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PEER MONITOR®

2020 Australia: State of the Legal Market

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FOREWORD

Jackie Rhodes

It is always a good thing to have market insights on hand. As business leaders in the legal profession, we task ourselves with being attuned to market developments to assist with our strategic direction and better serve clients. Right now, clarity and focus are so greatly needed.

I am pleased to share our annual *State of the Legal Market Report*, thanks to Peer Monitor's financial data gathering from law firms and their rigorous analysis. We have partnered with the subject matter expertise of Alpha Creates and Barolsky Advisors again to deliver this year's timely edition and thank them for their insights.

None of us could have tipped that a global health crisis would sweep through our personal and professional lives, yet here we are. Peer Monitor has reported encouraging levels of demand in the Australian legal profession, despite other challenges to the industry brought about by COVID-19. The data indicates that starting in Q1 demand for legal services grew, and maintained similar levels of growth for the entire year. Comparatively, results in Q4 of 2019 showed a contraction in demand for the first time since Q1 2017, so this rebound was greatly needed.

Looking at these law firm findings on a macro level, we can see that the Australian profession is performing significantly better than other major markets globally, but why is that exactly? The findings in our annual report will outline the driving forces behind such market movements, while advising caution on the road that lies ahead.

In part two of this report, you'll find an overview of the legal industry during the pandemic, including the impact of remote working and reliance on legal technologies. As expected, the current climate has prompted firms to reimagine their technology procurement decisions, and at times, fast-track them. The third section comprises of three hypothetical market scenarios and the potential ramifications of each likely outcome. I trust they will provide you with some food for thought as we enter into the next phase of our new normal.

Jackie

Managing Director
Thomson Reuters Asia and Emerging Markets

INTRODUCTION

Despite turmoil in the global economy brought on by the COVID-19 pandemic, the 30,000-foot view of the Australian legal market looks relatively rosy compared to other markets around the world. Demand in the first quarter bounced back and grew at an average of 6.0% across the market, which was a welcome rebound from Q4'19, when market demand contracted for the first time since Q1'17. Each of the subsequent three quarters also resulted in positive quarter-over-quarter demand growth, a trend that held true even in the fourth quarter, in the midst of a global pandemic.

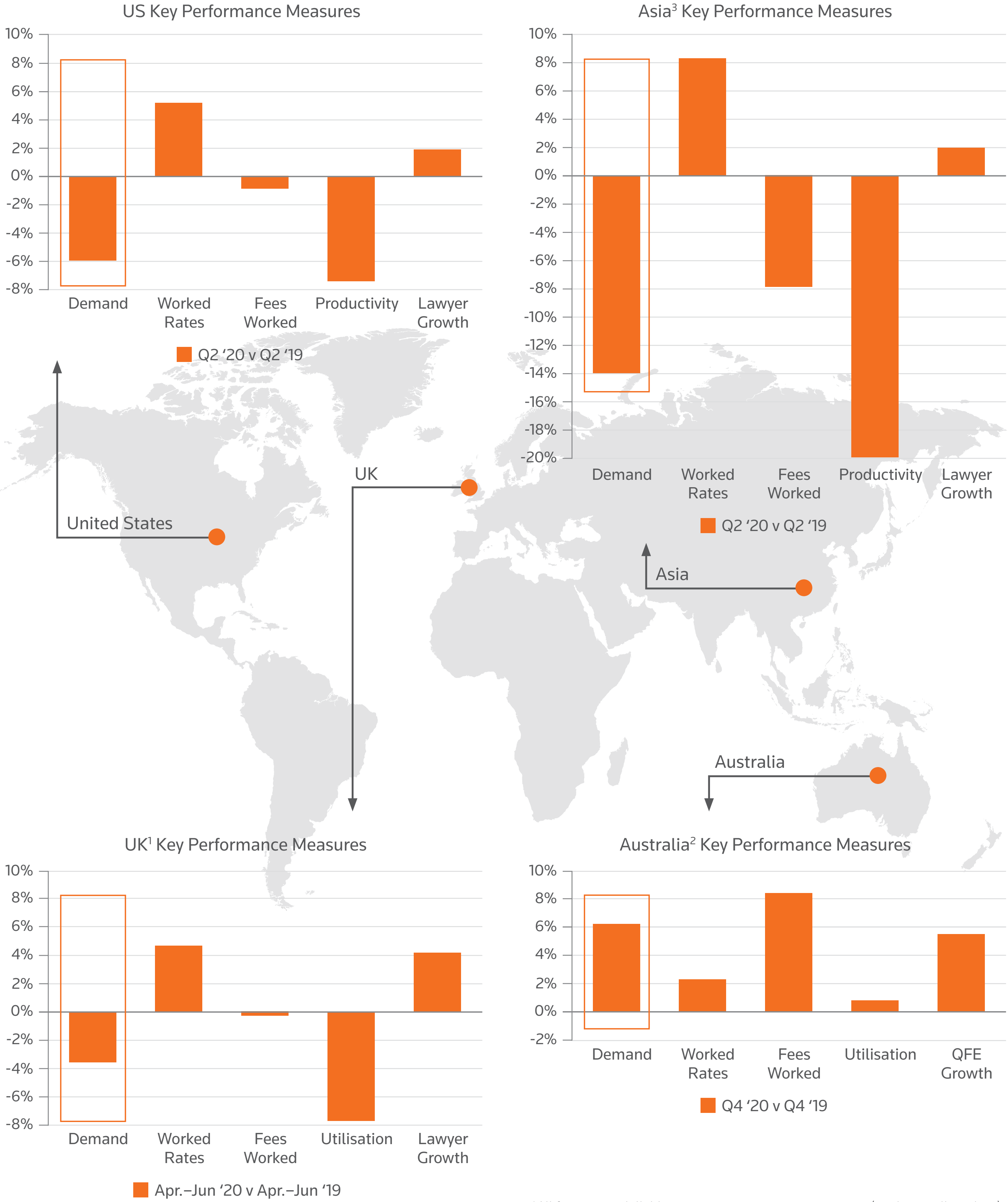
These are encouraging developments, certainly, but the Australian legal market, like all global markets, faces a great deal of uncertainty. Changes in how legal services are delivered are sure to come, and will be driven by economic imperatives that are all but impossible to escape. The larger question is: how and to what extent will the classic law-firm model evolve?

First, it is important to recognise just how well the Australian market performed relative to other major global markets. Most of the global response to the virus outbreak occurred in the final three months of the financial year, and demand contractions were the norm at law firms the world over—everywhere, that is, except Australia.

The Australian market was insulated from many of the negative factors affecting the rest of the international legal community for several reasons. First, the virus has had a measurably lower impact on Australia compared to other countries because it is relatively isolated geographically. Furthermore, courts in Australia already had virtual capabilities, so regular court proceedings could continue despite the pandemic. And financially, the continuation of commission work helped cushion law firms against the harsh economic realities faced by firms in other parts of the world. By comparison, demand contracted by 5.9% in the United States during the same period that demand *grew* in Australia by an average of 6.2%. Fees worked, a proxy for revenue, grew by 8.4% in the fourth quarter amid the pandemic (see Figure 1).

Thomson Reuters gratefully acknowledges the participation of the following persons in the preparation of this Report: from Alpha Creates – Eric Chin, Principal; from Barolsky Advisors – Joel Barolsky, Managing Director; and from Thomson Reuters – Joe Blackwood, Senior Analyst – Thought Leadership, Isaac Brooks, Analyst – Peer Monitor, Lucy Leach, Technical Research Manager, and David Johnson, Senior Client Relations Manager.

Figure 1 – Global Key Performance Measures During Pandemic



*All fee earners; billable time type; non-contingent matters (applies to all markets)

1 Based on US-based law firms activity in the United Kingdom financial year of May – April.
2 Based on Australia financial year of July – June.
3 Based on US-based law firms activity and US financial year of January – December.

It's unclear what 2021 and beyond holds in store for the economy and legal market. What is clear, however, is that the average Australian law firm enjoyed a great deal of success in the fourth quarter, while firms in the rest the world struggled under new and often unforgiving pressures. Regardless of their success, however, Australian firms would be wise to use this time of relative stability to implement strategic changes and initiatives with business continuity in mind. What happens in the next year depends upon how successful local and global responses to the virus are, but it's difficult to escape the conclusion that a slowdown may very well be on the horizon.

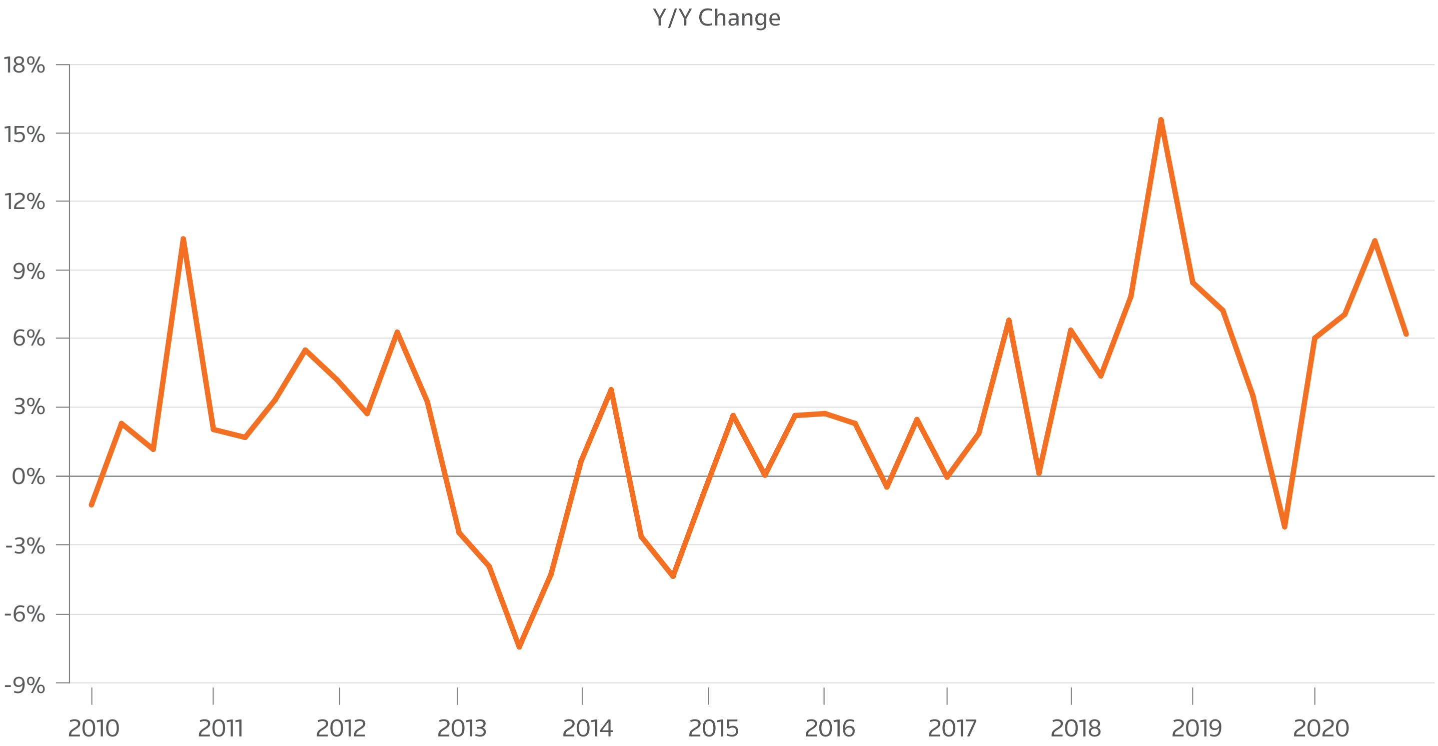
Demand

Demand, measured by the volume of billable hours worked at a firm, ended the year having grown on average by 7.4%. This compares favorably to year-end figures from FY2019, when demand grew by 4.8%. Over both of those years, however, Australian firms performed significantly better than other markets around the world.

In 2020, much of the performance improvement was due to a major resurgence of firms in the Large segment. In years past, market performance has been carried by firms in the Big 8. But in 2020, demand amongst Large firms grew by 7.1%, an increase of five percentage points from the year prior. Overall, the 7.4% demand growth in 2020 capped off half a decade of annual growth. In fact, over the past five years, there have only been four quarters in total where demand contracted.

Demand growth in 2020 was not geographically isolated, either. In fact, demand grew by more than 4.0% in all four of the major markets. Melbourne led the way with market demand there increasing by an average of 10.3%, followed by both Sydney and Brisbane, where demand increased by 9.2%. Perth, a market that has struggled in comparison to the other three, still managed an increase of 4.6% (see Figure 3).

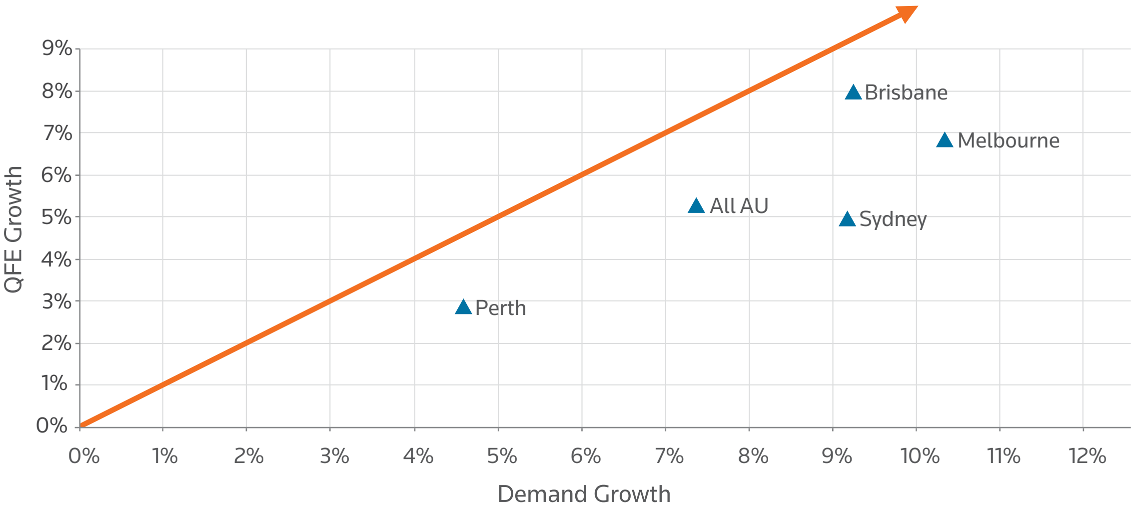
Figure 2 – Historic Demand Growth



All timekeepers
Billable time type; non-contingent matters; AU offices

Source: Thomson Reuters Peer Monitor®

Figure 3 – Markets Matrix – FY 2020



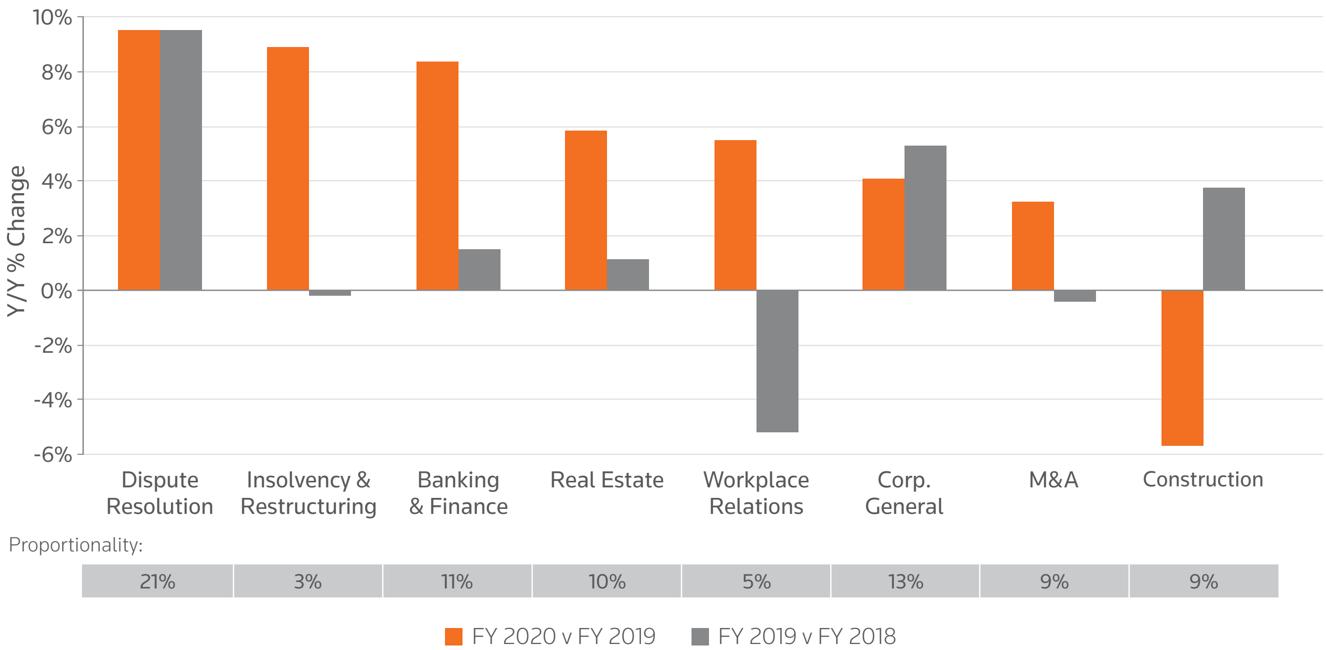
All fee earners
Billable time type; non-contingent matters

Source: Thomson Reuters Peer Monitor®

Demand growth occurred in nearly every major practice, but one of the major overall drivers of that growth was Dispute Resolution, which comprised 21% of all hours worked and is the largest practice by volume. In each of the past two years, Dispute Resolution grew by a market leading average of 9.5%. Corporate work, both general and M&A, saw demand increase by 4.1% and 3.3% respectively. Combined, these two practices make up 22% of hours worked in the market. Overall, seven of the eight major practices saw their demand grow by more than 3.0% in 2020.

Caution is advised, however, because demand increases in other areas could be indicative of broader economic slowdowns to come. For example, Insolvency & Restructuring is often viewed as a harbinger of approaching economic trouble, and demand for that practice has increased by an average of 8.9% over the past 12 months—an increase of nine percentage points from the year prior. Further, demand for Workplace Relations, another indicator of systemic stress, grew by 5.5% in 2020 after *contracting* 5.0% in 2019. An increase of hours in both of these practice areas is a sign of the challenges many companies are facing as a direct result of the COVID-19 pandemic.

Figure 4 – Practice Demand



All fee earners
Billable time type; non-contingent matters; AU Offices

Source: Thomson Reuters Peer Monitor®

Hiring/Talent Trends

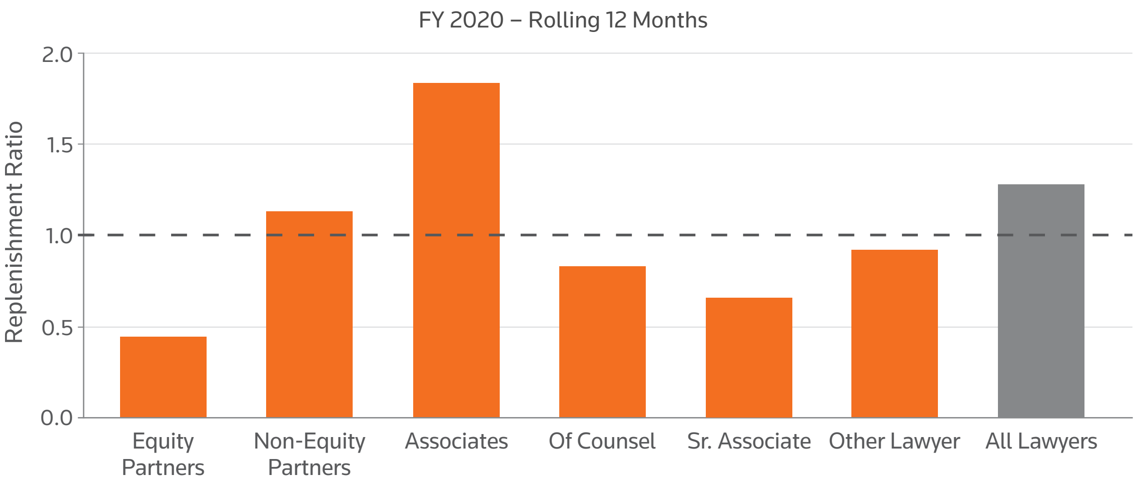
Five years of sustained annual demand growth have encouraged Australian firms to aggressively increase their lawyer headcount as well. In fact, qualified fee-earner headcount increased by an average of 5.3% at Australian firms in 2019. Concerns about the coronavirus did little to slow lawyer hiring, as fourth quarter QFE growth alone outpaced growth for the entire previous year.

Headcount growth in the lawyer ranks was not isolated to one segment, either. Growth in both Large and Big 8 firms exceeded 5.0% in 2020. The landscape looks a bit different when looking at growth by locale, however. Brisbane led the way with average lawyer growth of 8.0%, followed by Melbourne, Sydney, and Perth at 6.8%, 5.0%, and 2.9% respectively.

Looking at the replenishment ratio (the ratio of newly hired to terminated lawyers by title) over the last 12 months, it may come as no surprise that the highest volume of new hiring occurred in the Associate ranks. Across all firms in the market, Associates were replenished at a rate of 1.84, up from 1.46 in the year prior.

Another interesting trend that emerged in the replenishment ratio figures was the juxtaposition of equity to non-equity partners. Equity partners were replenished at a rate of 0.45 in 2020, meaning only 0.45 equity partners were added per terminated lawyer in this category, while non-equity partners were replenished at a rate of 1.13, highlighting a trend of increasing de-equitisation in the market.

Figure 5 – Replenishment Ratio



Source: Thomson Reuters Peer Monitor®

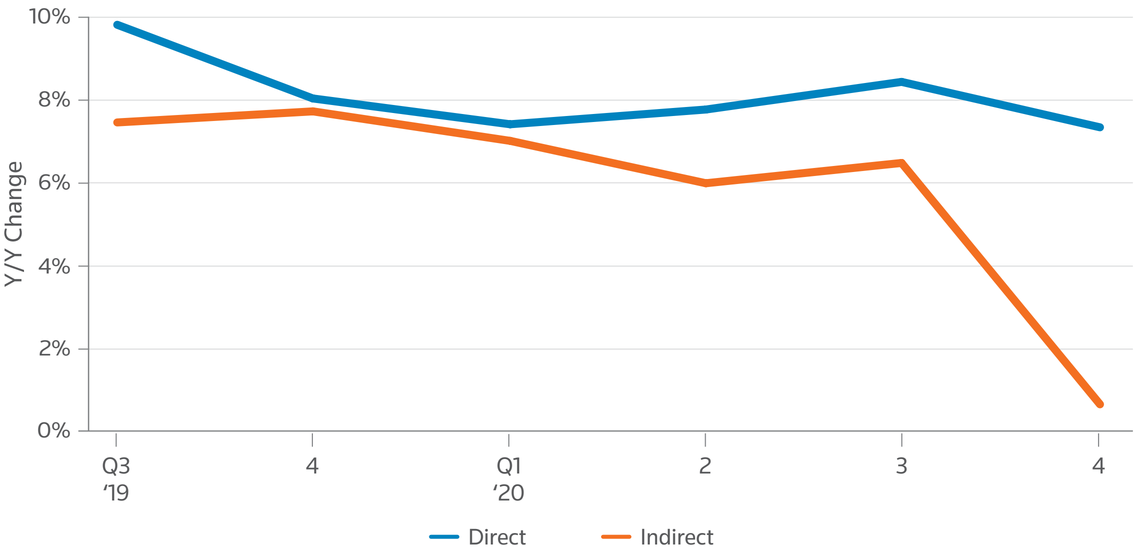
Expenditures

Both direct and indirect expenditures were relatively constant during the first three quarters of FY2020. Direct expenditures, primarily consisting of lawyer compensation, has increased by 7.4% on a rolling 12-month basis, exactly the same as in Q1. And while there has been some discussion about impending layoffs as a result of slowdowns associated with the global pandemic, they have yet to materialise in the lawyer ranks. Across the market, compensation growth has not dipped below 7.0% over the past two years.

Indirect expenses have been much more significantly affected, however, with a marked downturn in the fourth quarter. The year started with 7.0% growth in indirect expenditures, but significant decreases in areas such as marketing, business development, and office expenses have led to only a 0.6% increase in overhead expenditures over the last 12 months. Further, support staff compensation—the largest area of overhead expenditure by proportion—decreased by nearly 10.7% in the fourth quarter alone. So while layoffs and furloughs have not depleted the lawyer ranks, support staff has not been quite so fortunate.

Conversely, technology expenditures in Q4 increased by an average of 6.4% across the market as a result of rapid investment firms have made in technological solutions to ensure business continuity during the pandemic.

Figure 6 – Expense Growth*



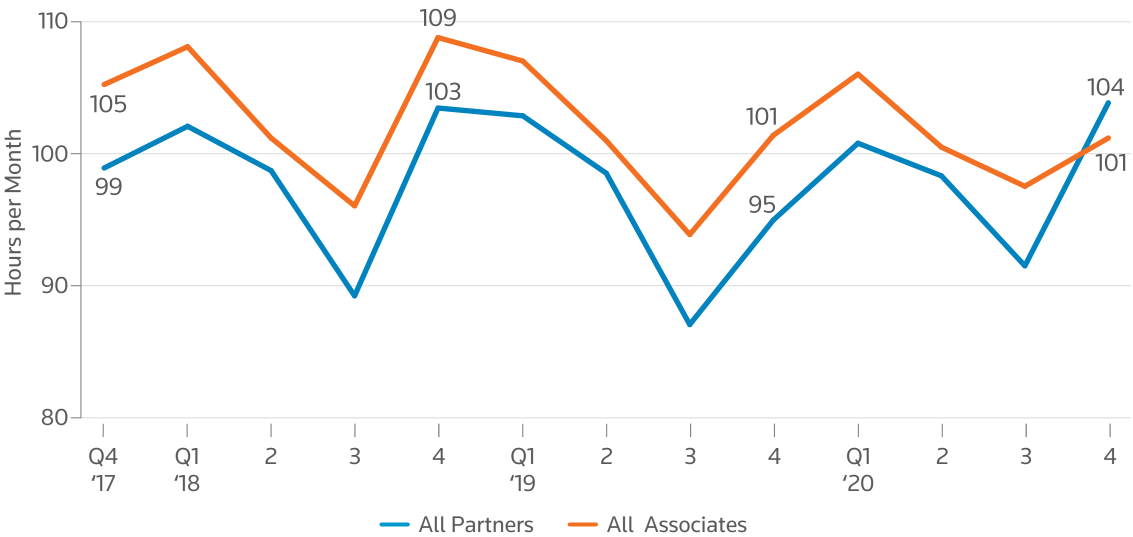
Expense Growth is rolling 12-month Y/Y change

Source: Thomson Reuters Peer Monitor®

Pandemic Prompts Proportional Shifts

One of the most interesting trends occurring in markets around the globe, including Australia, is a significant shift in work between lawyer titles during the pandemic. The classic approach has been to have Associates work more hours per month than those in the Partner ranks, but that trend inverted in the fourth quarter. In each of the preceding three fourth quarters, Associates worked an average of six more billable hours per month than a partner in Australia. But in the fourth quarter of 2020, Associate utilisation remained flat compared to last year, whereas there was a notable increase of nine hours per month in the partner ranks.

Figure 7 – Hours per Lawyer



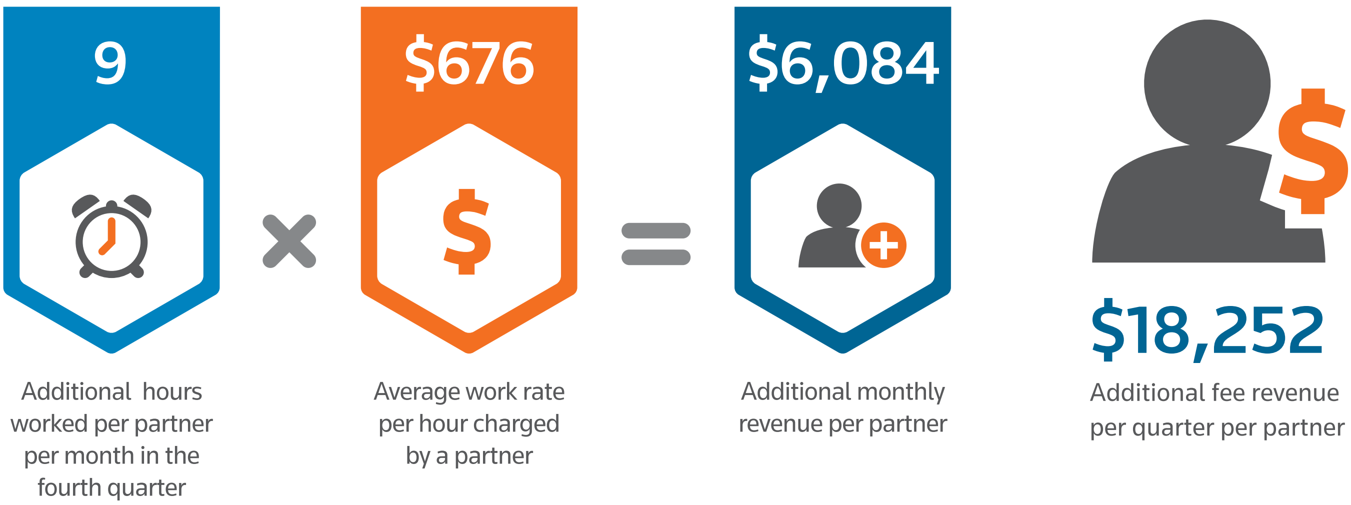
Qualified fee earners
Billable time type; non-contingent matters

Source: Thomson Reuters Peer Monitor®

The cause of this increase in partner hours is twofold. First, clients faced with unprecedented levels of uncertainty are demanding a higher volume of advisory work that cannot be completed by less experienced associates. At the same time, partners are filtering less work down—work that would typically be completed by Associates—to ensure their own billable-hour goals are met. The shift in demand from clients, coupled with a more eat-what-you-kill mindset from partners, is clearly evident in the utilisation figures. But the implications of this trend stretch beyond hours, and are borne out in the rate growth figures.

> *"We're seeing clients want more partner time now and more access to partners than ever before. Maybe it's because of the strategic nature of the work, or because they've realised that having a quick conversation with a partner is all they need to get them the comfort they're after. So [in the future] I think you'll end up with more pressure around the partner/grad model, especially with the use of technology."*

Before the pandemic, worked rate growth in the market was already muted. Worked rates grew by an average of 0.7% in the first quarter, followed by growth of 0.6% and 1.1% in the second and third quarters respectively. In the fourth quarter, however, the proportional shift in work led to a significant uptick in average worked rates charged in the market. As partner work increased, average worked rates also rose by an average of 2.3%. In terms of dollars, when coupling the average work rate of $676 per hour charged by a partner with the additional nine hours worked per month in the fourth quarter, this shift in working dynamics provided firms with an average of $6,084 more per month, or $18,252 more in fee revenue per partner in the fourth quarter.



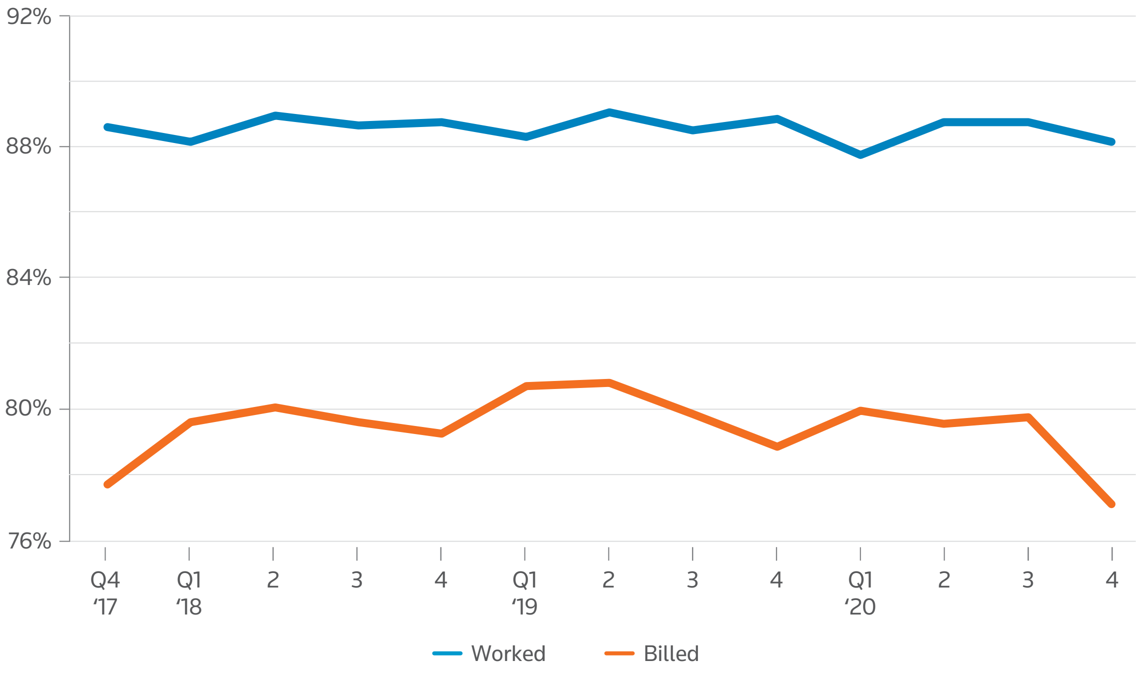
Despite the disruptions occurring around the globe in the fourth quarter, demand was up and many practices performed better than they did during the previous year. Expenses were recalibrated, and partners shouldered more of the load to mitigate risks associated with the COVID-19 crisis. So while the pandemic has affected almost everyone's daily life, it has not disrupted the legal market's financial performance thus far. In order to maintain their healthy balance sheets, however, much will depend on how firms manage their technology and personnel during the troubled times ahead.

OVERVIEW OF THE LEGAL INDUSTRY DURING THE PANDEMIC

As it has in most places, the COVID-19 pandemic has disrupted the Australian economy, and the ripple effect can be seen across the legal industry. Prior to the pandemic, corporate legal departments were focusing their strategic thinking on how to improve their commercial effectiveness and departmental efficiency. All signs suggest that the pandemic has only increased the urgency of these issues. Legal budgets have been slashed, or at best maintained, and workloads have increased as businesses adjust to the fluctuating demands of lockdown compliance regimes across the country.[4]

Businesses continue to require help navigating changing government lockdown rules, but they need these legal services delivered in multiple ways. Not only are firms advising clients on lockdown compliance, they are also helping businesses ensure that their supply chains, contracts, and operations continue to run seamlessly during the pandemic. As legal budgets are tightened and payments postponed, some firms are opting to invest in existing client relationships by providing services at reduced rates or on a pro bono basis. This trend can be seen in Figure 8, below, which shows billing realisation for all firms at 77%, a 13-quarter low.

Figure 8 – Worked and Billed Realisation against Standard



Qualified fee earners
Billable time type; non-contingent matters; AU Offices

Source: Thomson Reuters Peer Monitor®

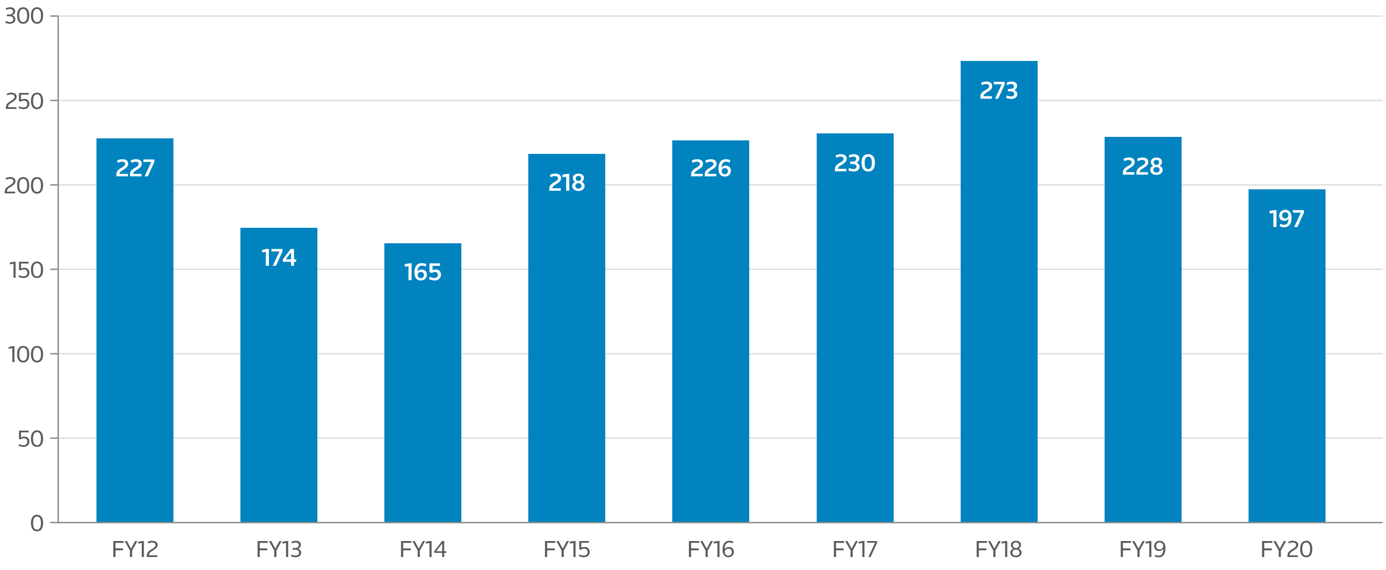
In anticipation of a tougher economic outlook, law firms began proactively implementing cost cutting measures in March, when lockdown rules were first announced across the country. At the same time, law firm leaders have rallied internal resources to help ease the transition to remote working. Having to maintain a largely remote workforce also highlights the need to invest in baseline technologies that ensure lawyers can work productively and securely offsite. Flexible arrangements have been proven to work at scale, though some lawyers have been busier and more productive through this period than others. In these circumstances, opportunities exist for firms to digitise and automate processes that can unleash a lawyer's productivity by reducing redundancy and busywork.

4 Source: Sharplegal research 2019/2020; Acritas, part of Thomson Reuters

How the Pandemic is Shaping the War for Talent

In addition to shifting workloads, the movement of partners in the legal industry also illustrates how firms are strategising for growth. According to research from the Australian legal consultancy Alpha Creates, 197 partners switched firms in FY20, down from the 228 partner moves in FY19 (see Figure 9).

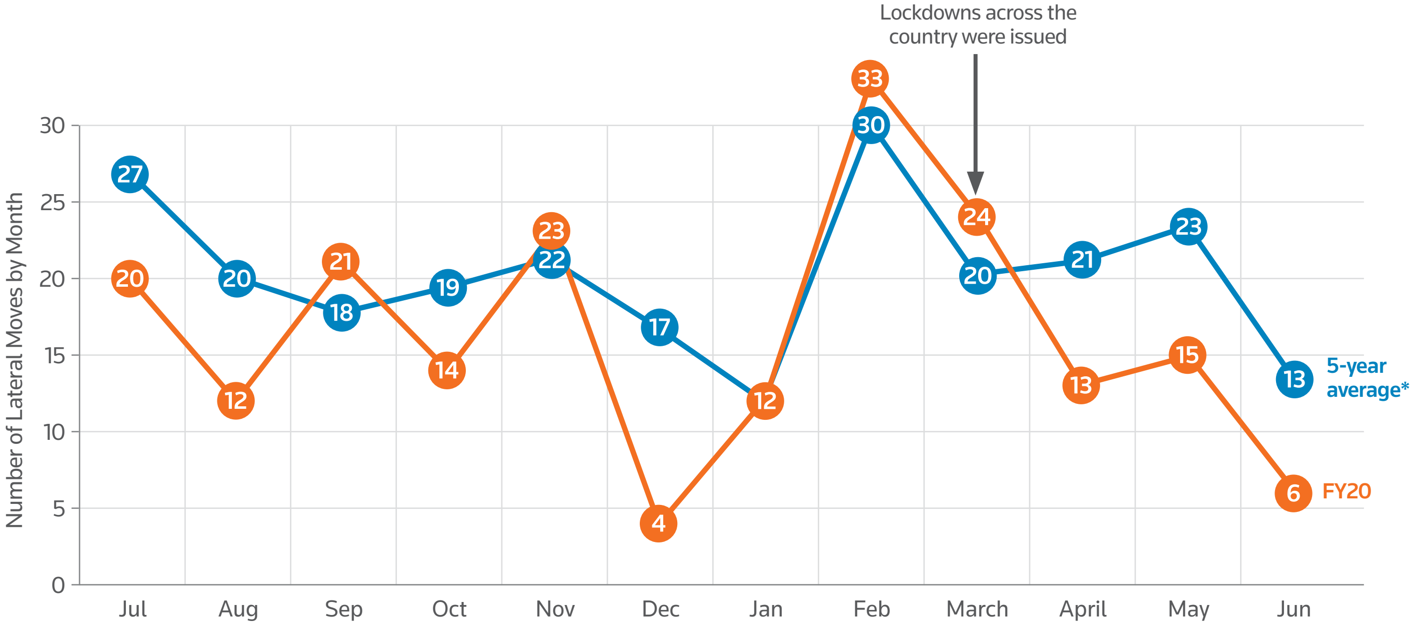
Figure 9 – Number of Partners Switching Firms by Financial Year



Source: Alpha Creates

FY20's downward trend is a five-year low, though it's not surprising that partner mobility has been affected by the COVID-19 crisis. A breakdown of partner movement by month in the last financial year shows a drop-off from March 2020 onwards that is much more significant than the previous five-year average trend (see Figure 10).

Figure 10 – Number of Lateral Moves by Month



*5-year average of FY15, FY16, FY17, FY18, and FY19

Source: Alpha Creates

A deeper dive into this movement data by practice area (Figure 11) reveals that firms have been gearing up for growth in Litigation and Dispute Resolution, Banking and Finance, Employment and Workplace Relations, Mergers and Acquisitions, and Property and Real estate.

Figure 11 – Practice Area Breakdown of FY20 Partner Movement

Source: Alpha Creates

This year's Alpha Creates research also reveals an emerging trend of firms that are beginning to build diversified practices by poaching partners in advisory services around business consulting, defense and commercial advisory, governance, legal operations, risk advisory, and technology consulting.

The trend towards team acquisition continues to shape the war for talent in the Australian legal industry as well. In 2020, 41 partners switched firms as part of a team of lawyers—the highest number of partners to move across with their team since Alpha Creates began tracking this data in FY16.

Globalisation continues to influence the legal landscape in Australia, too, with 19 international law firms gaining 58 partners through the lateral market in FY20. Baker McKenzie was the most active, acquiring three M&A partners, two banking and finance partners, and one partner each in teams dedicated to competition, consumer and trade practices, energy and resources, and intellectual property.

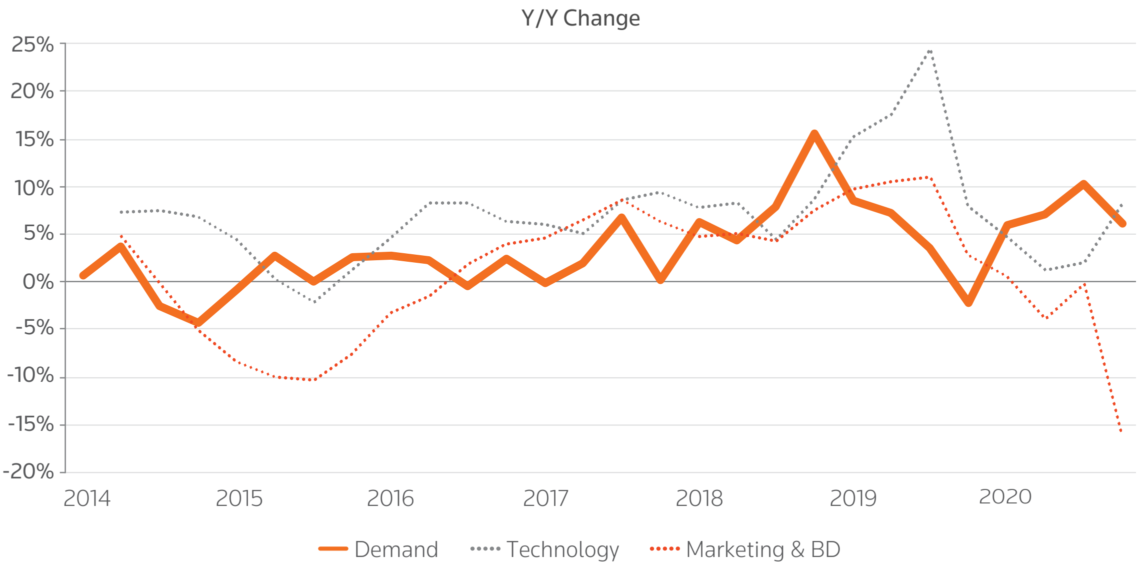
In addition to these trends, the continued rise of NewLaw firms and alternative legal services companies is also giving lawyers a broader palette of employment options. For example, Keypoint Law continued to add law firm partners to its ranks, gaining eight consulting principals through the lateral market. Nexus Law Group, meanwhile, expanded its footprint into the Adelaide market with the lateral hire of a wills and estate-planning lawyer.

How Legal Tech is Enabling Lawyers

As firms and businesses transition to remote working, another issue that has emerged front and center during the pandemic is the importance of legal technology (Legal Tech) in supporting lawyer productivity.

Among the challenges faced by firms implementing Legal Tech is how to digitise a client interface while simultaneously introducing workflows that enable lawyers to work more productively from home. As a result, the pandemic has fast-tracked technology procurement decisions at some firms, and those that had already invested in a robust virtual working environment have benefited tremendously during the pandemic. This trend is reflected in the emphasis on technology expenditures over marketing and business development in 2020 (see Figure 12).

Figure 12 – Technology and Marketing & BD Expenses



Demand – All timekeepers
Expenses – Rolling-12 month basis
Billable time type; non-contingent matters

Source: Thomson Reuters Peer Monitor®

The prior investment in technology by some firms in Australia is an indication of how important tech development is to firms that want to progress and adapt during COVID-19. Interestingly, whilst two thirds of Australian respondents to a recent survey said they wanted to see increased investment in technology, that figure was much lower than in other countries such as the U.S. and Canada, where more than 80% of lawyers felt their firm was currently under-investing in technology.[5]

5 Source: Stellar Performance: A Survey of Future Working Practices; June 2020; Acritas, part of Thomson Reuters

Although there was an initial rush to set up home offices during lockdowns, some firms are now seizing the opportunity to streamline their operations by redesigning their processes and optimising their workflows. Indeed, the continued uncertainty of lockdown rules across the country has pushed many firms to prioritise digital transformation. Whether they are simply improving existing technology platforms (*e.g.*, Microsoft 365) or exploring new solutions in the Legal Tech market, these firms are recognising that their future depends to a large extent on their technological resilience.

Another driver for greater technology adoption has come from the courts. The Family Court, Federal Court of Australia, and Federal Circuit Court have each moved to online hearings using Microsoft Teams and AAPT Teleconferencing. In order to participate in court hearings and continue representing their clients, then, firms have also had to invest in Microsoft Teams or similar videoconferencing platforms.

In these and many other ways, the pandemic has made it necessary for law firm leaders to transform themselves into remote team experts, much like product managers at tech companies who manage a team of dispersed designers and developers. Managing distributed legal teams also means developing a different skillset. Supervising remote workers is an ongoing exercise in expectation management, productivity nurturing, and constant communication, all of which must be undertaken without losing sight of the human need for interaction and a sense of accomplishment. Maintaining productivity is important, of course, but so is celebrating success.

Impact of Remote Working

It's not surprising that 100% of Australian lawyers surveyed said they had been working remotely during the COVID-19 crisis—many of them working seven days a week at home. Prior to the pandemic, less than a third of lawyers reported working remotely, and those who did averaged just one day per week working from home.

Lawyers in Australia have typically experienced the same downsides to remote working as their counterparts in other countries. The most common complaints are a lack of social interaction with colleagues and having no clear start and end to the day. Nevertheless, remote working appears to have had a positive impact overall for respondents in Australia, both in their personal lives and working practices. Three quarters of respondents reported a positive impact on their well-being while working at home, and almost half reported that their working practices had improved. Respondents mentioned improvements in communication as one benefit, resulting in more effective working relationships. This is particularly apparent in Australia, where almost a third of respondents reported having closer relationships with colleagues as a result of remote working during the crisis. Compared with the global average of 9%, Australia's lawyers appear to be getting along better than most.

"We have become better at communicating what needs to happen, why it needs to happen and when, because we are all working in different locations, so people have to actually ask for what they want, rather than mentioning off hand. This leads to more certainty of performance (and expectations)."

"More open communication about people's working preferences—about everything—has been phenomenal. At all levels. People being respectful of others and stopping to ask. More conversations about well-being and more cognisance about it. More presenteeism in meetings; more attendance!"

The flexibility to work at different times was also mentioned as having a positive impact on productivity.

> *"The ability to work flexibly—to take breaks and come back to a piece of work with fresh eyes."*

> *"Greater flexibility allows people to work more productively and lifts their engagement."*

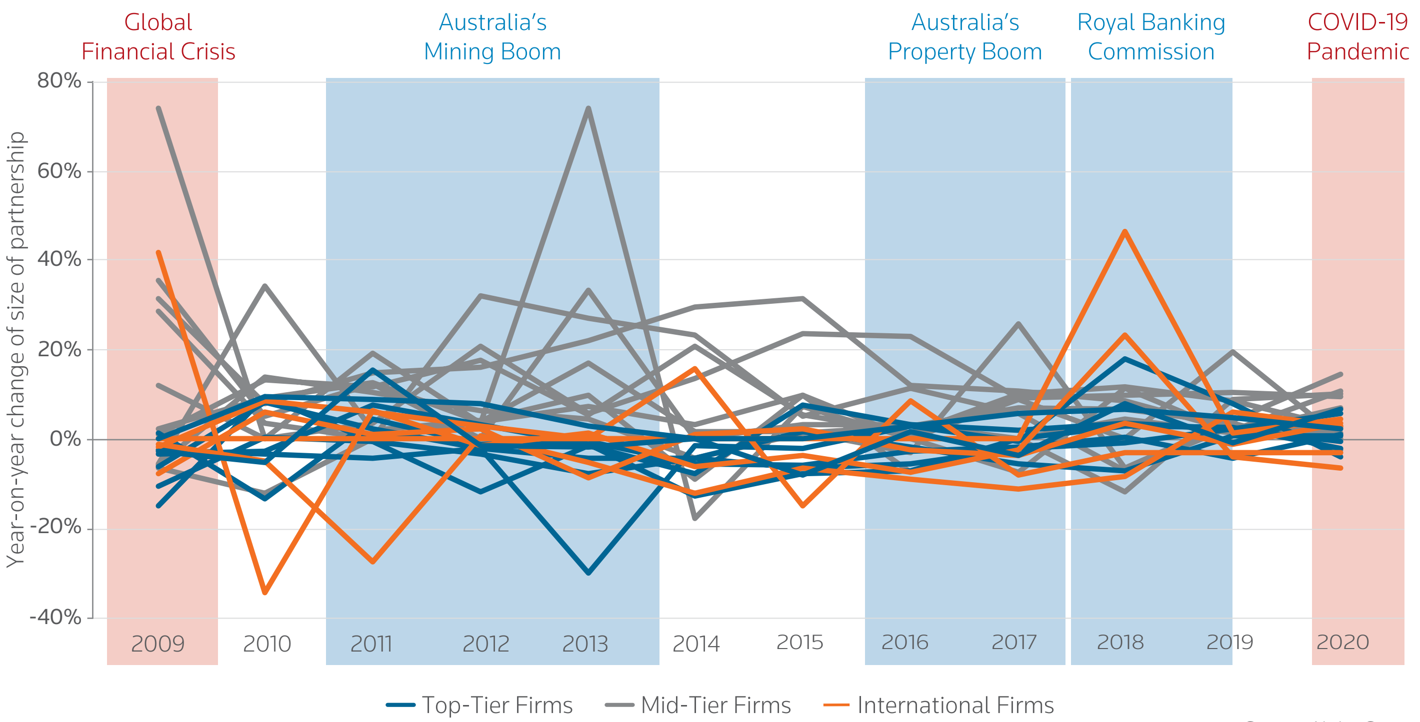
Equally unsurprising, however, is that fact that some lawyers have struggled with remote and flexible working. It is therefore important for firms to offer choices, so that those who are most productive working in the office can continue to do so once offices reopen, whilst others have the option to work more flexibly. By embracing modern working practices, law firms will not only provide their current lawyers with the means to maximise their potential effectiveness, they will also be positioning themselves to attract new talent.[6]

COVID-19 Impact on Law Firms

The global financial crisis (GFC) accelerated many long-term trends that were already in motion when the COVID-19 pandemic hit. The rise of fixed fees, pressure on pricing, rationalisation of legal panels, globalisation of law firms, and the rise of alternative service models—all of these trends seeded the future for the rise of legal innovation and Legal Tech in the industry. Fortunately, lessons from the GFC can help law firms respond to short-term challenges and set the right priorities for success in the long run.

Alpha Creates' analysis of partner counts at firms in Australia's top-tier, mid-tier, and international segments over the last 12 financial years (Figure 13) reveals that some firms seized opportunity and handled adversity much better than others during the period. At firms that adapted well, management teams redefined strategic segments in the short term to meet the legal needs of a market in constant flux.

Figure 13 – Year-on-Year Change of the Size of Partnership at Firms



Source: Alpha Creates

6 Source: Stellar Performance: A Survey of Future Working Practices; June 2020; Acritas, part of Thomson Reuters

The top-tier segment has seen increased competition through the rise of challenger firms Gilbert + Tobin, as well as the entry of international firms like Allen & Overy and Clifford Chance. Top-tier firms responded to increased competition by focusing on differentiation through project management, technology adoption, and innovation. This approach meant that scale was not the main strategic arsenal deployed to maintain and win market share.

Conversely, scale *has been* the major growth driver for mid-tier firms. HWL Ebsworth and Thomson Geer expanded through law firm mergers and partner poaching, for example, and Mills Oakley grew via partner acquisition. Over the last 12 years, all of these firms have seen continuous year-on-year growth in their partnership ranks. Others—such as Colin Biggers & Paisley, Hall & Wilcox, Lander & Rogers, Maddocks, and McCullough Robertson—expanded beyond their home states to create a regional (east coast) or national footprint. The mid-market segment also rationalised further when firms such as DibbsBarker, Henry Davis York, Herbert Geer, Kemp Strang, and TressCox were absorbed by others in the market.

From FY12 onwards, globalisation shaped major parts of the Australian legal market. Local top-tier firm Allens Arthur Robinson became Allens Linklaters; Blake Dawson became Ashurs; Freehills became Herbert Smith Freehills; and Mallesons Stephen Jacques became King & Wood Mallesons. The globalisation trend also re-shaped the mid-market segment through the entry of Bird & Bird, Clyde & Co, DWF, Dentons, DLA Piper, K&L Gates, Norton Rose Fulbright, and Squire Sanders, to name a few.

Because digitisation of the legal work environment enables lawyers to work from home, and doing so is now the norm, firms of all sizes are faced with a short-term problem (how to continue operations amid a global pandemic) that requires a long-term solution; namely, operations, systems, and processes that can be maintained no matter what the external circumstances may be. For those actively investing in a post-COVID-19 world, the crisis itself may well be a catalyst for the acceleration of Legal Tech adoption, especially if management teams view technological leadership in the legal market as a competitive advantage.

AUSTRALIAN MARKET OUTLOOK

No one knows precisely when and how the COVID-19 crisis will end. Consequently, no one can be certain what the full impact of the pandemic will be on the broader Australian economy or, by extension, the legal market. With so much uncertainty clouding the picture, it makes sense at the moment to envision different market scenarios and assess the implications of each. But at some point the pandemic will end, and the world will return to some new form of normal, one inexorably shaped by the lessons learned during this unprecedented global catastrophe.

In this new normal, law firms will need to make clear choices about how they plan to compete and operate. Our market outlook explores three market scenarios and three strategic options each law firm can consider when planning their post-pandemic position in the legal marketplace.

Three Market Scenarios

Scenario planning is particularly helpful when uncertainty is high and there are sharp differences of opinion. Imagining different scenarios and developing responses can also help management teams develop a common framework for discussing strategy without stifling diversity of thinking.

As we see it, there are three broad scenarios for the Australian legal market over the next 12 to 24 months.

The first we call "**Deep Fog**", and is characterised by ongoing uncertainty, instability, and hesitancy. Deep Fog is mostly a continuation of the state of the market from mid-March to August 2020. In this scenario, a COVID-19 vaccine is approved in early 2021, but questions remain over its efficacy and long-term side-effects, as well as the logistics of vaccination. As confidence in the government's response waxes and wanes, so does confidence in the economy.

If an ongoing Deep Fog materialises, overall legal demand will remain flat, but there will be an increase in work related to insolvency, restructuring and dispute resolution. Corporate activity will remain constrained by the inability of buyers and sellers to price assets. There will be an increase in individual partner movements across firms, but no significant change to the broader structure and composition of the business law segment of the market.

The second scenario, "**Sustained Recession**", sees an extended period of negative economic growth across the globe due to the dramatic contraction of the US, European, Asian, and South American economies in 2020. COVID-19 vaccines emerge in 2021, but community uptake is far too low to create herd immunity or lift overseas travel bans. Governments' borrowing capacity reaches its limits and safety-net funding to support businesses and jobs dries up. In Australia, we see significant falls in property and equity prices. Some major companies and institutions (*e.g.* universities) will consolidate or merge in order to stay viable, and some will simply fail.

Under this scenario, countercyclical legal areas such as insolvency, corporate restructuring, employment and government-funded projects will be in high demand. Some other practice areas will remain relatively immune, such as general insurance, but most others will decline. Excess capacity across the legal market will drive down pricing. Firms will be forced to shed partners and staff, reduce occupancy, and cut most innovation and BD spend. There will be a significant increase in partner movements, and weaker law firms will be cherry-picked of talent, then forced to close.

The final scenario revolves around a "**Rapid Recovery**". In this case, a trusted COVID-19 vaccine emerges in late-2020, market confidence returns quickly and the economy responds well to government stimulus spending and bank liquidity. Business investment increases and infrastructure projects resume. Demand for most legal services is strong, and firm occupancy and other expenditure reverts to 2019 levels. In a Rapid Recovery scenario, there would be no major change to the composition and structure of the legal market other than the changes already set in motion by the pandemic.

Three Strategic Options

Regardless of which of the above scenarios actually unfolds, or some combination thereof, law firms have three fundamental options as to how they will compete and operate in this new normal:

I. ***Restore*** – go back to where things were in 2019.

II. ***Reset*** – take advantage of the some of the pandemic-related changes, such as work-from-home flexibility, less paper, and virtual BD, and lock them in.

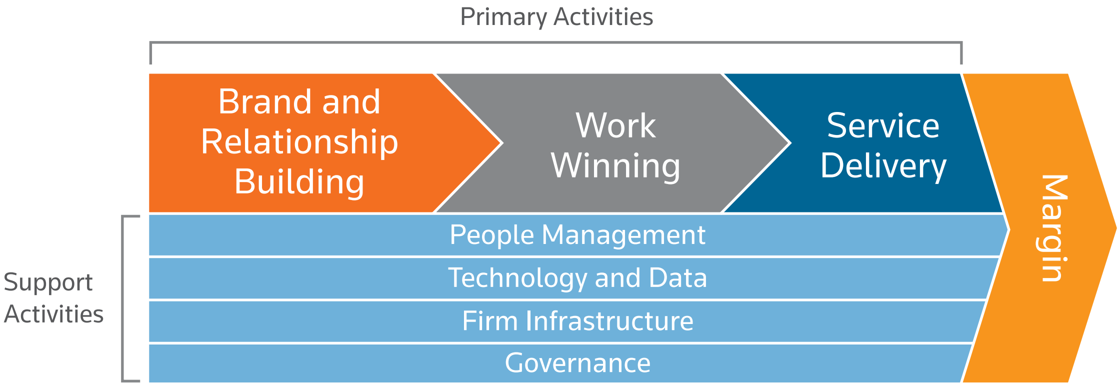
III. ***Reimagine*** – view the pandemic as a catalyst to transform the firm so that it can compete more effectively over the long-term

Our advice is that firms take the opportunity now to explore the **Reimagine** option, and work out what specific elements of their firm to protect, adapt or completely refresh.

An obvious way to reimagine the firm is to examine where and how the firm competes—*e.g.*, its client markets and service range—and explore new options.

An alternative approach is to look at the firm through the lens of a *value chain*. This approach, pioneered by Michael Porter[7], views the organisation as a system made up of subsystems, each of which has inputs, transformation processes, and outputs. How value-chain activities are carried out determines costs and affects profits. Our adaptation of Porter's model to law firms is presented in Figure 14.

Figure 14 – A Law Firm Value Chain



All three primary activities are essential for adding value and creating competitive advantage:

- **Brand and relationship building:** the process of creating strong brand awareness and affinity, as well as deep client and referrer relationships. These activities can lower client acquisition costs, facilitate cross-servicing, drive price premiums and attract top talent. They can also augment the firm's core offering by adding 'weight' to the firm's legal advice.
- **Work winning:** the process of prospecting, pricing and selling legal services. This activity drives revenue growth, which is the primary profit driver in most law firms that have a high percentage of fixed costs.
- **Service delivery:** the process of legal problem identification and problem-solving. The spectrum of activities varies widely between transactional and dispute work types. Usually, it involves a combination of legal knowledge, legal technology, legal system infrastructure, and materials, all supported by human expertise and judgement. Other sub-processes include client experience journeys, workflow design, and legal project management.

7 Porter, Michael E. (1985). *Competitive Advantage: Creating and Sustaining Superior Performance*. New York.: Simon and Schuster

The reimagined law firm could be one with more virtual branding and work winning processes, which would also give the firm a much wider geographic reach. Service delivery could also be redesigned with standardised and centralised hubs for those doing mostly process work, and distributed nodes for those doing bespoke advisory tasks.

The four support activities described below help make primary operations (Figure 14) more effective or efficient:

- People management: the recruiting, hiring, training, locating, developing, compensating, leading and managing of everyone who works in the firm.
- Technology and data: the systems and infrastructure needed to assist with document creation and storing, legal research, knowledge capture, practice management, client service delivery, marketing, communications, and collaboration.
- Firm infrastructure: finance, facilities, administration, procurement, risk, planning, and general management.
- **Governance:** the decision-making, information sharing and control processes that shape firm culture and strategic direction. The partnership structure and remuneration model is often a critical system in law firms—but it is not the only management model.

The reimagined law-firm model could be one where staff spends between 40 to 60% of their time working in the office, and the balance of their time at home or visiting clients. A new governance model might be one that involves incorporation and widening of equity ownership across the firm. Either way, the point is that having the courage to re-think how each element of the firm supports and interacts with the others can yield insights that lead to new and better ways to run the firm's overall business.

CONCLUSION

As expected, many of the major deviations from the norm in the Australian legal industry occurred in the final three months of the financial year, as the COVID-19 pandemic spread across the globe. Despite the turmoil in Q4, however, Australian firms have weathered the crisis relatively well. Demand for services remains high, and firm headcounts have increased from the previous year. Nevertheless, in the latter stages of 2020, the global pandemic prompted firms to quickly adapt to a new and alarming reality, one that is in constant flux with no clear resolution in sight. Firms have adapted to the extent that they can, but with no way to know which way the economic winds will blow, the immediate future for the legal market remains unclear. Current market conditions have however provided forward-looking firms with an opportunity to radically reimagine the structure of their organisation and transform their delivery model for legal services. Technology has an important role to play in this revolution, one that classic firms wedded to legacy systems ignore at their peril. What law firm operations in Australia will look like by the end of 2021 is still up in the air, but there can be no doubt that seismic changes are underway. Though there are many ways to organise and manage a successful law firm, those that have the courage to do a holistic re-assessment of their capabilities stand the best chance of surviving and thriving in the uncertain future that awaits us all.

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