

CommBank

Legal Market Pulse

Conducted by Beaton Research + Consulting

February 2016 (Wave 1 FY16)



Contents

Foreword	1
----------	---

Economic outlook	2
------------------	---

Snapshot of survey findings	4
-----------------------------	---

Respondent profile

Office locations	7
------------------	---

Primary practice areas	7
------------------------	---

Business conditions

Perceived performance of the Australian economy	8
---	---

Perception of business conditions – present to 2018	8
---	---

Perception of business conditions – by area	9
---	---

Perception of business conditions – by area and tier	9
--	---

Market entry	10
--------------	----

Revenue predictions

Changes in revenue over the next 6 months – by location	11
---	----

Changes in revenue over the next 6 months – by practice area	12
--	----

Increase in revenue – by practice area	13
--	----

Decrease in revenue – by practice area	14
--	----

Realised rates

Expected changes in realised rates – next 6 and 12 months	15
---	----

Expense and profitability predictions

Changes in expenses over the next 6 months	16
--	----

Changes in staffing over the next 6 months	17
--	----

Change in operating margins over the next 6 months	18
--	----

Alternative fee arrangements

Revenue across different fee types	19
------------------------------------	----

Margin on fixed fees relative to hourly rates	19
---	----

Type of work with fixed fee quotes	20
------------------------------------	----

People, staff and talent

Turnover of core workforce in the last 6 months	21
---	----

Expected change in turnover of core workforce in FY2016	21
---	----

Change in remuneration of core workforce in FY2016	22
--	----

Percentage of contract workforce across levels	22
--	----

Change in proportion of casual/ contract staff headcount	23
--	----

Top 3 reasons

Top 3 reasons for staff to remain with a firm	24
---	----

Top 3 reasons for staff to leave a firm	25
---	----

Outsourcing back office functions – over the last 12 months	26
---	----

Outsourcing office functions to a lower cost location - in the last 12 months	26
---	----

Gender split across work levels	27
---------------------------------	----

Confidence improves however challenges remain



Marc Totaro

National Manager, Professional Services
Commonwealth Bank

I am very pleased to bring you the first-half edition of the CommBank Legal Market Pulse for the 2015/16 financial year, conducted in partnership with Beaton Research + Consulting.

The survey found a material improvement in the industry's perception of current business conditions. While still very much in the negative territory, overall sentiment has risen from net negative 37 per cent in the previous survey to a net negative 18 per cent.

The more positive mood is also evident in the fact that the largest law firms expect realised rates to increase by 0.9 per cent in the next 12 months while mid-tier firms anticipate a rise of 1.2 per cent. In an environment where negotiating price with clients is one of the industry's greatest challenges, this is a significant finding.

Across both groups of law firms M&A and corporate advisory work is expected to be one of the most lucrative areas for revenue growth in the next 12 months, along with construction, engineering and major infrastructure.

M&A and corporate advisory work is generally more profitable for law firms. Being mission-critical, it is less price sensitive than many other types of work.

The Legal Market Pulse also found that the top three challenges for the legal industry, whilst remaining the same, have deteriorated slightly.

Among those challenges, law firms are struggling to keep staff fully utilised. This is an interesting contrast with the accounting profession where finding and keeping quality staff is problematic. The difference may reflect the accounting firms' success in diversifying sources of revenue so they're able to deploy staff into different areas within their business.

There is no doubt that business models continue to evolve, with the prevalence of fixed and capped fee work increasing. Of the fixed fee work, 89 per cent relates to transactional matters and 37 per cent to litigation work.

Large law firms view this as a positive development, with 88 per cent reporting that the margin on their fixed fee work is around the same or higher than the work conducted at standard hourly rates.

CommBank's Legal Market Pulse captures the industry's latest views and trends, making it a useful tool for business planning. We value the opportunity of sharing the resulting insights with you.

Email: marc.totaro@cba.com.au

Tel: +61 2 9303 1940

Economic outlook



Diana Mousina

Associate Director Economics
Commonwealth Bank

The six months since the last CommBank Legal Market Pulse have been volatile for the global economy. There were continuing debates about whether the US central bank (The Federal Reserve) would raise interest rates, pronounced fears about the slowdown in the Chinese economy, collapsing bulk commodity prices, a falling oil price and (finally) an increase in US interest rates. Over 2015, overall current business conditions for Australian corporate and commercial law firms improved but still remained negative. Legal firms continue to be optimistic about the future, a trend that has been consistent in recent Pulse reports. In the latest Legal Market Pulse report, the average legal firm holds a neutral perspective on the expected performance of the Australian economy over the next twelve months. Top-tier law firms are optimistic about the economy's performance while mid-tier firms are pessimistic.

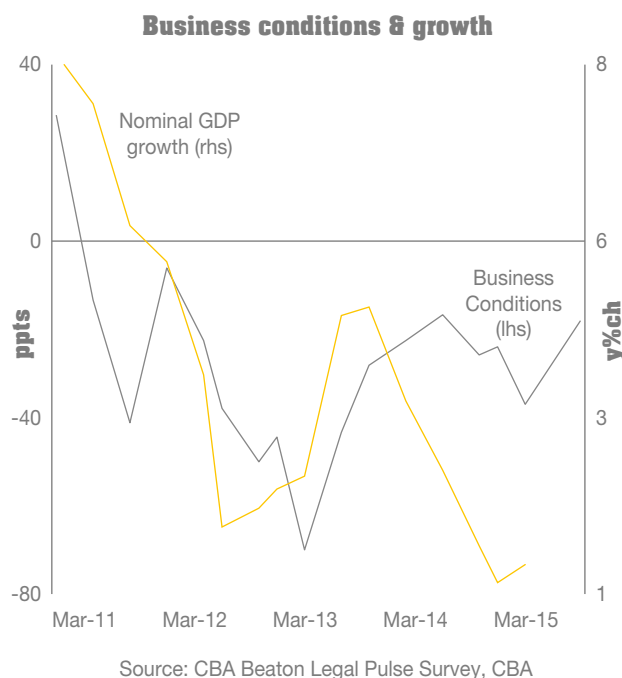
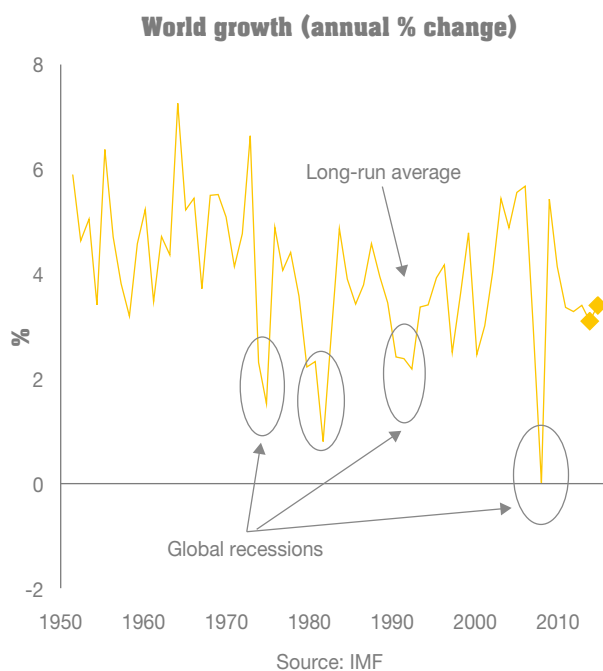
CommBank's forecasts assume that the economy grows by 2.75 per cent in 2016. This outcome would be in line with our estimates of potential or "trend" growth. Therefore, we expect the unemployment rate to grind lower during 2016. Nevertheless, unemployment will remain relatively high, keeping a lid on wages growth. Legal firms indicated that on balance, staff numbers are expected to increase. Firms are looking to grow junior lawyers and senior associates/senior lawyers, while shared services staff and secretarial and admin staff numbers are expected to decline.

The risks to the Australian growth story (and rest of the world) from numerous global economic risks look more intense at the beginning of the year. Over the past decade, the global economy became increasingly dependent on China and the rest of emerging Asia to drive economy growth. Therefore, the slowdown in the Chinese economy is a concern. Chinese growth prospects are central to global risks in 2016. We expect the Chinese economy to grow by 6.5 per cent in 2016. Such an outcome would fall short of the likely 7.0 per cent outcome for 2015. But the mathematics of big economies means that lower GDP growth rates should not be too alarming. While the Chinese economy is transitioning from resource-heavy industries to a services-based economy, there will still be important opportunities for Australia. Education and tourism service demand will be important for Australia. These two industries already rank in Australia's top-five exports.

Another key global risk is around how much further the US Federal Reserve will raise interest rates. The Federal Reserve finally lifted the Fed Funds rate by 25 basis points in December into a 0.25 to 0.50 per cent range. Further rises are pencilled in for 2016. Policymakers are at pains to stress that these rises will be gradual and data dependent. Higher interest rates in the US pose risks to exchange rate markets, particularly in the emerging economies. Emerging market economic growth tends to be sensitive in a time of slower world growth, a higher US dollar and higher US interest rates. But, policymakers in emerging markets have taken steps to strengthen their balance sheets. We see a low chance of an emerging market crisis in 2016.

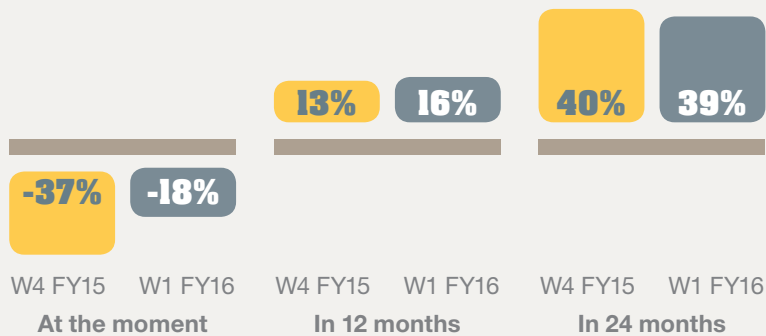
For the domestic Australian outlook in 2016, there remains a lot of uncertainty around the transition from mining to non-mining led growth. But in our view, Australia is more advanced through the transition than most would probably appreciate. We are already about 70 per cent of the way through the expected decline in mining capex. In terms of the impact on the labour market, we estimate that we are around 60 per cent of the way through the expected decline in mining construction-related jobs.

Policy in Australia remains very accommodative, a big positive given the risks to growth. Low interest rates are continuing to support borrowing and spending. The Australian dollar has now fallen below US\$0.70, to a range where the Reserve Bank of Australia is comfortable. This outcome is very positive for Australian exporters and import-competing businesses. Service industries, particularly education and tourism, are noting the positive impacts on their business from the lower currency. We see the Reserve Bank keeping interest rates on hold at 2.0 per cent throughout 2016.



Snapshot of survey findings

Perception of business conditions for law firms suggests muted optimism



Net % (positive - negative)

Geographic areas with highest revenue growth expectations

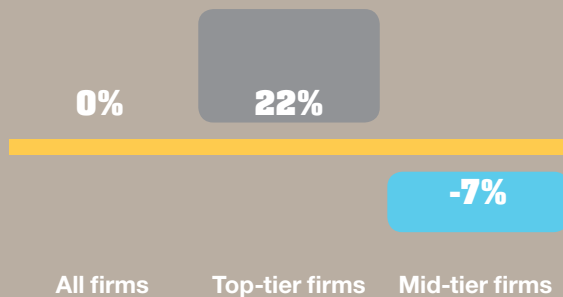
75% UK / Europe

71% Asia

68% Sydney

Net % (increasing – decreasing)

Perceived performance of the Australian economy over the next 12 months is weak overall



Net % (positive - negative)

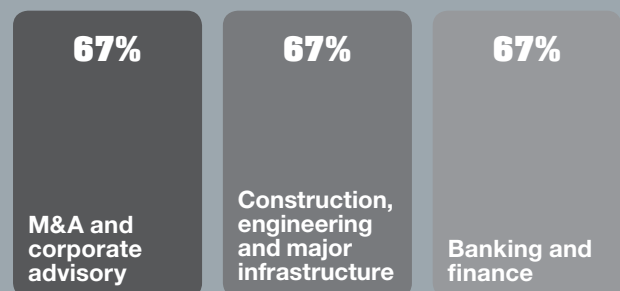
Top 3 most challenging business elements for law firms



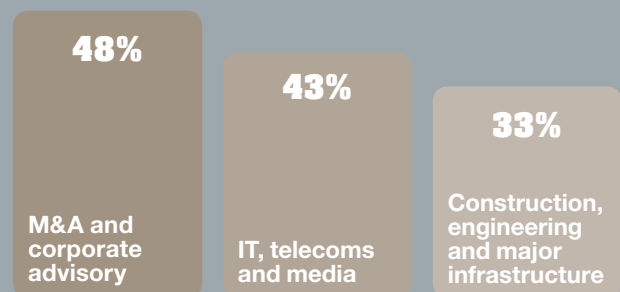
Net % (challenging - easy)

Practice areas with highest revenue growth expectations

Top-tier firms



Mid-tier firms



Net % (positive - negative)

Realised rates

+0.7%

In the next 6 months

+0.9%

In the next 12 months

Top-tier firms

-0.1%

In the next 6 months

+1.2%

In the next 12 months

Mid-tier firms

Forecast expenses

Top-tier firms



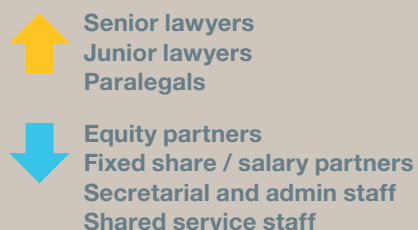
Mid-tier firms



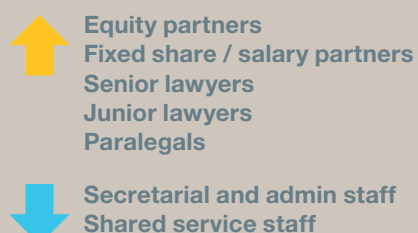
Net % (increasing - decreasing)

Staff numbers

Top-tier firms



Mid-tier firms



Net % (increasing - decreasing)

Turnover of core workforce

12.6% Junior lawyers

9.6% Secretarial and admin staff

9.5% Senior lawyers

8.9% Paralegals

8.8% Shared service staff

5.6% Salaried partners

3.1% Equity partners

Outsourcing

44%

outsourced
back office
functions

22%

outsourced office
functions to lower
cost locations

Top-tier firms

34%

outsourced
back office
functions

14%

outsourced office
functions to lower
cost locations

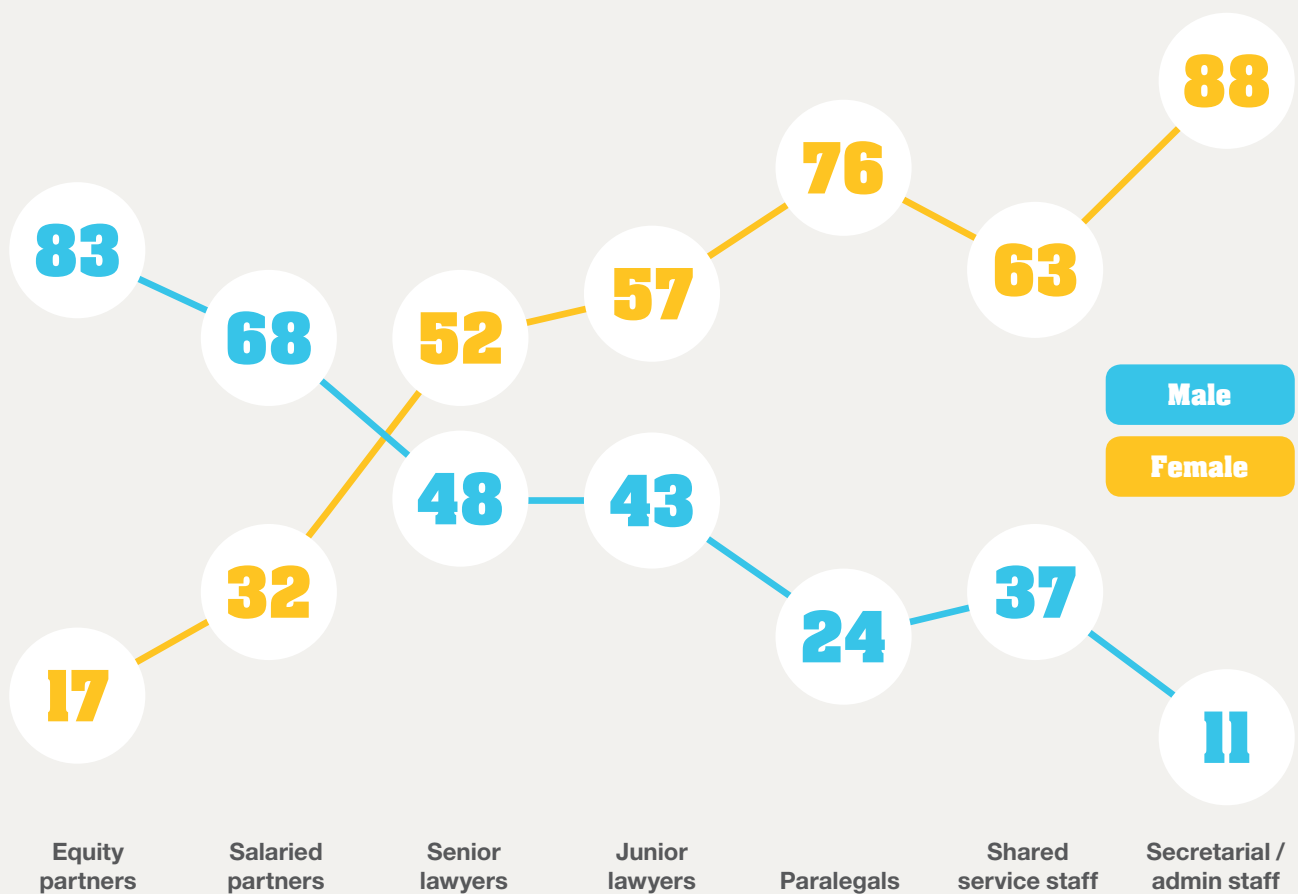
Mid-tier firms

Type of work with fixed fees

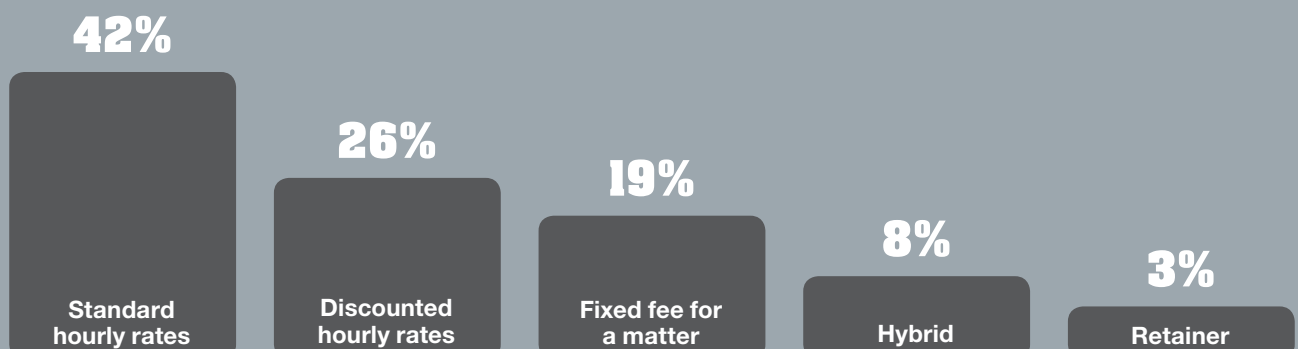
89% Transactional matters

37% Litigation matters

Gender split across work levels

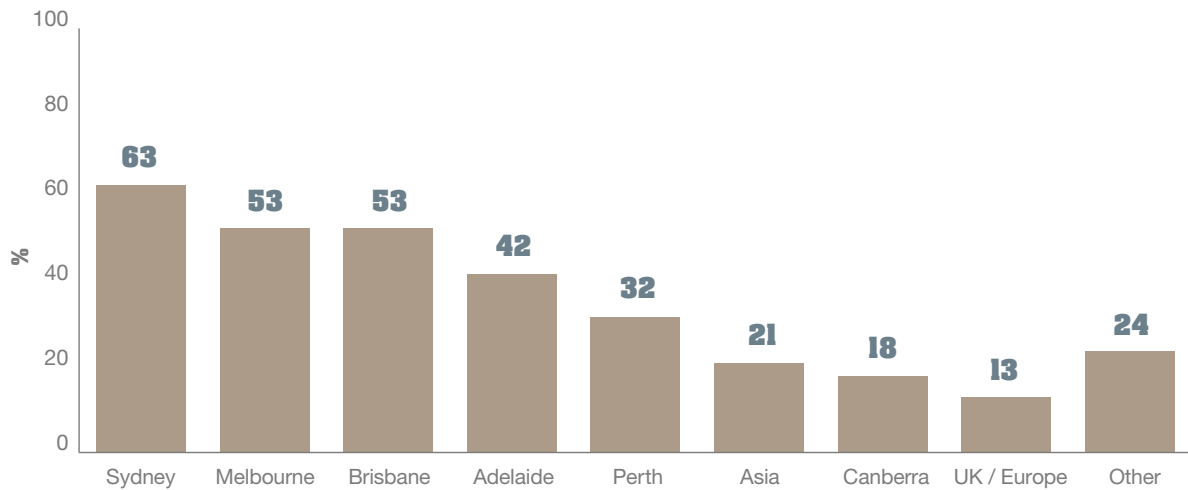


Revenue across different fee types

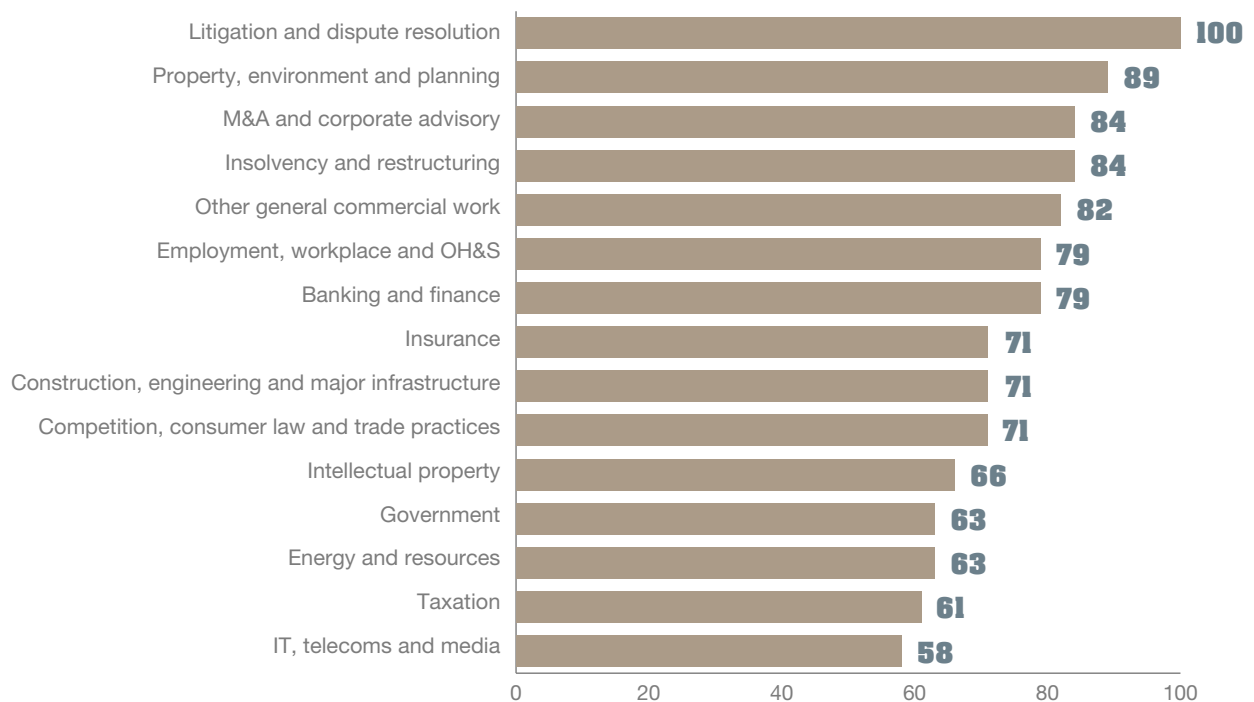


Respondent profile

Office locations



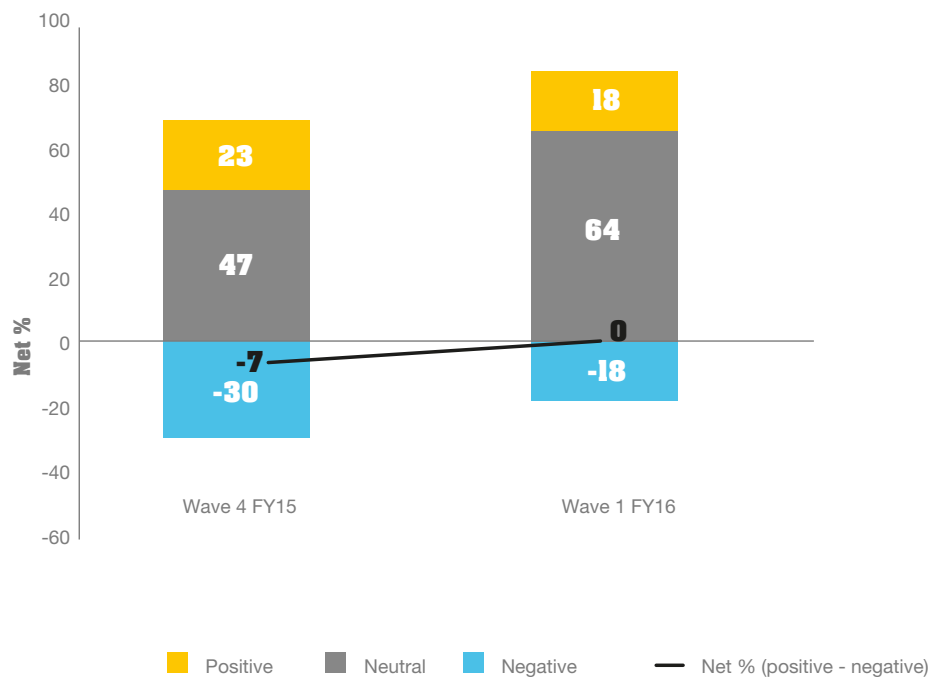
Primary practice areas



Business conditions

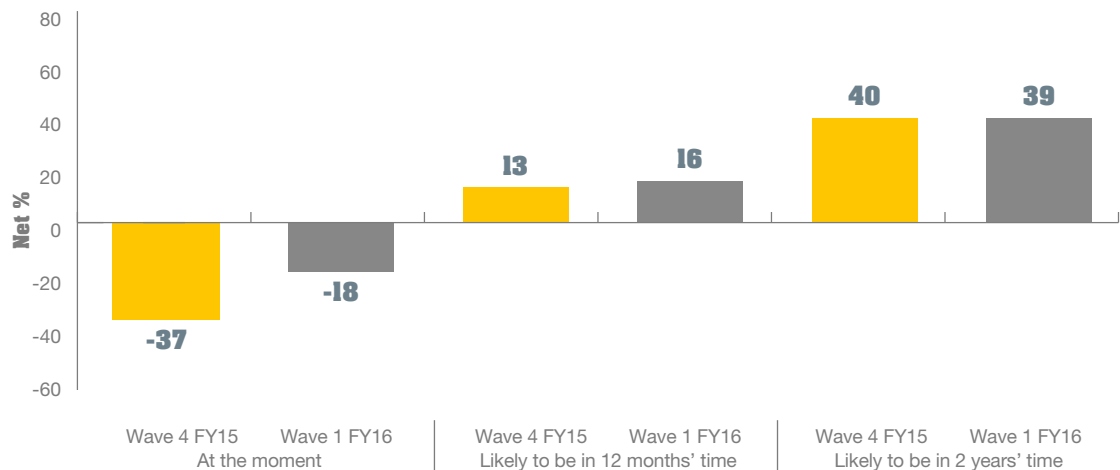
Perceived performance of the Australian economy

Law firm leaders are somewhat less pessimistic about the Australian economy compared to the last report.



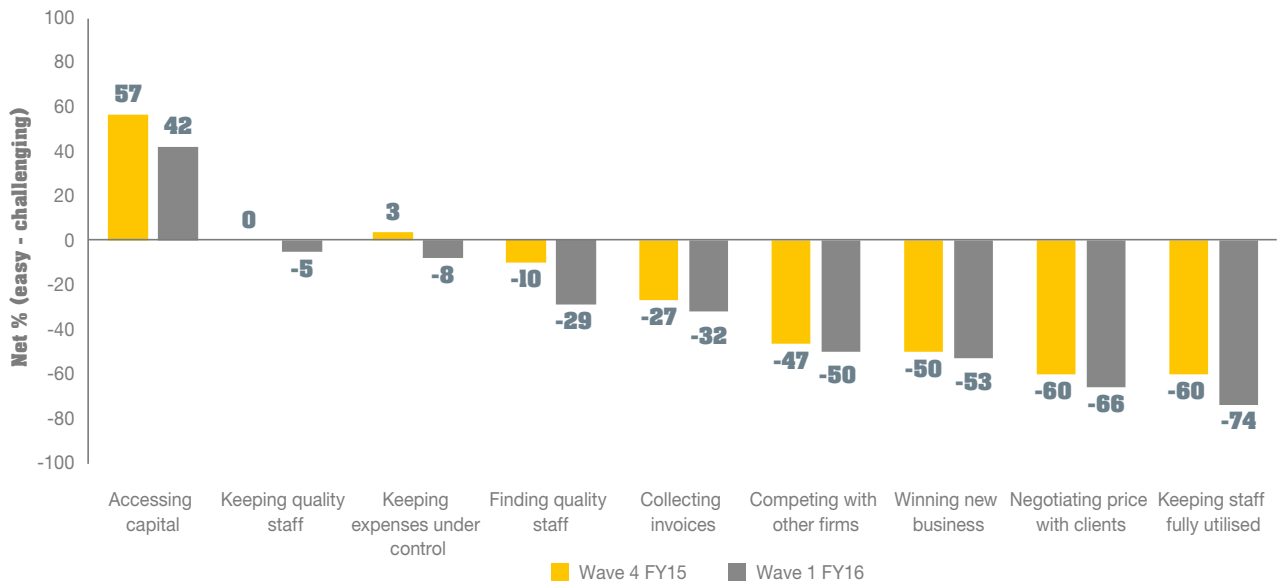
Perception of business conditions – present to 2018

Perception of current business conditions has improved in the short term.



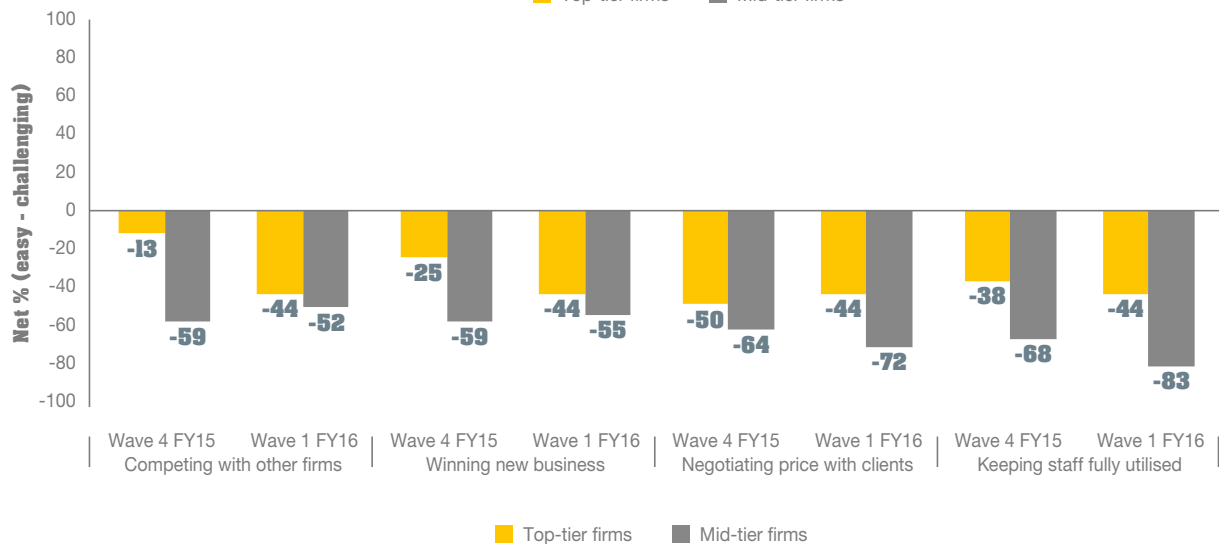
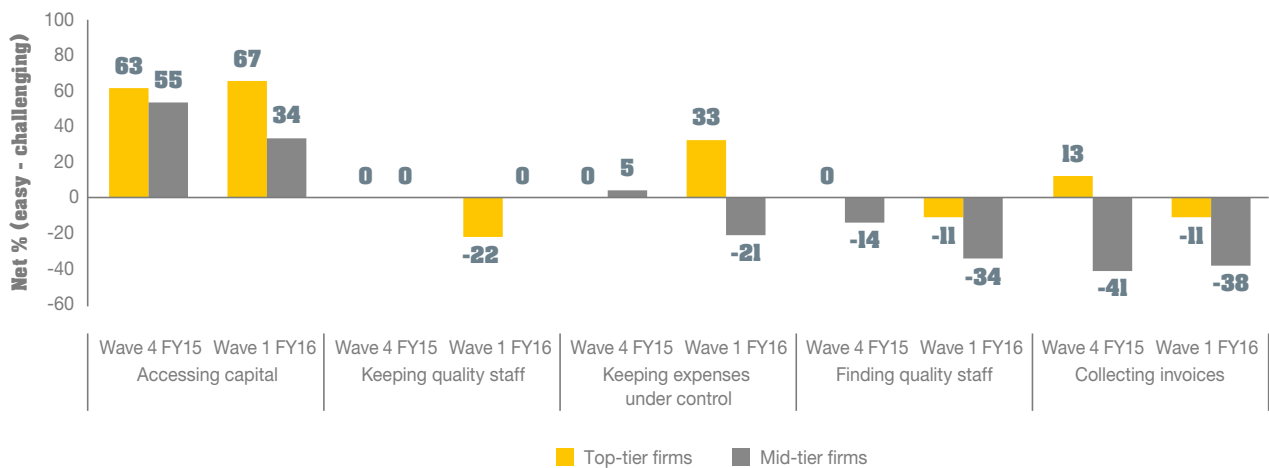
Perception of business conditions – by area

Perception of business conditions has dropped across all areas, compared with the previous report.



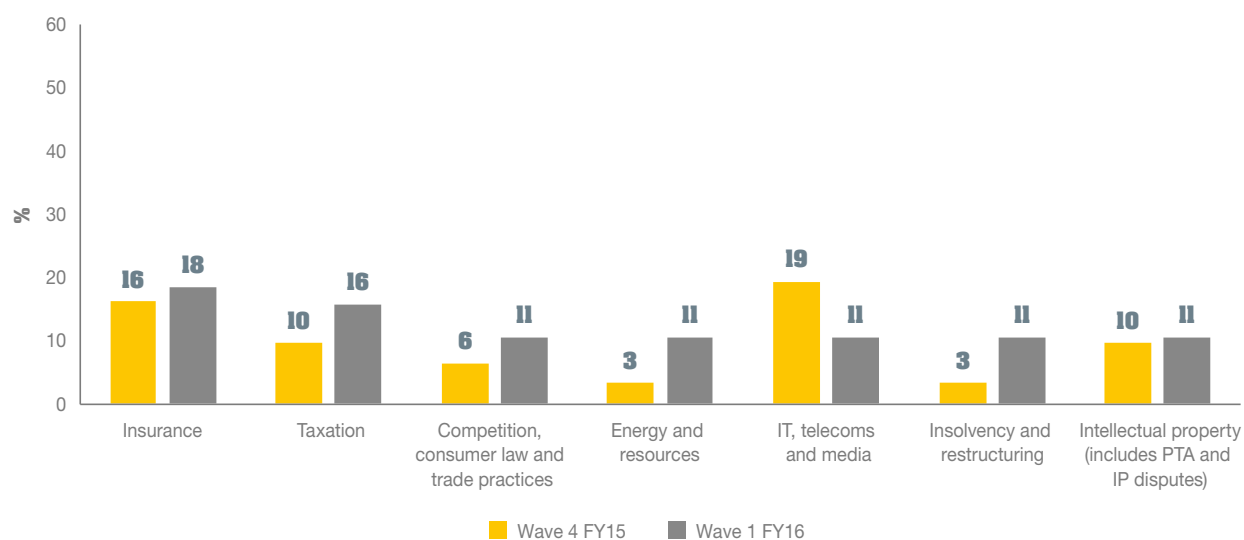
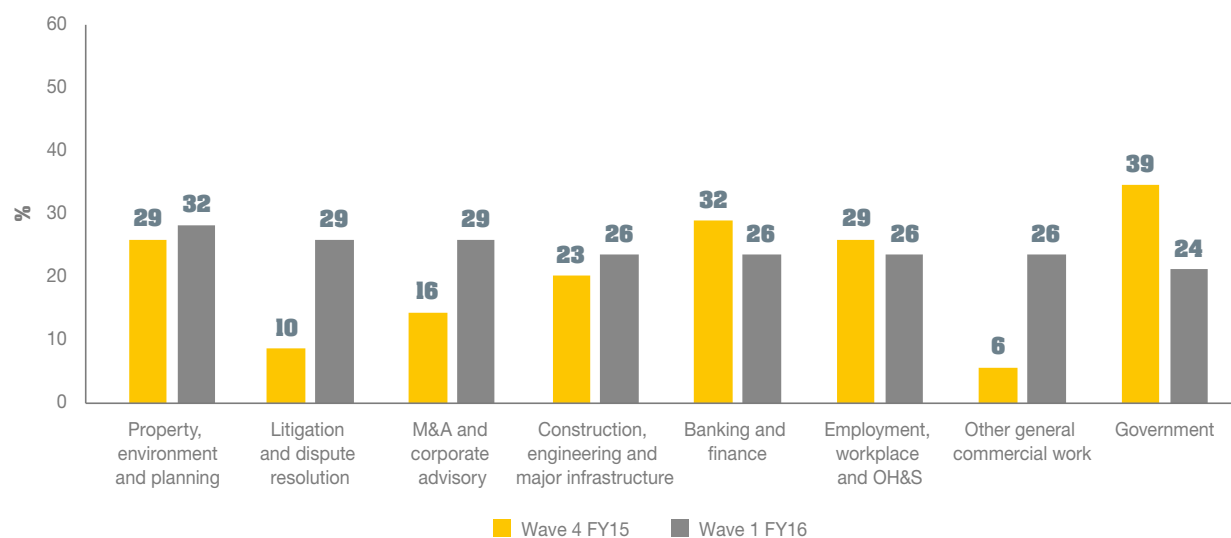
Perception of business conditions – by area and tier

Top-tier firms are finding business conditions less challenging than mid-tier firms across all areas other than keeping quality staff.



Market entry

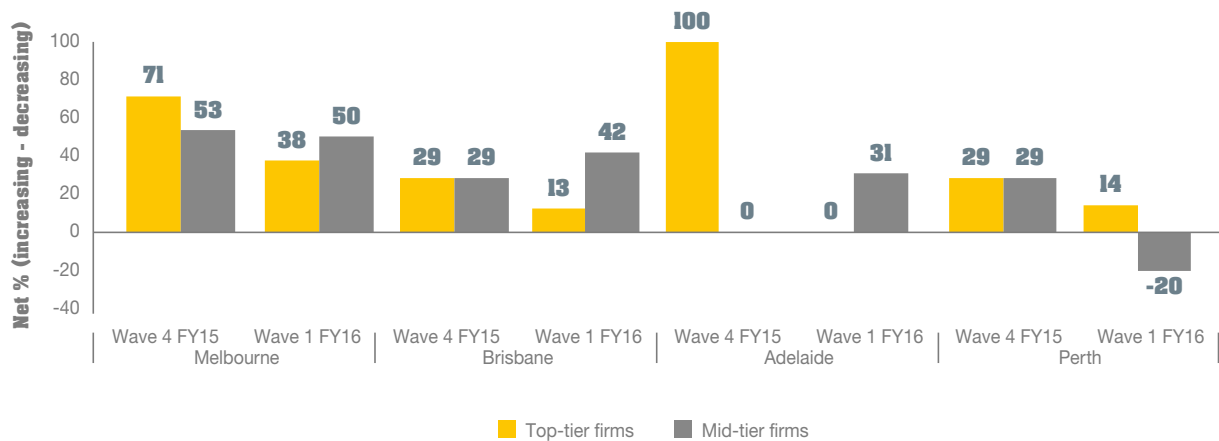
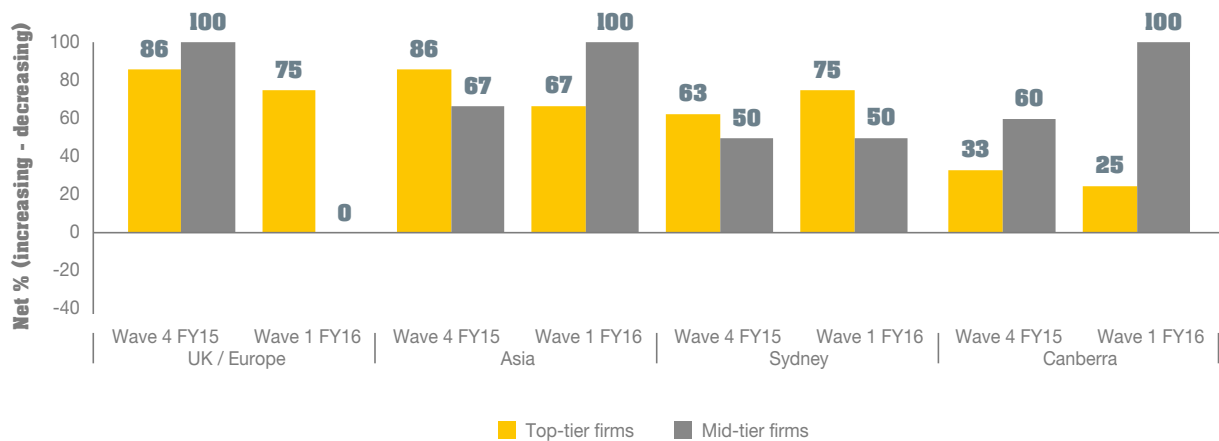
The top three practice areas law firms are looking to grow are 1) Property, environment and planning; 2) Litigation and dispute resolution; and 3) M&A and corporate advisory.



Revenue predictions

Changes in revenue over the next 6 months – by location

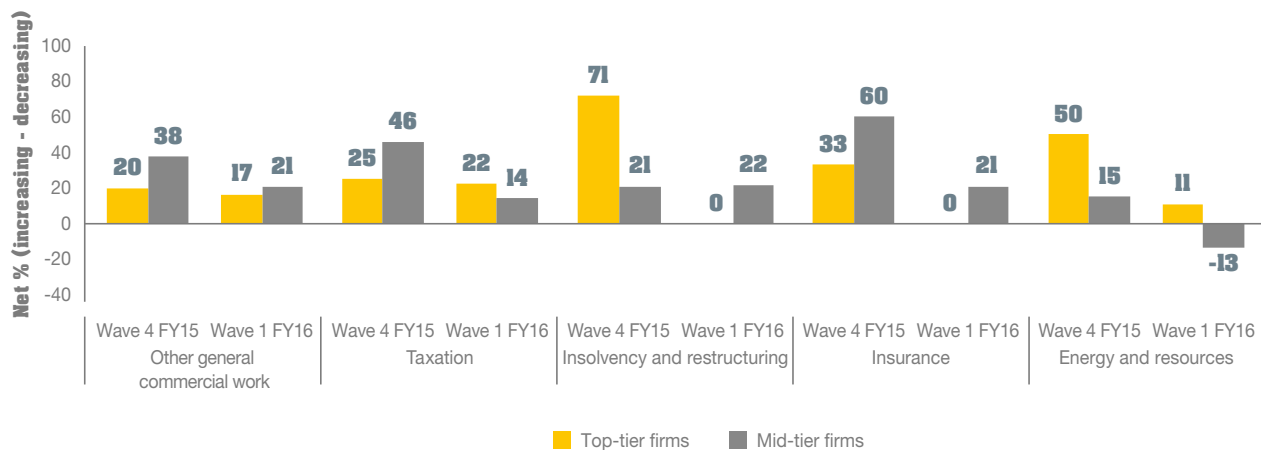
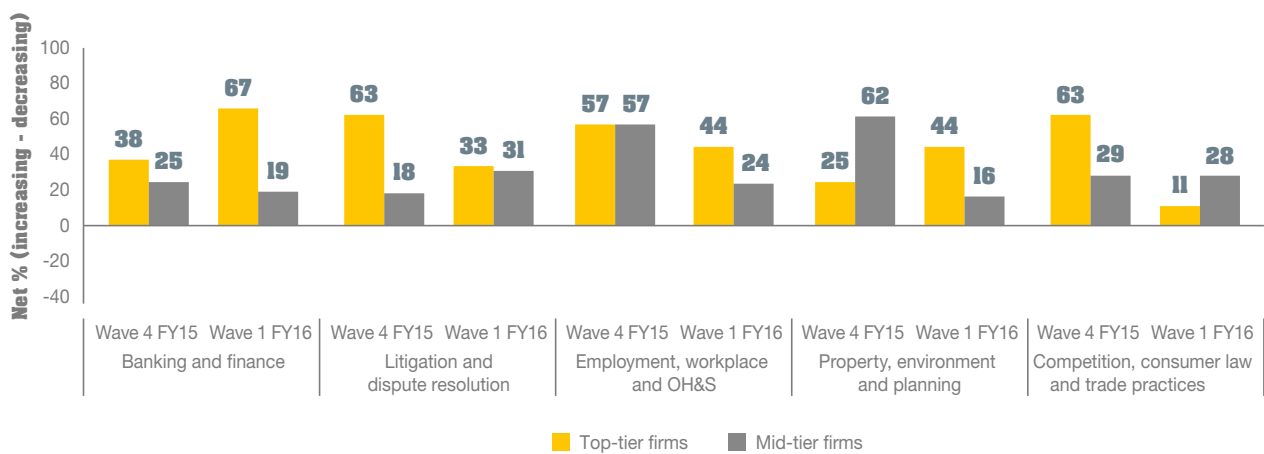
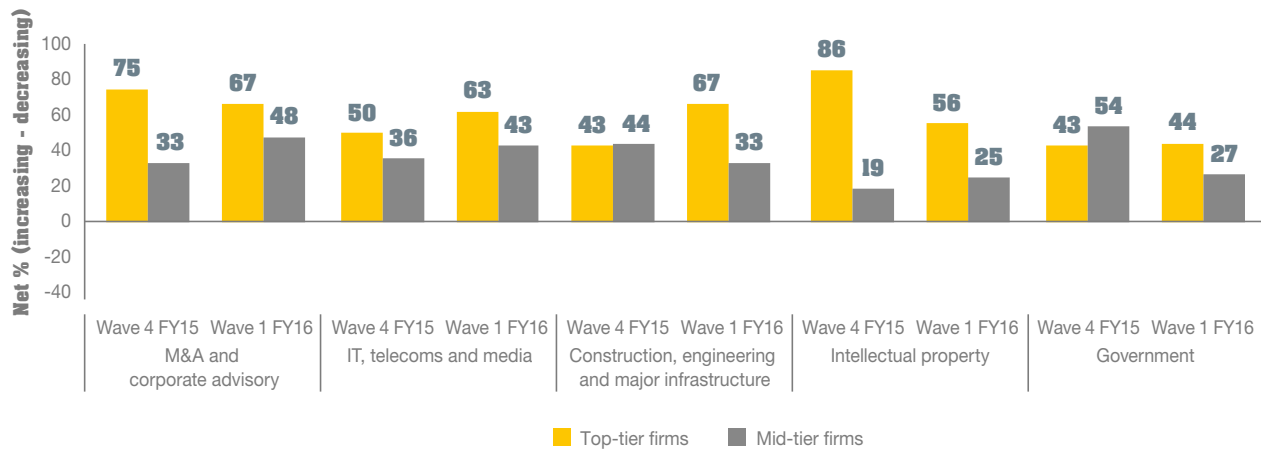
Optimism in Sydney is being driven by top-tier firms, however in Canberra it is being driven by mid-tier firms.



Changes in revenue over the next 6 months – by practice area

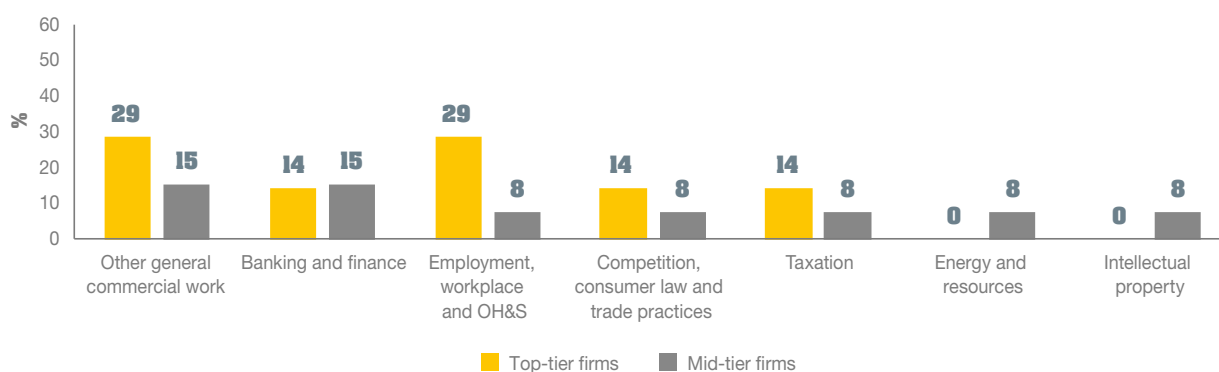
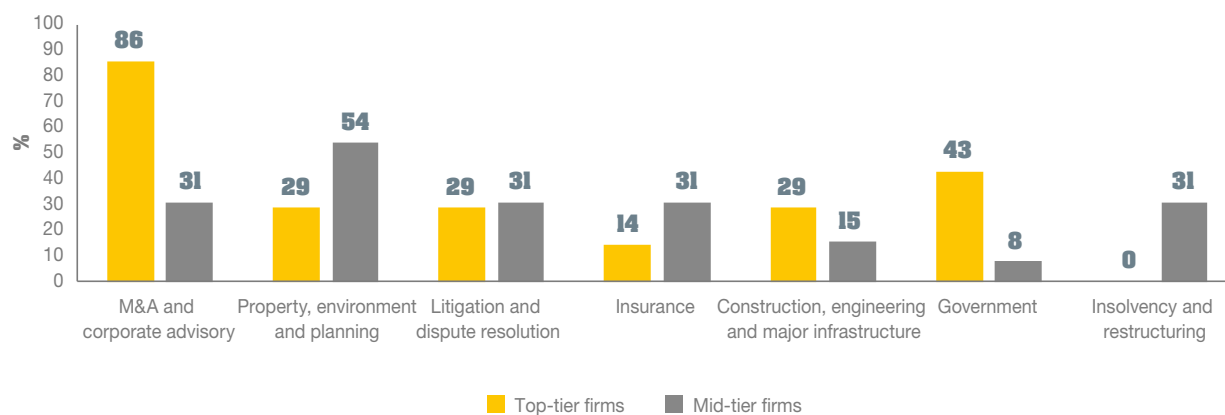
Top-tier firms are forecasting greatest net growth across Construction, engineering and major infrastructure, M&A and corporate advisory and Banking and finance practice areas.

Mid-tier firms forecast highest net increase across M&A and corporate advisory and IT, telecoms and media practice areas.



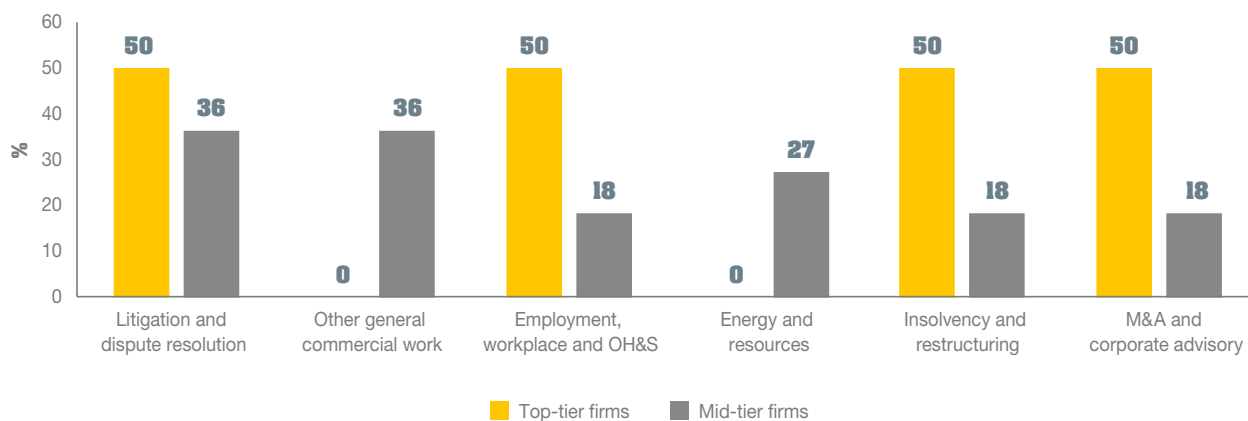
Increase in revenue – by practice area

Among firms who have seen an increase in revenue compared to this time last year, the main practice areas of growth are 1) M&A and corporate advisory and 2) Property, environment and planning.



Decrease in revenue – by practice area

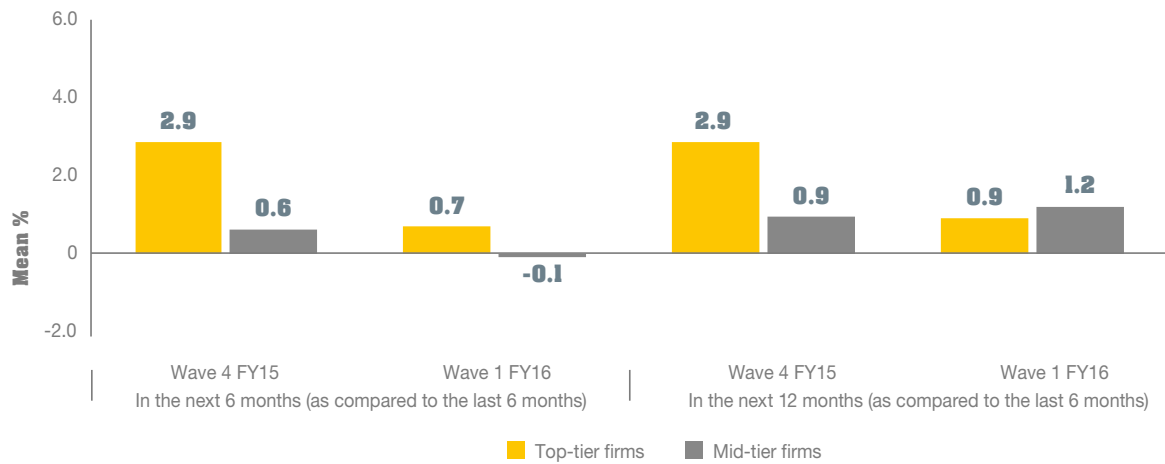
The main decline among mid-tier firms since the last report is in Litigation and dispute resolution and Other general commercial work practice areas.



Realised rates

Expected changes in realised rates – next 6 and 12 months

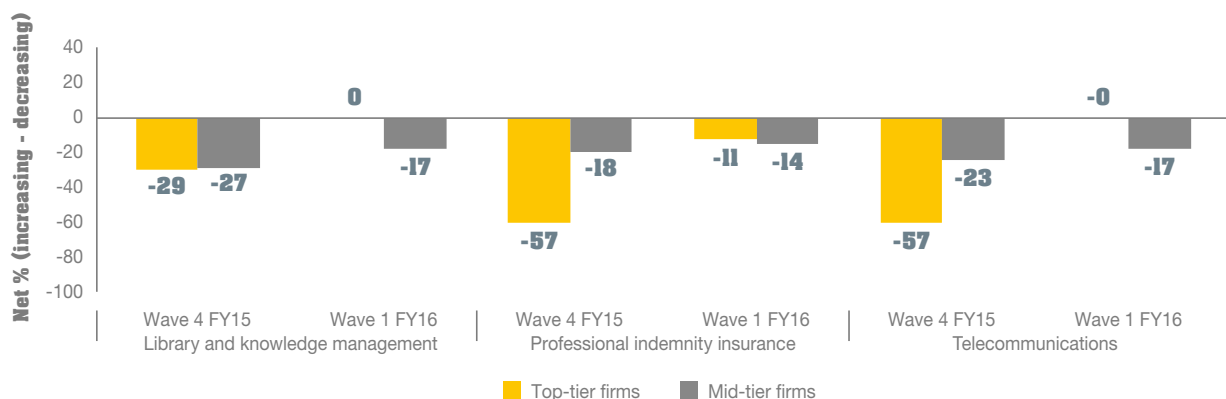
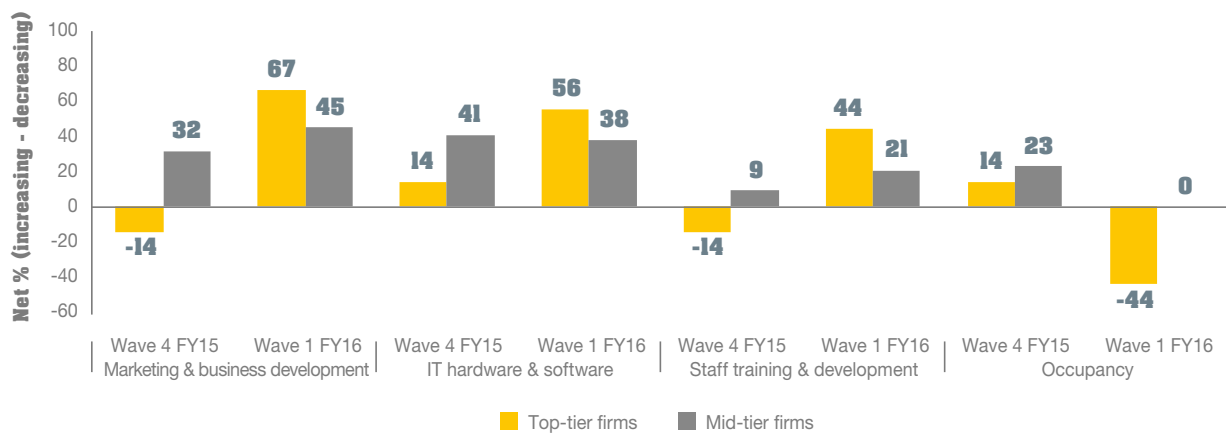
The forecast decline in realised rates is being driven by top-tier firms.



Expense and profitability predictions

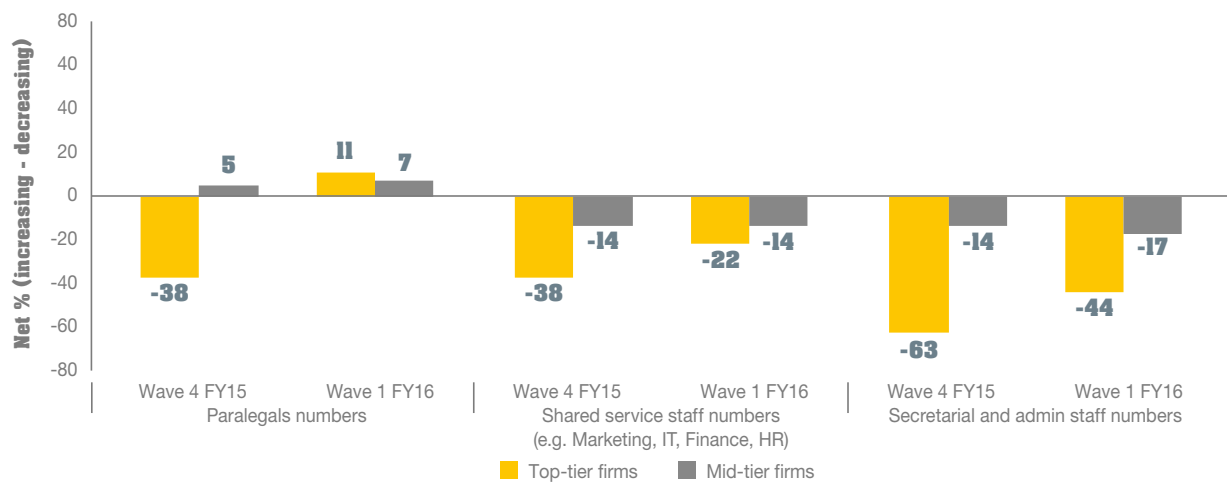
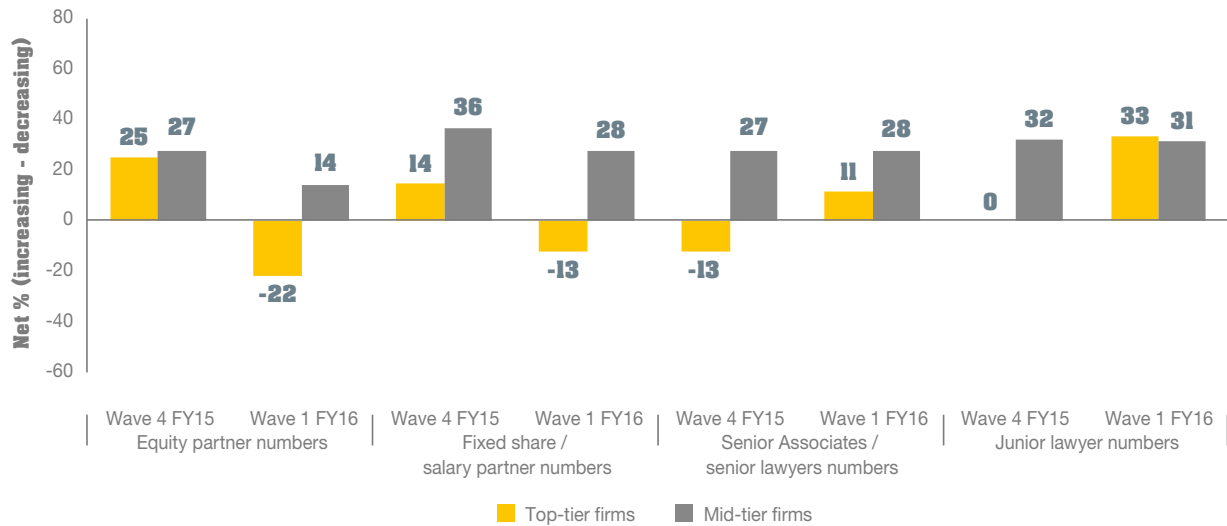
Changes in expenses over the next 6 months

Top-tier firms forecast a significant increase in expenses across all areas except Occupancy. Mid-tier firms expect the greatest increase in Marketing and business development.



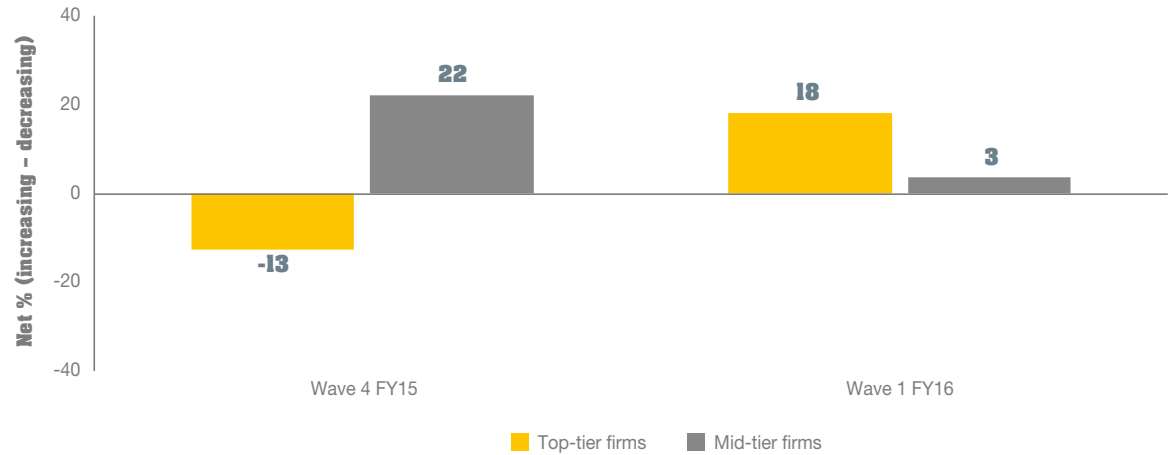
Changes in staffing over the next 6 months

The forecast decrease in partner numbers is being driven by top-tier firms.



Change in operating margins over the next 6 months

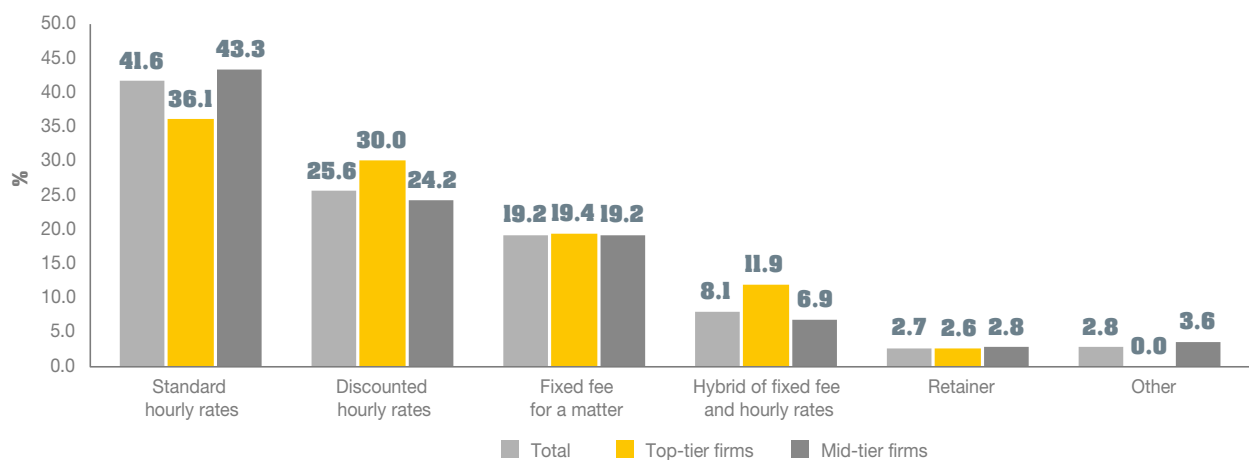
Top-tier firm leaders forecast a significant increase in operating margins, whereas mid-tier firms expect the opposite.



Alternative fee arrangements

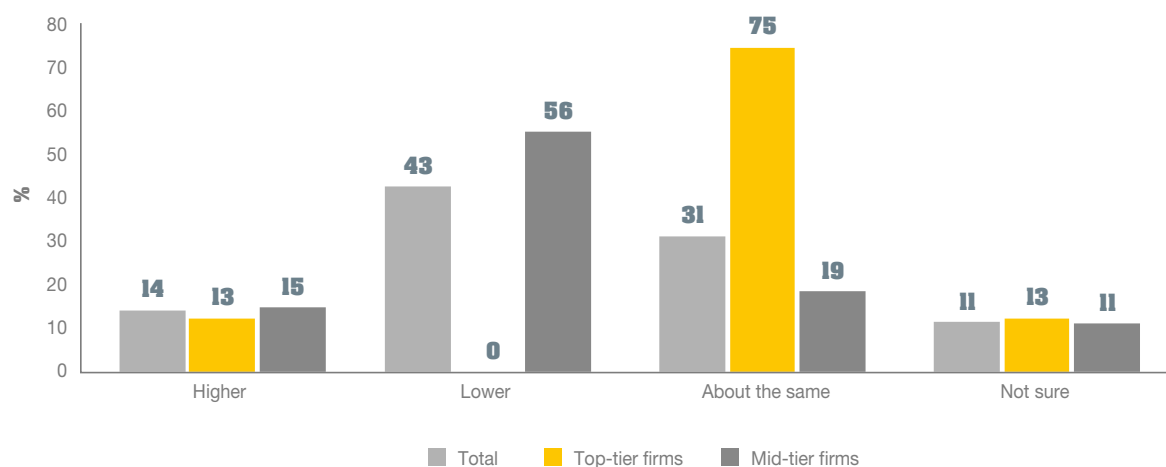
Revenue across different fee types

Revenue is still predominantly derived from hourly rates. However, almost 20% of all firms revenue, irrespective of size, is now coming from fixed fees.



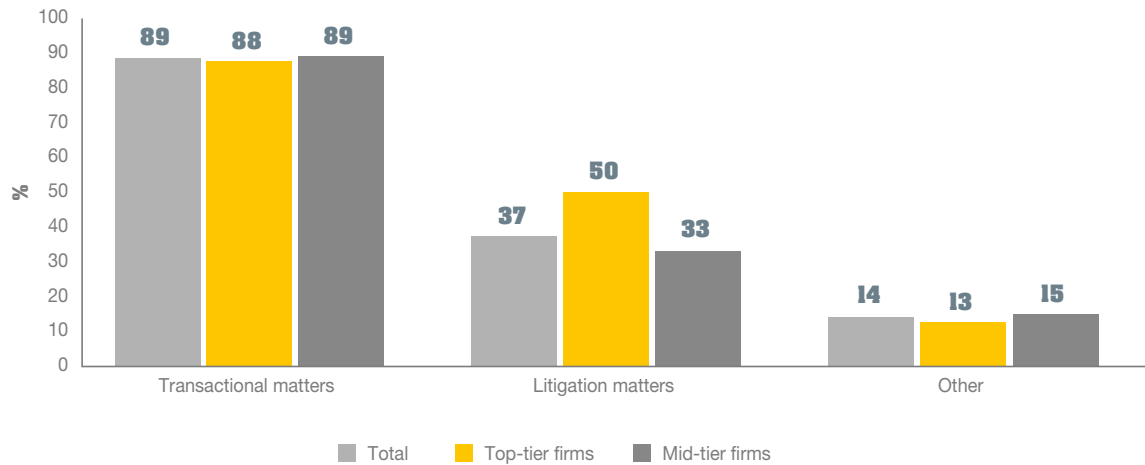
Margin on fixed fees relative to hourly rates

Top-tier firms are pricing their fixed fee work more profitably compared to their mid-tier counterparts.



Type of work with fixed fee quotes

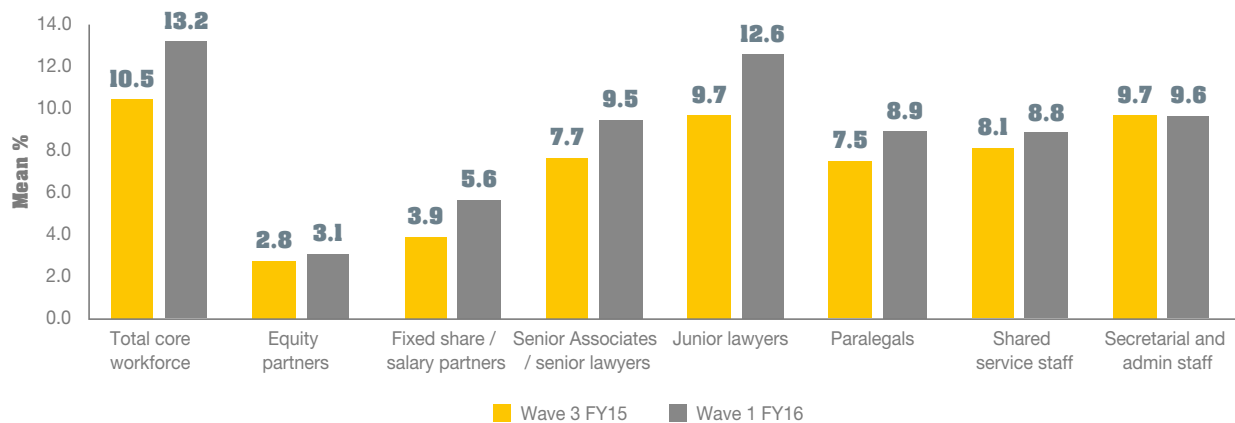
Fixed fee work is predominantly on transactional matters. Top-tier firms are more likely to provide fixed fee work on litigation matters than mid-tier firms.



People, staff and talent

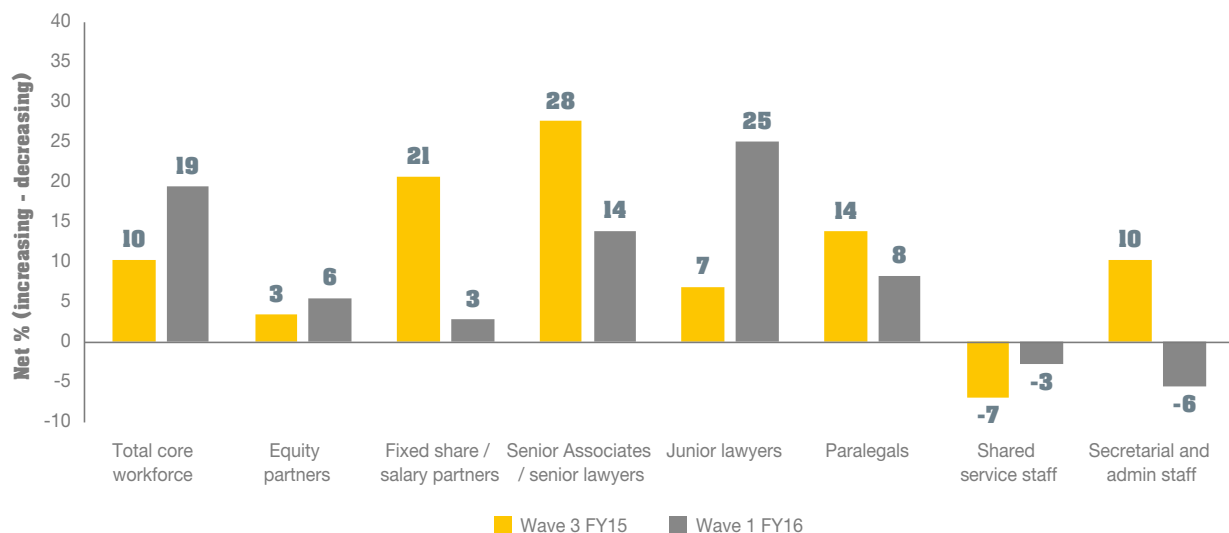
Turnover of core workforce in the last 6 months

Staff turnover is highest amongst Junior lawyers.



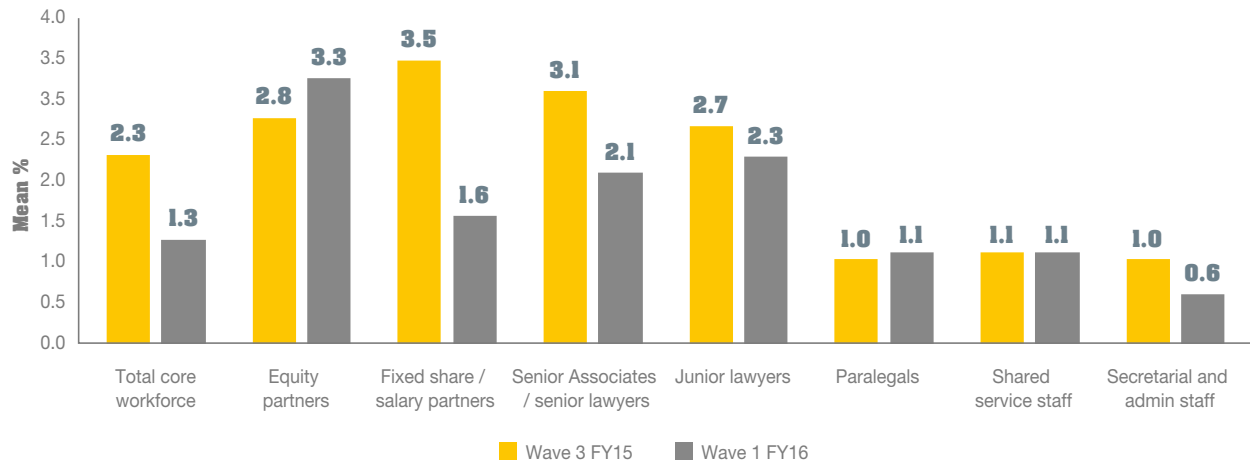
Expected change in turnover of core workforce in FY2016

Firms expect turnover of Junior lawyers to continue at a higher rate compared to the previous report. On the other hand, they expect turnover of Fixed share/salary partners and Senior lawyers to decrease.



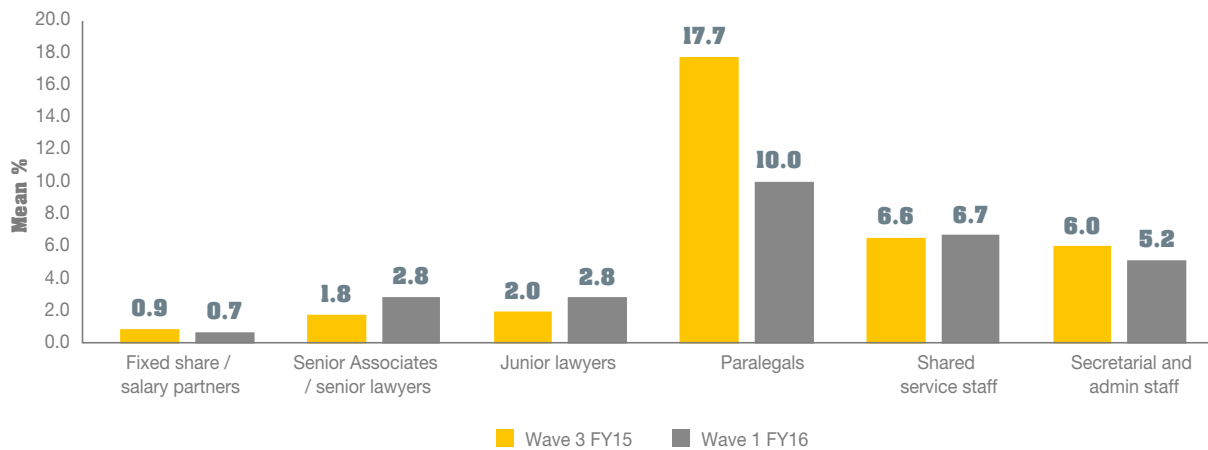
Change in remuneration of core workforce in FY2016

Average remuneration in FY2016 is expected to increase at a lower rate compared to the previous report, especially among salary partners and senior lawyers.



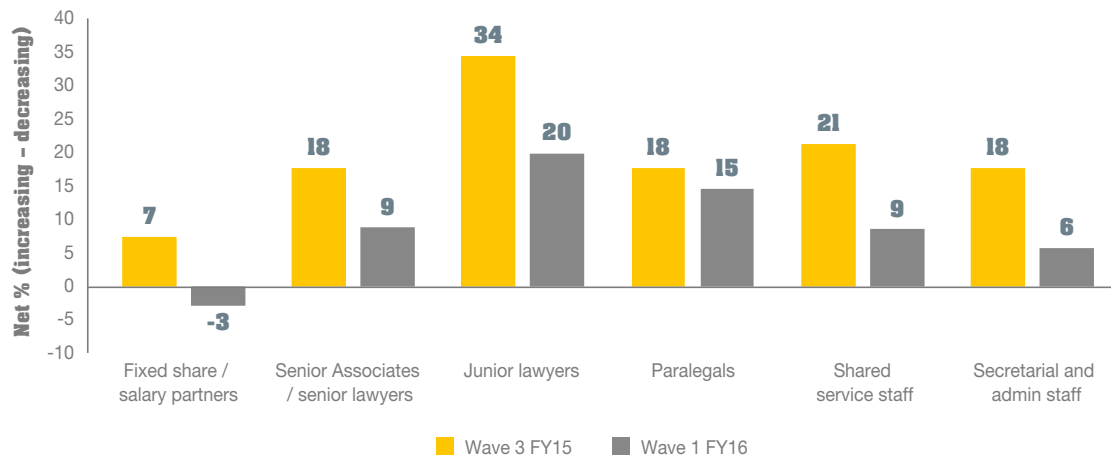
Percentage of contract workforce across levels

Paralegals are most likely to adopt contract roles in the workforce.



Change in proportion of casual/contract staff headcount

Law firms leaders expect a decrease in contract roles across all levels compared to previous report.



Top 3 reasons for staff to remain with a firm

“Quality and availability of mentoring and development”

– Chief Operating Officer / General Manager, Top-tier firm

Quality

“Quality of clients and work”

– CEO / Managing Partner, Top-tier firm

“Positive culture - people enjoy coming to work and where there are defined values which are respected”

– Chief Operating Officer / General Manager, Mid-tier firm

Conditions

“Working conditions - culture, hours, firm management, quality of direct supervision, location”

– CEO / Managing Partner, Mid-tier firm

“Satisfied with current role or positive about future prospects”

– Chief Operating Officer / General Manager, Top-tier firm

“Great clients and excellent work experience”

– CEO / Managing Partner, Mid-tier firm

“Opportunity to work on interesting and challenging client matters”

– Chief Operating Officer / General Manager, Mid-tier firm

Opportunity

“Opportunities for learning and career growth”

– Chief Operating Officer / General Manager, Mid-tier firm

Top 3 reasons for staff to leave a firm

“Disengaged and under valued. Higher remuneration”

– Chief Operating Officer / General Manager, Top-tier firm

Recognition

“They are uncomfortable working in a law business rather than a law practice”

– Chief Operating Office / General Manager, Mid-tier firm

“Annoying or unpleasant supervision: micromanagement or arrogance”

– Chief Operating Officer / General Manager, Mid-tier firm

Management

“Lack of strategic direction. Lack of quality management. Firm not keeping up with technological changes”

– Chief Operating Officer / General Manager, Top-tier firm

“Unhappy with direct management that is provided to them in their role”

– CEO / Managing Partner, Mid-tier firm

Opportunity

“Inability to match other benefits that may be provided at larger workplaces - paid maternity leave for non professionals”

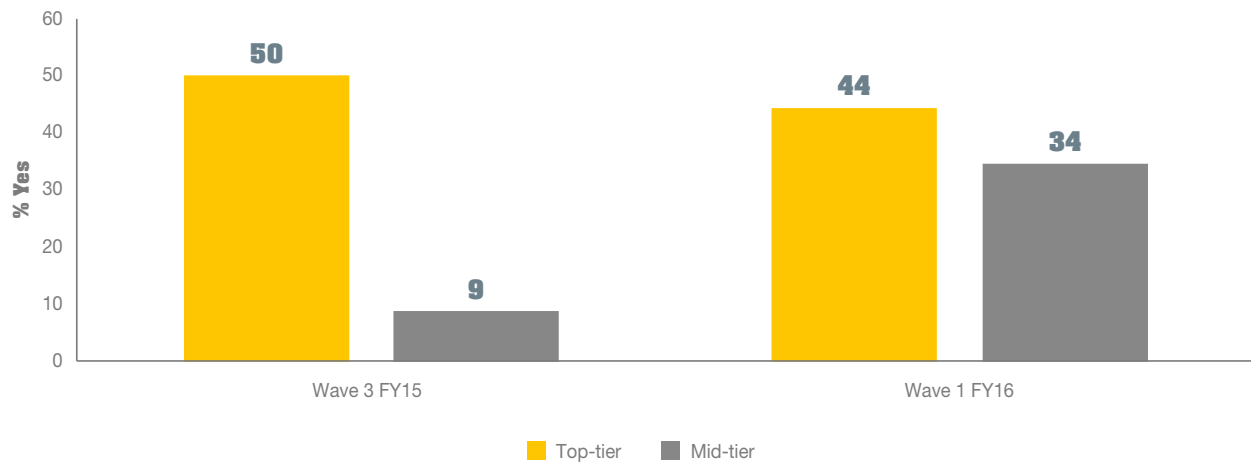
– CEO / Managing Partner, Mid-tier firm

“Lack of opportunity or quality work”

– CEO / Managing Partner, Mid-tier firm

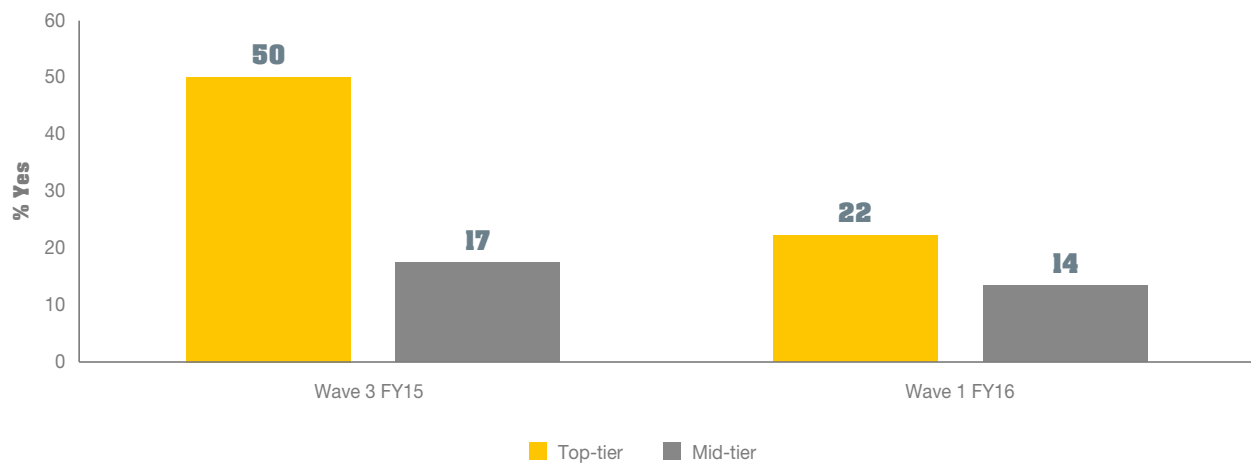
Outsourcing back office functions – over the last 12 months

The proportion of mid-tier firms who have outsourced back office functions has increased significantly over the last 12 months.



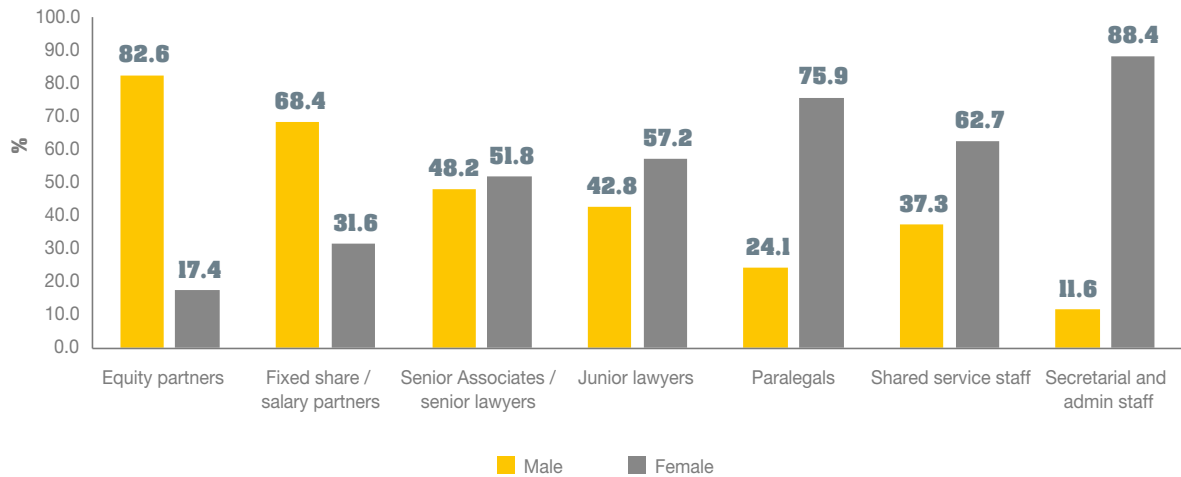
Outsourcing office functions to a lower cost location - in the last 12 months

The proportion of top-tier firms who have moved office functions to lower cost locations has decreased over the last 12 months.



Gender split across work levels

Partners in law firms are predominately males. Paralegals and non fee-earners are predominantly females.



Further information

For further insights or information, please contact:

**Marc Totaro, National Manager
Professional Services**

Mobile: 0477 739 315

Phone: +61 2 9303 1940

Email: marc.totaro@cba.com.au

Web: commbank.com.au/legalmarketpulse

For media inquiries, please contact:

**Bethany Poore,
Public Relations Advisor**

Phone: +61 2 9303 1259

Email: bethany.poore@cba.com.au

About Beaton Research + Consulting

Beaton Research + Consulting is a full-service research firm which offers a full range of solutions for professional services firms, financial services firms and associations. Their expertise includes benchmarking, thought leadership, brand solutions, customised solutions and client satisfaction.



Things you should know: This report is published solely for information purposes. As this report has been prepared without considering your objectives, financial situation or needs you should consider the appropriateness to your circumstances and, if necessary, seek appropriate professional advice. This quarterly report has been prepared independently by Beaton Research + Consulting and is commissioned by Commonwealth Bank. The confidential online survey used to prepare this report was undertaken by Beaton Research + Consulting in October to November 2015. The report is based on the views of 38 law firms across Australia. Any opinions, conclusions or recommendations are reasonably held or made based on the information available at the time of its compilation. No representation or warranty, either expressed or implied, is made or provided as to the accuracy, reliability or completeness of any statement made in this report. The project was undertaken in compliance with the requirements of ISO 20252. Commonwealth Bank of Australia ABN 48 123 123 124.