner (PPEP) across the legal market has recorded a marginal decrease from 49% in 2018 to 45% in 2019. Looking at firm size reveals that while increased distributions among equity partners at top-tier firms are not as high as 2018, partners at mid-tier firms took a bigger slice of profits than the previous year.

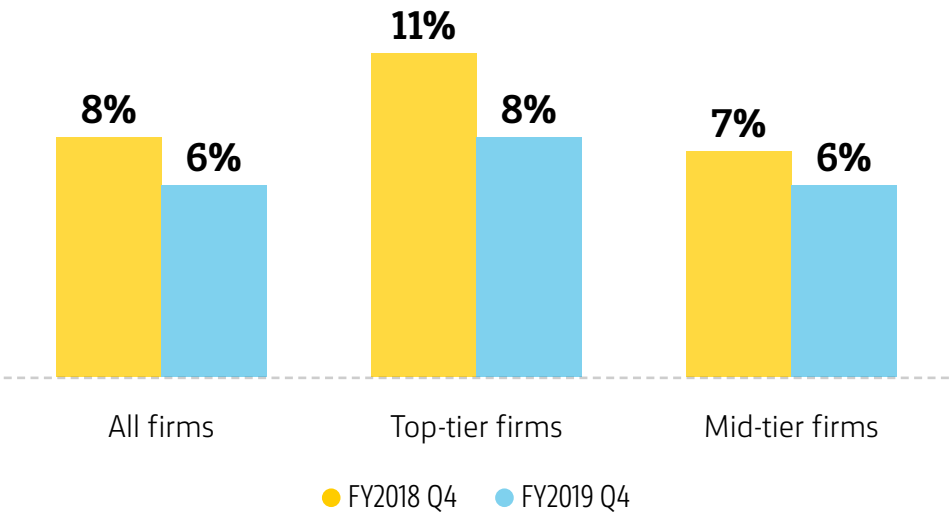
Firms also expect expenses to rise in every area of their business covered by the research, particularly professional indemnity insurance, staff training and development and office premises.

The stand-out area for rising costs however, is their investment in staff training and development. This reflects the need to continue to develop their workforce's skills, not just their professional development, but also expertise in the new technology firms are adopting.

With work volumes softening from 2018 for top-tier firms, the research shows that pressure on salaries has eased. However mid-tier firms are expecting to increase investment across the board in the next 12 months, with an uplift in expenses in every category.

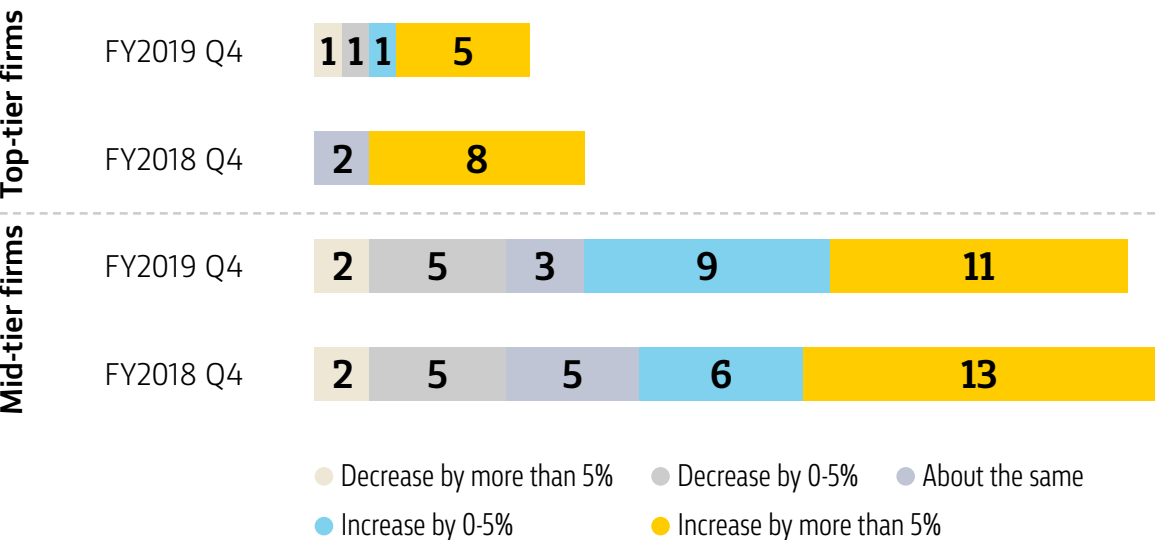
Profits continue to increase, but at a lower rate

What is the expected profit change for FY19 (compared to last financial year)



Profit Per Equity Partner rises for mid-tier firms

How did you expect your firms' Profit Per Equity Partner to change between this financial year and last financial year?



Staff utilisation emerges as an issue for top-tier firms

To accommodate a substantial uplift in client demand for legal services in FY2018, law firms recruited heavily, and challenges associated with workforce utilisation eased.

As this surge in activity tapered off, firms are again looking at the issue of keeping their newly expanded teams at capacity. While not ranked among the top challenges facing firms overall, staff utilisation was the element of business conditions that saw the largest net decrease year-on-year. This net decline from -2% in FY2018 to -12% in FY2019 was led by the top tier firms.

However, firms of all sizes still rank identifying and securing top talent as their most significant challenge and is largely unchanged from the prior financial year. This suggests that in addition to ensuring their workforce is deployed efficiently, firms are positioning themselves for future client demand. Having a high calibre team in place may also allay other top-rated challenges such as negotiating prices with clients and competing with other firms.

Following a period of heightened activity, top-tier firms have joined mid-tier firms in finding that some clients are slow to settle invoices. Winning new business has also returned as one of their top challenges.

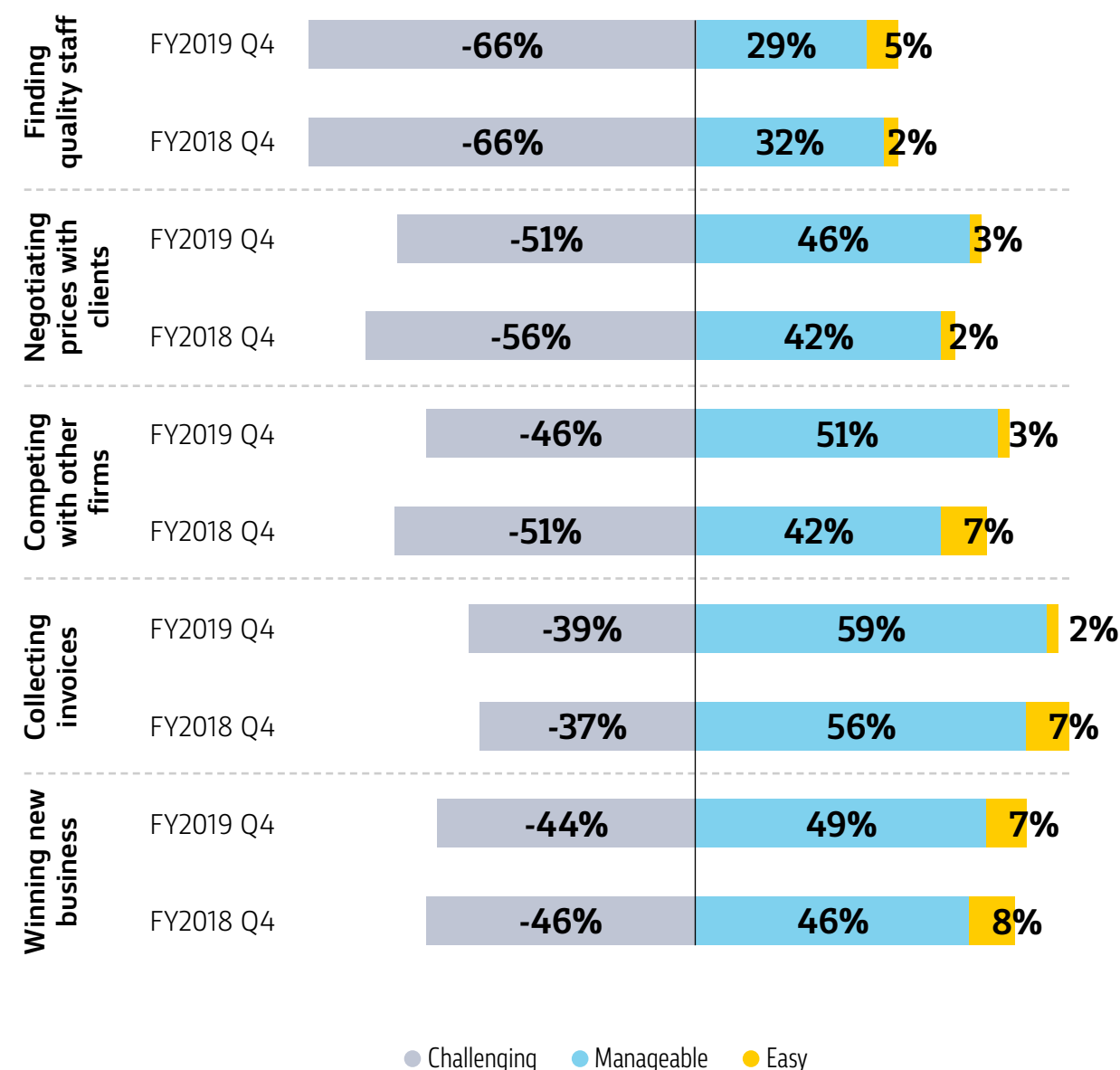
Mid-tier firms, in contrast, are finding most aspects of business slightly less challenging. Managing expenses, however, is becoming increasingly difficult for this group.

“The competitive legal market and tight economy sees clients seeking more value for less cost. While we must remain competitive with our pricing, we do not strive to compete solely on price. Instead we are focussing on complex and value-add 'consulting' advice that attracts higher margins, rather than commoditised work.”

COO/General Manager
Australian mid-tier firm

Top rated business challenges

How would you rate each of these elements of business conditions at the moment?



The workforce of the future

Getting resourcing right

Firms are trying to find the sustainable balance of salaried staff, contractors and outsourcing that ensures operational efficiency without compromising value to clients.



Jump in demand for junior lawyers, paralegals

The long-running challenge associated with attracting and retaining qualified staff is evident in firms' recruitment plans for the coming year.

Compared with three years ago, the last time staffing was examined within the Legal Market Pulse report series, firms are placing considerably more focus on increasing the number of junior and senior lawyers and paralegal staff. This is being led by the mid-tier firms that are also looking to secure equity and salaried partners. Top-tier firms indicate only moderate growth in partner appointments in the coming year which represents a significant slowdown from three years earlier.

Top-tier firms' recruiting efforts for legal professionals are entirely concentrated on senior associates, namely those with a minimum of four years' experience. This helps explain why these firms are experiencing less pressure to increase expenditure on salaries than mid-tier firms.

Common across all firms is that the drive in FY2016 to reduce staff in shared services (HR, Marketing, Finance and IT) and support functions (Secretarial and Administration) has run its course.

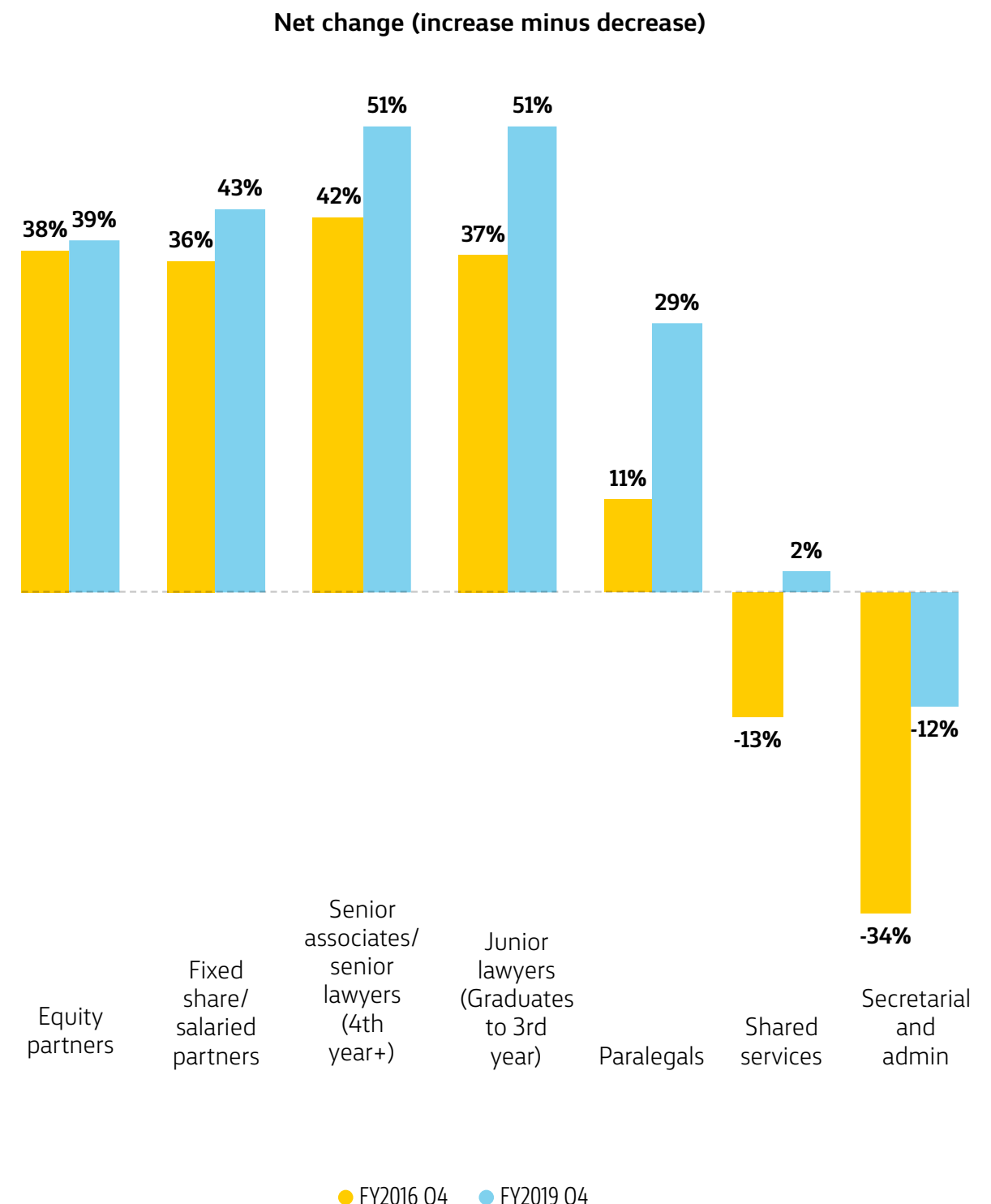
Firms are also expanding the contractor pool for these and other areas of their business, which has helped to entrench contracting as part of the way that law firms manage their workforce to cost-effectively service clients.

“To find quality staff you have to be renowned for a high-quality culture characterised by diversity, inclusion, technical excellence and international opportunities - all up a culture which enables talented people to become their very best.”

Head of Clients
International top-tier firm

Changes in staffing over the next 12 months

What is your firm's forecast for staffing for each of the following levels over the next 12 months?



Contracting increases, but only marginally

The uplift in firms' regulatory and disputes work that coincided with strong corporate deal activity in FY2018 underlined the need for law firms to have the flexibility to deal with ebbs and flows in demand for legal services. Some firms have sought to increase the proportion of contractors within their teams as a result.

The use of contractors for paralegal, shared services and support functions has been well discussed. Overall, however, the proportion of senior and junior lawyers in contractor roles has also grown in recent years. According to firms, contractors are currently employed in 4.9% of senior lawyer positions, up from 2.8% in 2016, and account for 3.9% of junior lawyers, up from 2.8% over the same period.

The use of contractors for any overflow of support and shared services work is more so part of the operating model of mid-tier firms. However, top-tier firms appear to be moving the other way. They are now using contractors less than they did three years ago.

The notable exception is paralegal work. Almost 18% of paralegal work among the ten top-tier respondents is performed by contractors. The corresponding percentage at the 31 mid-tier firms is around 8%.

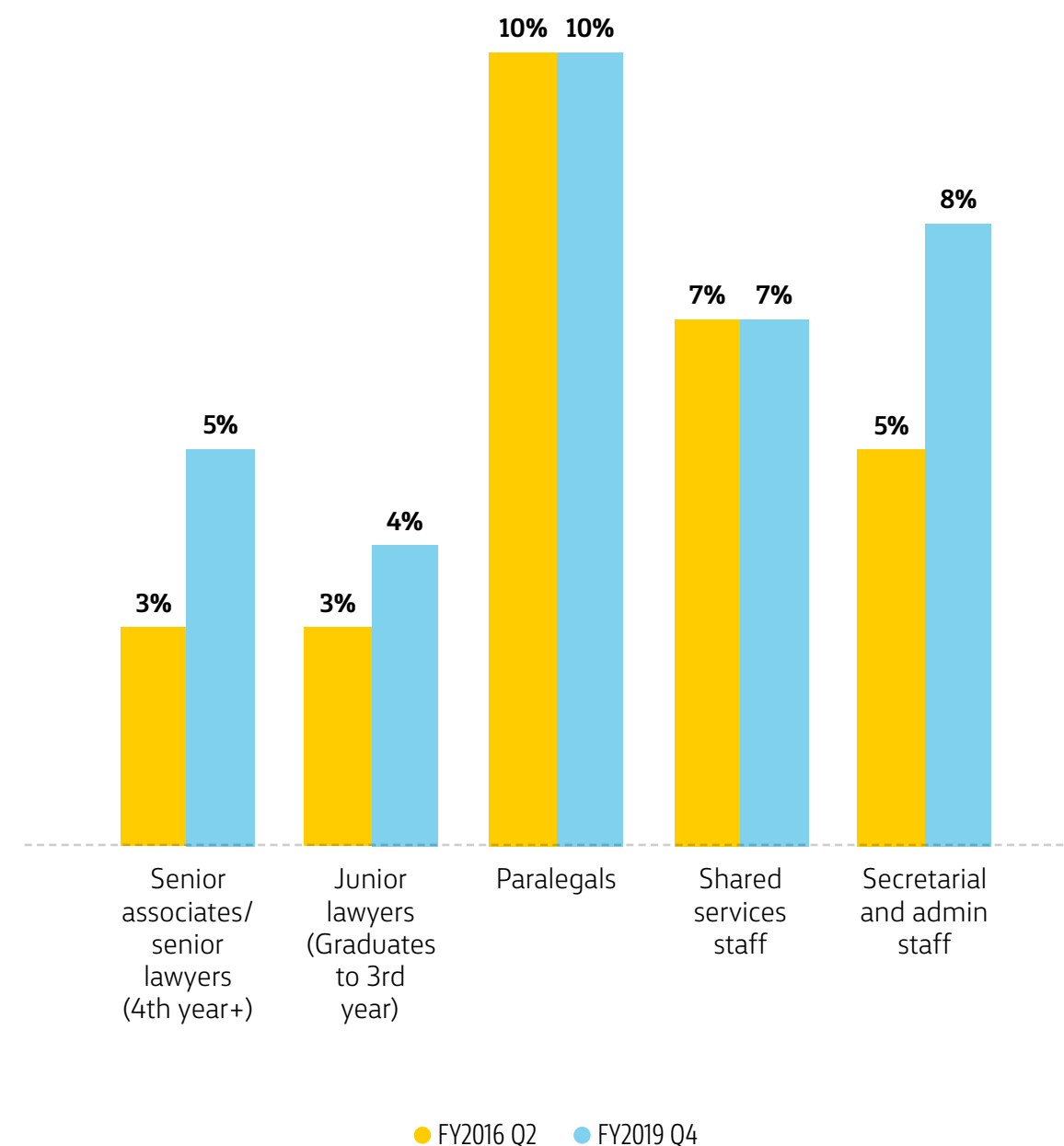
“We have seen a rise in the use of contractors in more senior legal practitioner roles in recent years. This has been supported by firms moving to introduce their own contract legal businesses to manage fluctuations in workflow.”

Marc Totaro

National Manager, Professional Services Business & Private Banking
Commonwealth Bank of Australia

Proportion of contract staff

What percentage of your headcount is your contracted workforce?



Outsourcing edges higher

The other way that firms are looking to manage workforce costs is by directing work to legal processes outsourcing (LPOs) and legal services outsourcing (LSOs).

Over the past six years, outsourcing has edged up to the point that slightly more than half of the surveyed firms have outsourced, or are considering outsourcing, some client work in the past 12 months.

Large firms have led the way. Eight of the ten top-tier firms surveyed have used LSOs and LPOs during this period. These firms are most likely to be using these providers on an ad-hoc basis as subcontractors where specific client projects require it, cited by six in 10 top-tier firms.

The same proportion of firms also indicated that clients now direct them to use outsourced suppliers which is an increase from the two in seven in 2013 that were being directed by clients to do so.

While 18 of the 31 mid-tier firms are yet to use an LSO or LPO, these firms are gradually following the lead of their top-tier counterparts. The difference is that usage of outsourced partners among mid-tier firms is more likely to be driven by the firms' requirements, not instructions from clients.

“The use of outsourced providers is on the rise as firms seek to free up resources to focus on quality service delivery and responding to client demand for greater cost efficiencies. We have seen some of the larger firms go even further, striking up exclusive collaborative agreements or establishing their own LPOs and LSOs.”

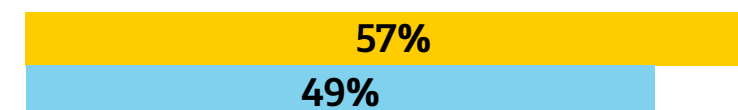
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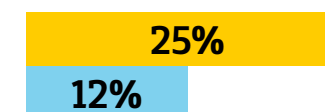
Outsourcing legal work

In the last 12 months, how has your firm worked with LPOs and/or LSOs in delivering legal services to clients?

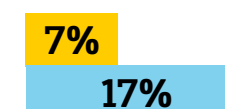
We have not worked with LPOs and/or LSOs in the last 12 months and are not currently exploring how we work with them



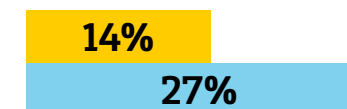
We are currently exploring how we work with LPOs and/or LSOs



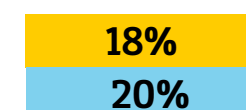
We have been directed by clients to use LPOs and/or LSOs in specific matters



We have engaged LPOs and/or LSOs as subcontractors in specific matters for clients



We have a formal contractual relationship with an LPO and/or LSO under which we subcontract legal work for clients



● FY2013 Q2 ● FY2019 Q4

Top tier firms retain high hopes

Industry speculation about the growth of LSOs and LPOs appears at odds with the fact that according to firms, around 2% of work (3.5% at top-tier firms, 1.4% at mid-tier firms) is outsourced.

That is well short of forecasts two years earlier that outsourcing would account for almost 7% of revenue-earning work by now (or 9% as top-tier firms had forecast in the latter half of 2017).

Top-tier firms stand by their forecast that outsourced work will reach 9%, albeit two years later than originally expected. However, mid-tier firms have scaled back their expectations and now anticipate around 5% of revenue will come from outsourced work in two years' time.

The difference in forecasts may reflect the fact that clients of top-tier firms are already sending work to LSOs and LPOs directly. Eight in 10 top-tier firms expect this trend to grow in the coming 12 months.

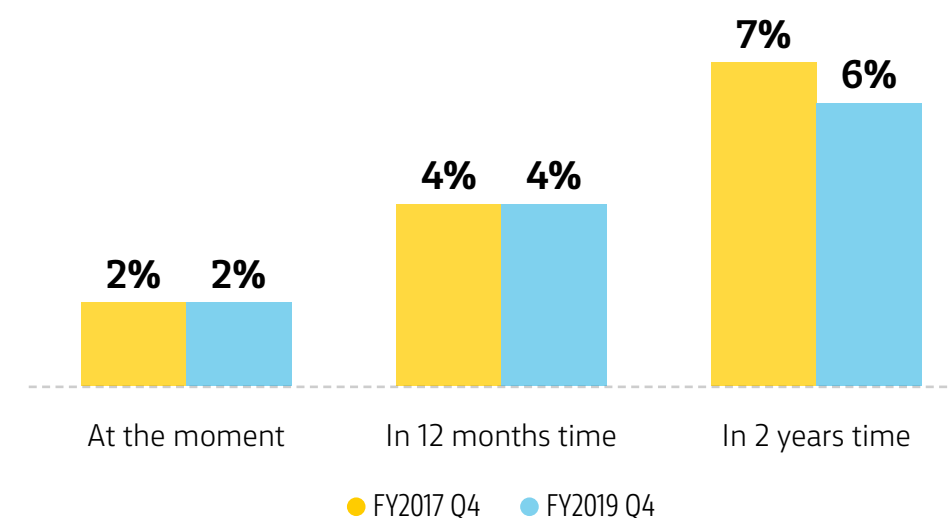
If their forecasts are accurate, the drift of clients to LSOs and LPOs will have implications for firms' fixed costs, fixed fees and perhaps their entire business model. Already some top-tier firms are experimenting with new models.

“We’re placing significant emphasis on transforming our own business and operating model, continuing to look at how we best deliver value. This means responding to our clients' needs as they change, evolving our technology and legal delivery offering, and embracing new ways of working.”

Paul Jenkins
Global managing partner
Ashurst

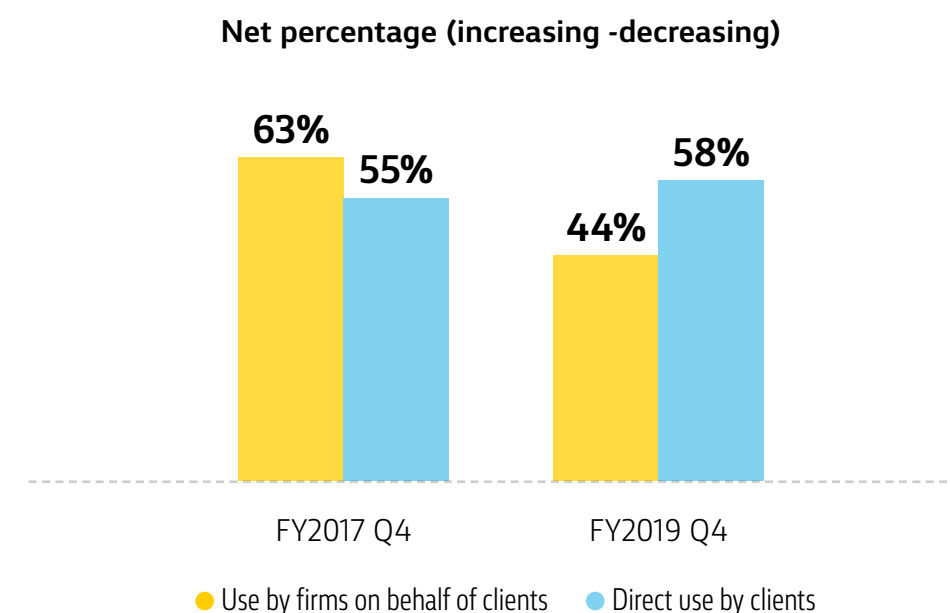
Proportion of fee-earning work outsourced

Of all the fee-earning work done by your firm, what proportion is or will be outsourced to LPOs and LSOs?



Change in use of outsourcing

How do you think the use of LPOs and LSOs in the Australian legal market will change over the next 12 months?



Case study: Ashurst



Ashurst

Interview conducted 26 September 2019

As global chief operating officer of Ashurst, Geoff Gishubl's responsibilities extend across the firm's 27 offices in 16 countries. Geoff explains that his remit includes improving Ashurst's business and a focus on what is internally known as 'efficient delivery'.

According to Geoff, 'efficient delivery' is an integral part of Ashurst's proactive response to "rapid and fundamental change in the legal services industry". Geoff cites influential drivers of change to be Legal Process Outsourcing (LPO), Legal Services Outsourcing (LSO), competition from the big four accounting firms' legal practices and LegalTech, which ranges from start-ups to non-traditional entrants.

"Our most pressing challenge is transforming and adapting our business to these changing conditions," Geoff says.

This sentiment is echoed by Ashurst's global managing partner, Paul Jenkins. "We're seeing a revolution in the legal services market, and it's continuing to accelerate," Paul says. "In response, we're placing significant emphasis on transforming our own business and operating model, continuing to look at how we best deliver value."

"This means responding to our clients' needs as they change, evolving our technology and legal delivery offering, and embracing new ways of working. Our strategy has been hugely successful and the strong performance we've seen across our firm is evidence that we're on the right track, continuing to deliver high quality legal services to our clients, efficiently," Paul added.

Geoff says that core to Ashurst's 'efficient delivery' drive is its NewLaw offering, Ashurst Advance, which was an initiative originally launched in 2016 as the firm's platform for innovation in legal service delivery. Today, Ashurst Advance is one of the firm's five global divisions, led by NewLaw expert Chris Georgiou.

This year has seen Ashurst Advance expand its focus to include a partnership with South African LSO Cognia Law who provide legal managed services, and the launch of an in-house development and investment arm, Ashurst Digital Ventures.

Optimising its legal workforce is a key element of Ashurst's focus on improving resourcing and forms a core part of Ashurst Advance. Geoff says that the starting point is operating as one global unit rather than having local profit centres. This facilitates moving people around the world to accommodate localised spikes in demand.

This is complemented by ongoing analysis of Ashurst's traditional legal services. "We are constantly looking to change the nature of the traditional services we offer, always improving and transforming delivery models to make them more efficient," Geoff says. "This includes having dedicated analysts that take a more scientific approach to breaking down the workload, pipeline and resources."

According to Geoff, Ashurst is increasingly drawing on its own growing pool of flexible resources. The firm also 'in-sources' work to the large Global Delivery Centre (GDC) staffed by legal analysts in Glasgow and Brisbane. Another initiative that allows Ashurst to "flex up and down" in line with client demand is its partnership with Cognia Law, which works collaboratively with the firm's delivery teams. "Cognia together with Ashurst Advance is part of our efficient delivery solution and is getting prominent investment and focus, both internally and externally."



Diversification continues

New offerings take shape

Driven by client demand, firms continue to enter and grow into new areas, including non-legal services.



Expansion into new service lines

Firms continue to enter or grow significantly in a broad range of service lines. Three of the most popular areas reflect the current economic cycle, namely the boom in infrastructure, ongoing corporate activity and embedding the latest regulations into clients' operations as efficiently as possible.

The most favoured area for expansion among top-tier and mid-tier firms alike is corporate advisory work. This includes legal services related to mergers and acquisitions, capital raisings and private equity. It is complex work and difficult for clients to do in-house. Growth in insolvency and restructuring work is also high on the list for top-tier firms.

Given the long list of nation-building projects being undertaken by the public and private sectors, construction and infrastructure-related work is also popular among the firms surveyed.

Where the two groups of firms differ is that top-tier firms also anticipate rising demand from clients in funds management, while mid-tier firms are putting a priority on being able to service clients' needs relating to employment, health and safety.

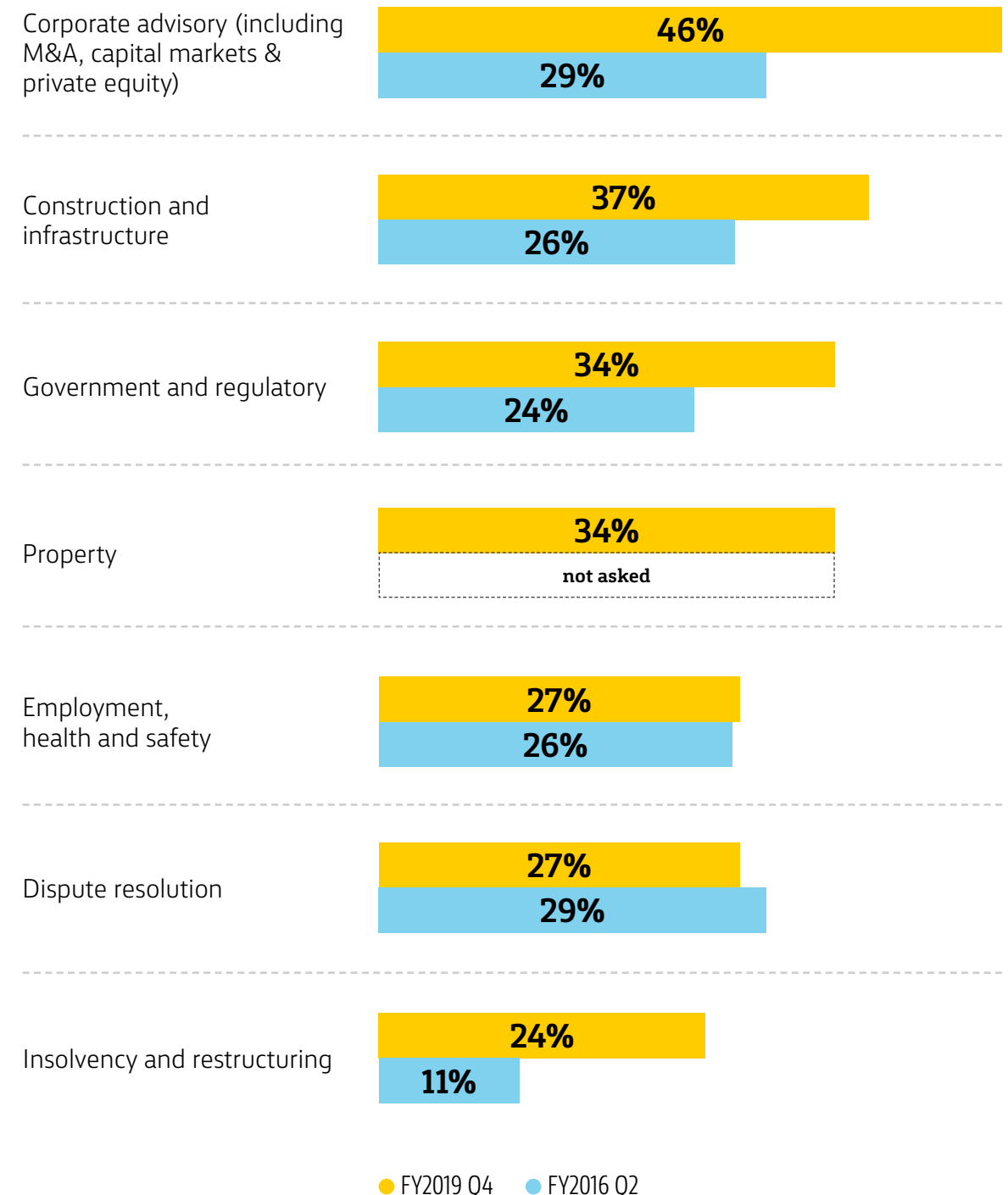
They also see considerable growth opportunities in the property sector. This type of work can be quite commoditised and is therefore less attractive to top-tier firms.

“Our priority practice areas in the next 12 to 18 months are risk consulting and advisory services, particularly to financial services clients, as well as data and digital strategy, governance and commercialisation. Plus, there is the broad regulatory practice.”

CEO/Managing Partner
International top-tier firm

Practice area entry and growth

In which practice areas are you planning to enter or grow significantly in the next 12-18 months?



Revenue growth from non-legal services to continue

Diversification into other service areas has been a long-running trend in the legal sector. Around four years ago, 42% of firms surveyed offered non-traditional or non-legal services. Since then, the percentage has risen to 54%.

During that period, the proportion of firms that derive at least 2.5% of their revenue from diversified service offerings has almost doubled from 23% of firms to 45% of firms.

Among the top-tier firms, around four in 10 respondents are earning at least 2.5% of revenue from these additional services. That's up from three in eight of firms four years earlier.

Back then no mid-tier firm sourced more than 2.5% of their revenue in this way. Today six in 31 mid-tier firms are earning at least 2.5% of total revenue from non-legal and non-traditional service lines.

Both mid-tier and top-tier firms expect the trend to continue with the smaller firms seeing a significantly more positive revenue outlook compared to the 2015 financial year.

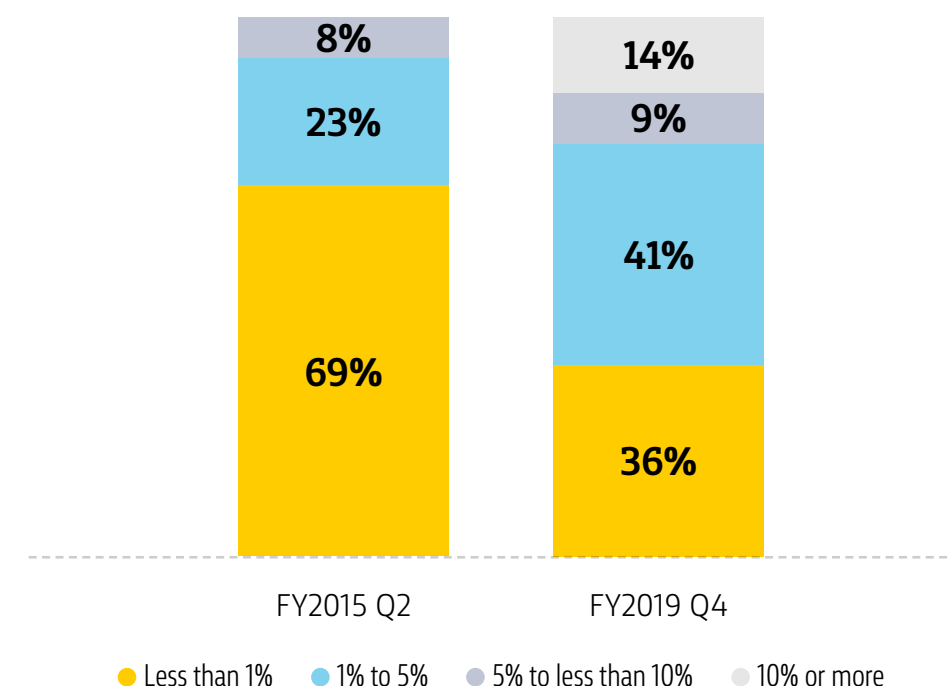
“Many firms continue to introduce non-legal services to meet more complex and holistic client demands. This is a growing source of revenue for these firms and this is expected to become even more prominent over the medium term.”

Marc Totaro

National Manager, Professional Services Business & Private Banking
Commonwealth Bank of Australia

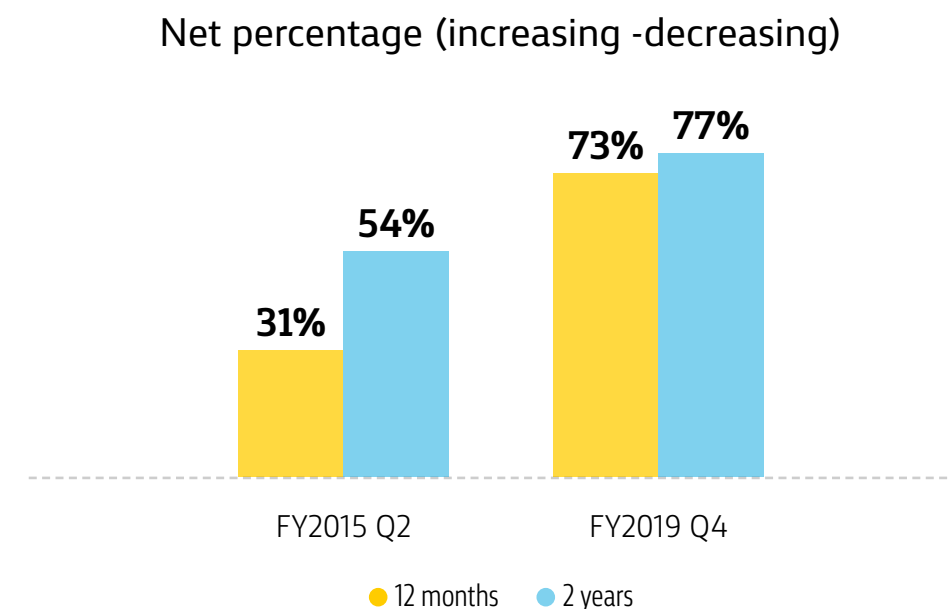
Revenue from diversified services

Approximately what percentage of your current revenue comes from these non-legal services?



Outlook for revenue from diversified services

How do you think the proportion of revenue you receive from non-legal services will change over the following time periods?



Conclusion

While confidence in the legal services sector has subsided from its peak in 2018, it is encouraging that many firms are taking active steps to more effectively resource their future workload while meeting the needs of clients.

For many law firms, this includes implementing strategies that provide the workforce flexibility to manage fluctuations in client work. The research also suggests that firms are seeking to strike a balance between the quality and efficiency of legal service delivery. Some of the key strategies include:



Staffing outlook – finding quality staff remains the top challenge among firms despite lower confidence in future business conditions. Overall, firms have indicated that they are most likely to be recruiting senior and junior lawyers, and that the drive to reduce shared services and admin staff has run its course.



The contracted workforce – the use of contractors remains more concentrated in paralegal roles, plus shared services and admin staff. However, it has edged up for senior and junior lawyers.



Harnessing outsourced providers – firms' use of outsourced providers including LPOs and LSOs is on the rise. Just over half of all firms have engaged an outsourced provider or considered doing so in the past year. This is more pronounced among top tier firms, often at the direction of clients.



Building and expanding capabilities – firms continue to enter or grow into a range of service lines, with corporate advisory work ranking highest. Most firms also now offer non-legal services, a trend they expect to continue.



Business confidence

Net percentage (positive – negative)



	2019	2018
Now	54%	85%
Next 12 months	22%	63%
Next 24 months	10%	37%

Profit growth

(year-on-year growth comparison)



	2019	2018
Profit (all firms)	6.3%	8.2%
Top-tier	7.9%	10.7%
Mid-tier	5.8%	7.4%

Top 3 business challenges

Net percentage (easy - difficult)



	2019	2018
Finding quality staff	-61%	-63%
Negotiating price with clients	-49%	-54%
Competing with other firms	-44%	-44%

12-month outlook for expenses – highest expected increase

Net percentage (increasing - decreasing)



	2019	2018
Salaries	80%	85%
IT hardware/ software/ cyber security	76%	73%
Staff training & development	61%	37%

Planned changes in staffing over next 12 months

Net percentage (increasing - decreasing)



Senior associates/senior lawyers (4th year +)	51%
Junior lawyers (graduates to 3rd year)	51%
Fixed share/salaried partners	43%
Equity partners	39%
Paralegals	29%

Proportion of contract staff



Paralegals	10.2%
Secretarial & admin staff	8.0%
Shared services staff	6.8%
Senior associates/senior lawyers	4.9%
Junior lawyers	3.9%

Proportion of fee earning work that is outsourced



	Top-tier firms	Mid-tier firms
Currently	3.5%	1.4%
In 12 months' time	6.3%	2.7%
In two years' time	8.9%	5.5%

Top practices areas for entry/growth

Percentage yes response



Corporate advisory	46%
Construction & infrastructure	37%
Government & regulatory	34%

Revenue from non-legal services*



	Top-tier firms	Mid-tier firms
7.5% or more	2 in 10 firms	2 in 31 firms
2.5% to less than 7%	2 in 10 firms	4 in 31 firms
0.5% to less than 2.5%	1 in 10 firms	6 in 31 firms
Less than 0.5%	zero firms	5 in 31 firms

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