

THOMSON REUTERS INSTITUTE

AUSTRALIAN LEGAL MARKET

MIDYEAR UPDATE

EXECUTIVE REPORT
ISSUED 22 FEBRUARY 2024

SURGE CONTINUES FOR AUSTRALIA'S LAW FIRMS

The 2024 financial year (FY 2024) has shown none of the shakiness that marked the beginning of the prior year. Instead, the average Australian law firm has enjoyed financial performance that would rival any of their peer firms around the world. As inflation continues to cool on the continent, businesses remain poised to increase their legal spend on outside counsel, creating possibilities for law firms in a wide variety of practices and resulting in firms finding a solid footing at the midway point of FY 2024.

The key performance indicators show strengths across the spectrum. Demand for legal services, a measure of total billable hours worked by the average law firm, grew by an impressive 7.2% in the first half of the year compared to the same point last year. For comparison, that same metric at the midyear point of FY 2023 showed demand for the average law firm's services contracting by 5.0%, so this year's performance demonstrates a remarkable turnaround — really a continuation of a trend that started in the latter half of the prior financial year.

This growth in demand was driven by nearly every practice area tracked. Dispute resolution and general corporate work accounted for more than two-thirds of all hours at the average firm, and grew by 9.5% and 7.5% respectively, setting a strong pace for other practice areas to follow. The slowest growing practice area, mergers & acquisitions, still posted a healthy 2.4% growth. To provide a global comparison, according to the recently released Report on the State of the US Legal Market¹ from the Thomson Reuters® Institute, the fastest growing practice area in the U.S. during 2023 was bankruptcy,² which posted 4.4% growth for the year.

Perhaps a less favourable comparison comes from comparing growth in law firm rates. The average Australian law firm posted growth in their worked rates, also known as agreed rates, of 4.9% through midyear. For comparison, that is down from the 5.6% growth posted at the midyear point of FY 2023, and well behind the 6.0% growth posted by the average U.S. law firm through the end of 2023. However, when one considers that the last two years set the post-2014 record for worked rate growth in Australia, some slowdown may be inevitable. Luckily, the slower pace of rate growth does not seem to have placed too much of a drag on law firm revenue potential. Fees worked, a measure of the year-over-year growth in the product of worked hours multiplied by rates, grew an impressive 12.4%, far outpacing comparable marks. The combination of respectable rate growth with outstanding demand growth performance worked to push this mark, which is often a stand-in for firm profitability, into remarkable territory. That said, law firms would do well to pay close attention to protecting and growing their rates to provide the greatest potential for future profitability.

However, a slight concern about worked rate growth may be the largest concern found in the midyear results of key performance indicators (KPIs) for Australia's large law firms. Both qualified fee earner (QFE) or lawyer growth and utilisation posted strong marks to begin the financial year, with QFE growth being particularly notable at 5.9%, outpacing the prior year's midyear mark by a considerable margin. However, that strong growth in fee-earner headcount was more than offset by strong demand growth such that the average lawyer's utilisation improved by 1.2%. In a global legal market in which growth in lawyer productivity or utilisation can be difficult to find, Australian law firms have clearly set a benchmark for improvement in this key area.

At the same time, law firms have been able to strike a balance between growing headcount and managing expenses. Since the start of FY 2023, growth in both direct and overhead expenses has noticeably cooled, even as headcount has grown. Law firms have slowed the pace of direct expenses growth — those associated with attorney compensation and benefits — from nearly 13% at the start of FY 2023 to 7.3% now. What will be telling in the coming year is whether and to what extent Australian firms move to match the latest salary scales being pushed by the largest U.S. law firms. The pressure to match U.S. salaries is largely credited with the last major uptick in law firm direct expenses, the effects of which linger today. If Australian firms move to match lawyer compensation, that will cause an acceleration in the pace of direct expense growth. While the average firm could likely absorb it, whether they want to, or need to, is a separate question.

KEY PERFORMANCE INDICATORS

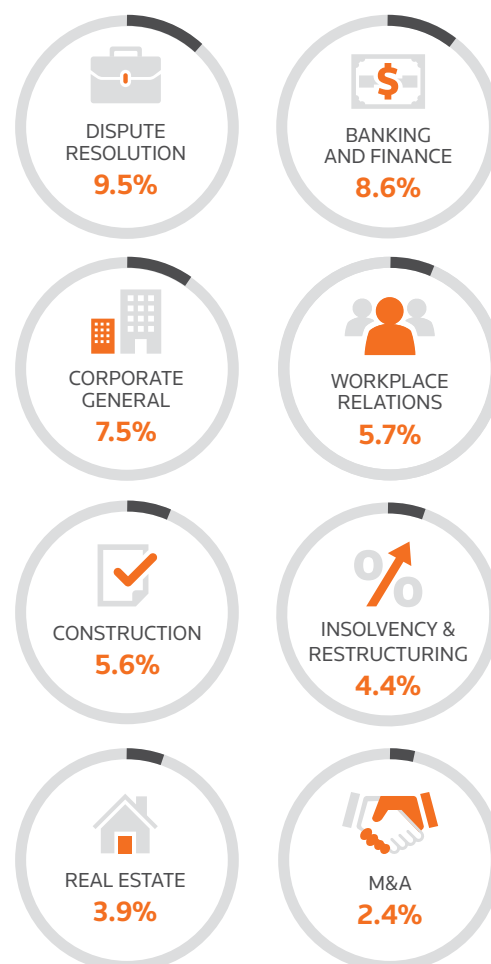
Y/Y Change | YTD: FY 2024 vs. FY 2023

Demand	7.2%
Worked Rates	4.9%
Fees Worked	12.4%
Utilisation	1.2%
QFE Growth	5.9%

All fee earners; billable time type; AU Offices
Source: Thomson Reuters

PRACTICE DEMAND GROWTH

Y/Y Change | YTD: FY 2024 vs. FY 2023



*Circular band surrounding practice is equal to the Proportion of Hours Worked in FY 2023.
All fee earners; billable time type; AU Offices.
Source: Thomson Reuters

¹ Available at thomsonreuters.com/en-us/posts/legal/state-of-the-us-legal-market-2024/.

² For purposes of this update, bankruptcy is otherwise referred to as insolvency & restructuring.

Setting the stage for future growth?

Leaders of Australia's large law firms are likely proud of their achievements, and rightly so. The question is whether the market will continue to be favourable. Indications appear to point toward yes. In its Economic Survey of Australia, the intergovernmental Organisation for Economic Co-operation and Development (OECD) notes that growth in Australia's economy is slowing after a rapid post-pandemic recovery. However, per OECD figures, GDP growth is projected to settle around 2%, in line with the pre-pandemic trend and hardly an indication of austere times ahead. The OECD also highlights the slowing pace of inflation in Australia, which while still high, has cooled quite a bit since its 2022 peak — another indication of a return to something resembling economic normalcy.

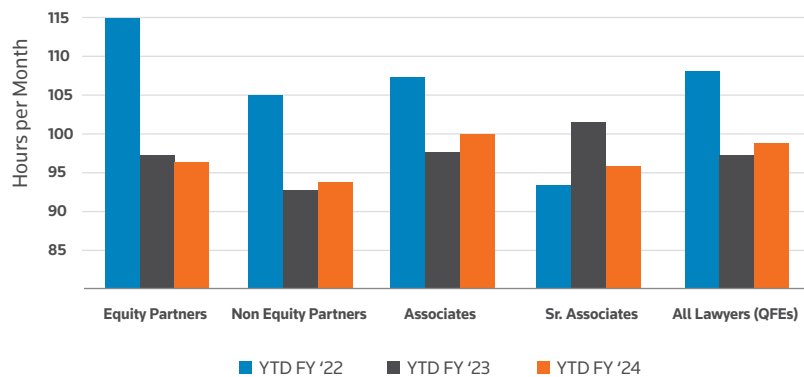
Adding to this landscape, clients are expressing widespread likelihood that their spend on outside counsel is likely to increase in the coming 12 months. Australian general counsel were asked whether they expected their legal spend to increase or decrease in the coming 12 months. The percentage of those who said they anticipate contraction is subtracted from those who anticipate growth to arrive at what we call Net Spend Anticipation (NSA).⁴ For Australian GCs, the current NSA score stands at a strong 32. Additionally, higher legal spend is also anticipated across a wide swath of practice areas. In fact, only banking & finance and insurance posted negative NSA scores; by contrast, M&A, disputes, labour & employment, and regulatory work all show positive NSA scores in double-digit figures.

The Australian legal market appears well positioned to continue its long string of success, having seemingly fully recovered from the doldrums of early FY 2023 with no signs of looking back. While there is room for some improvement around the growth of agreed rates, particularly against global competitors, it is unlikely that comparatively slower rate growth is causing too much concern given the strength of other driving forces. A strong finish to FY 2024 will position Australian law firms well to make key investments into the future for emerging artificial intelligence technologies which will, themselves, usher in a new era of evolution to the legal industry.

³Available at oecd.org/economy/australia-economic-snapshot/; dated 26 October 2023, accessed on 17 January 2024.

⁴Net positive in this context refers to the difference, in percentage points, in the percentage of corporate law departments that said they expect to increase spending on legal services, minus the percentage of those that said they expect it to decrease.

HOURS PER LAWYER

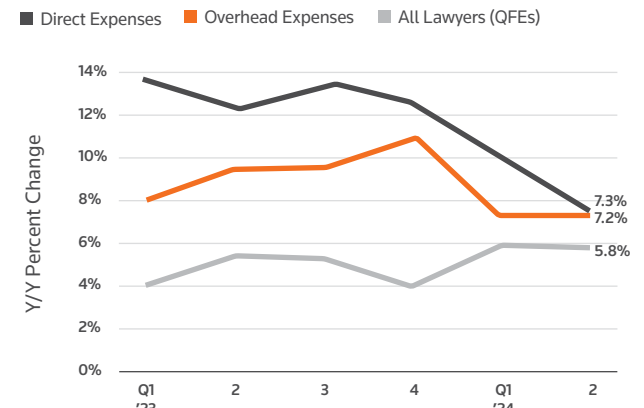


Lawyers (QFEs)
Billable time type; non-contingent matters

Source: Thomson Reuters

EXPENSE VS. LAWYER (QFE) GROWTH

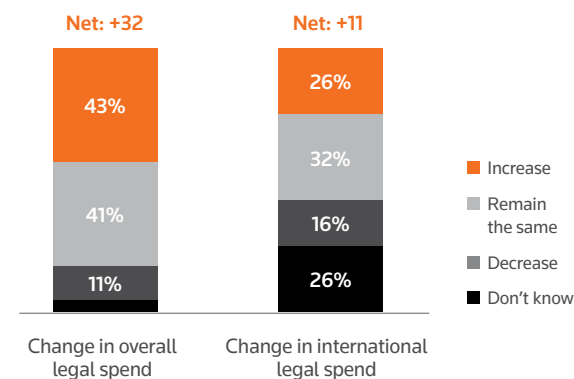
Rolling 12-Month Change



Source: Thomson Reuters

OVERALL AND INTERNATIONAL NET⁴ ANTICIPATED SPEND

YTD: FY 2024 | Average Australian legal buyer

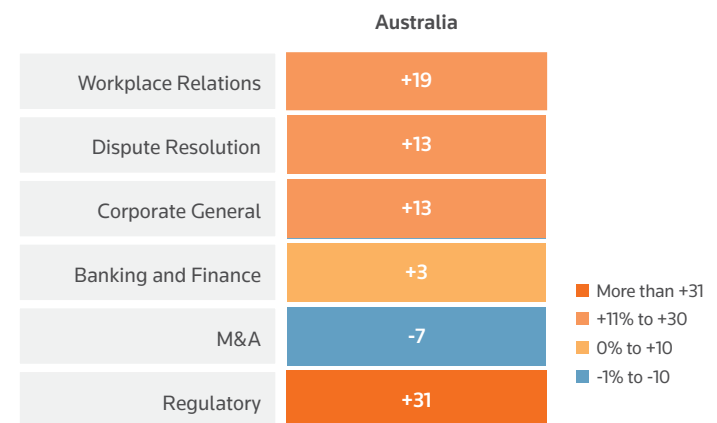


Source: Thomson Reuters

NET ANTICIPATED SPEND BY PRACTICE

Do you anticipate your spending on each of the following work types to be higher, lower, or the same in the next six months?

YTD: FY 2024 | Average Australian legal buyer



Source: Thomson Reuters