# An industry in transition

## 2017 Legal Benchmarking Results

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# Contents



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# Key findings

# Benchmarking your performance

## About the research

This year's survey captured insights from more firms than ever before, ranging from one-person practices to large national firms. One in two participants were equity partners or directors, while 10% of firms had a turnover of $20m or more.

## Objectives

**1.**
Map the trends reshaping the legal industry

**2.**
Track the performance of firms across Australia

**3.**
Uncover the unique features that enable firms to outperform today

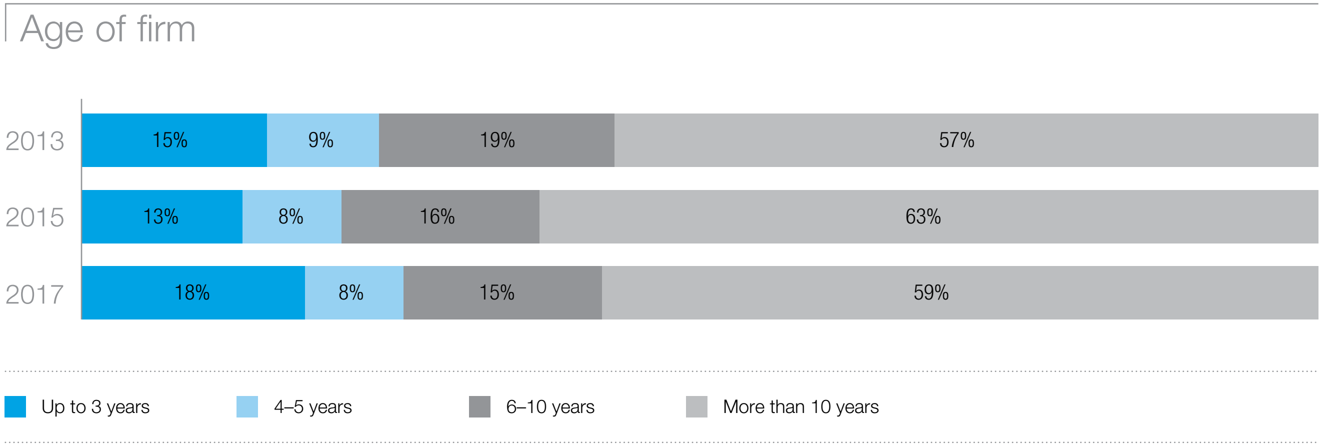
**4.**
Identify the characteristics that the firms of the future will need to succeed tomorrow

**5.**
Establish best practice benchmarks you can use to improve your performance

# Benchmarking your performance

## The participants

Our 2017 survey included 275 participants, providing a diverse cross-section of firms of every size in every state. This robust sample enabled us to carry out an in-depth analysis of firms by location, size and profitability.



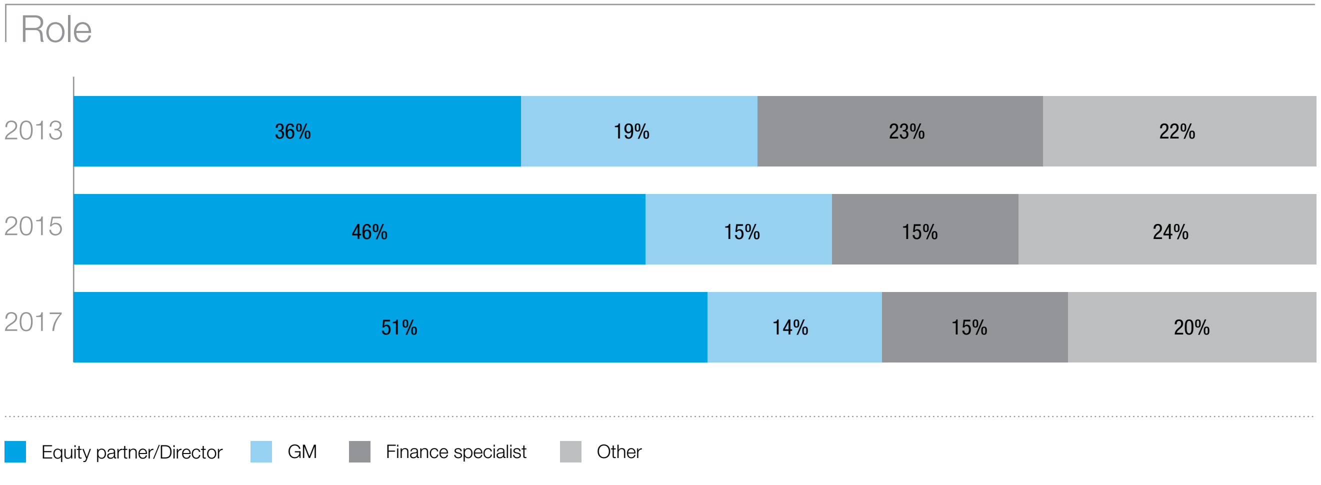

### Number of completed surveys

**2017: 275**

**2015: 226**

**2013: 134**

**2011: 107**



# Benchmarking your performance

## The participants

### Head office location

**Western Australia**

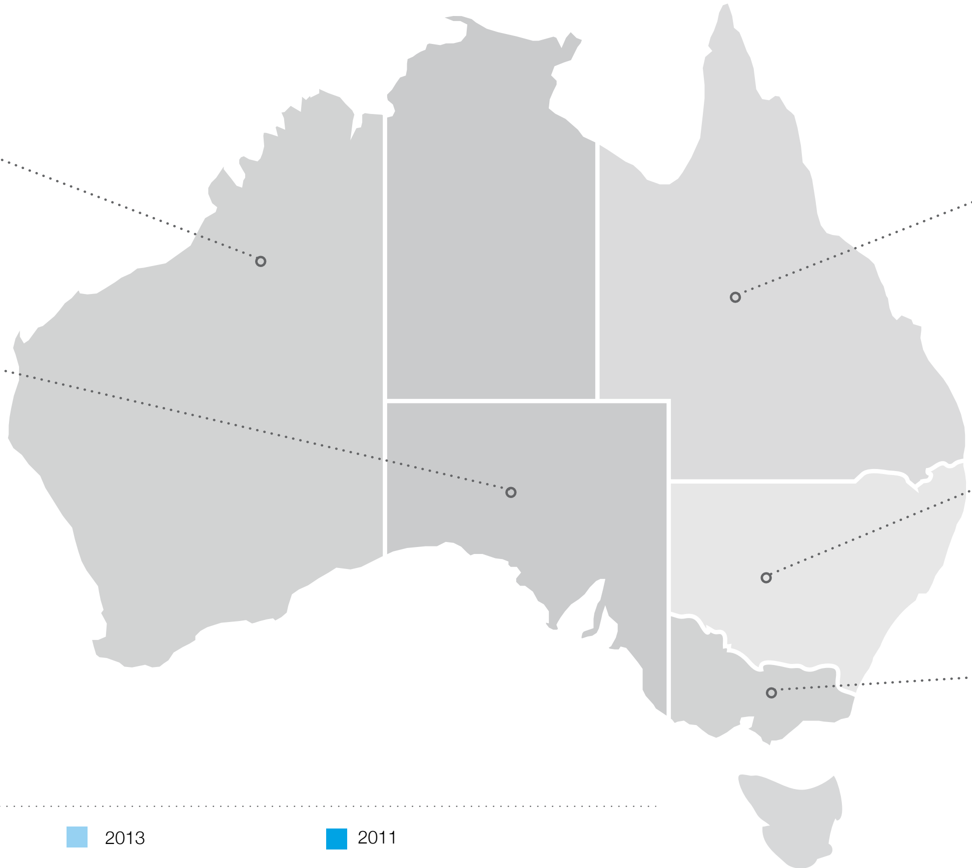
13%
14%
11%
7%

**South Australia**

8%
8%
10%
8%

**Australian Capital Territory / Tasmania / Northern Territory**

4% 5% 4% 1%



**Queensland**

11%
14%
18%
22%

**New South Wales**

39%
36%
34%
42%

**Victoria**

26%
23%
24%
19%

2017 2015 2013 2011

# Benchmarking the market

## Measuring size and performance

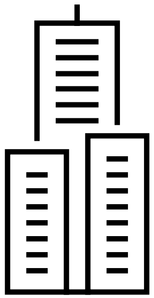
With a larger sample of firms than ever before, including a higher proportion of large firms, we have taken a different approach to analysing performance in this year's report. Recognising that smaller firms have more opportunity to achieve high margins and rapid growth, we have used different performance benchmarks for small, mid-size and large firms, dividing each cohort into two groups:

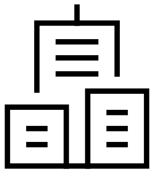
– Higher profit firms, with margins equal to or higher than average for their cohort

– Lower profit firms, with margins below average for their cohort

Throughout this report, we describe firms using these definitions, based on FY2017 results

| | **Large** | **Mid-size** | **Small** |
|---|---|---|---|
| Firm size | Gross fees over $20 million<br>**27 firms** | Gross fees between $4 and $19.99 million<br>**70 firms** | Gross fees less than $4 million<br>**165 firms** |
| Higher profit | Profit margin: 17% or higher<br>**11 firms** | Profit margin: 25% or higher<br>**35 firms** | Profit margin: 26% or higher<br>**66 firms** |
| Lower profit | Profit margin: less than 17%<br>**16 firms** | Profit margin: less than 25%<br>**35 firms** | Profit margin: less than 26%<br>**88 firms** |





# State performance

## The east coast accelerates

East coast practices are performing strongly, with New South Wales reporting the country's highest average profit growth from FY2016 to FY2017, at 24%. But Western Australian firms continue to be impacted by the end of the mining investment boom, despite hopes of better times ahead.

### Key insights

69% of Queensland firms increased revenue in FY2017

1 in 4 Victorian firms had a profit margin of 35% or more

48% of WA firms saw gross fees fall in FY2017

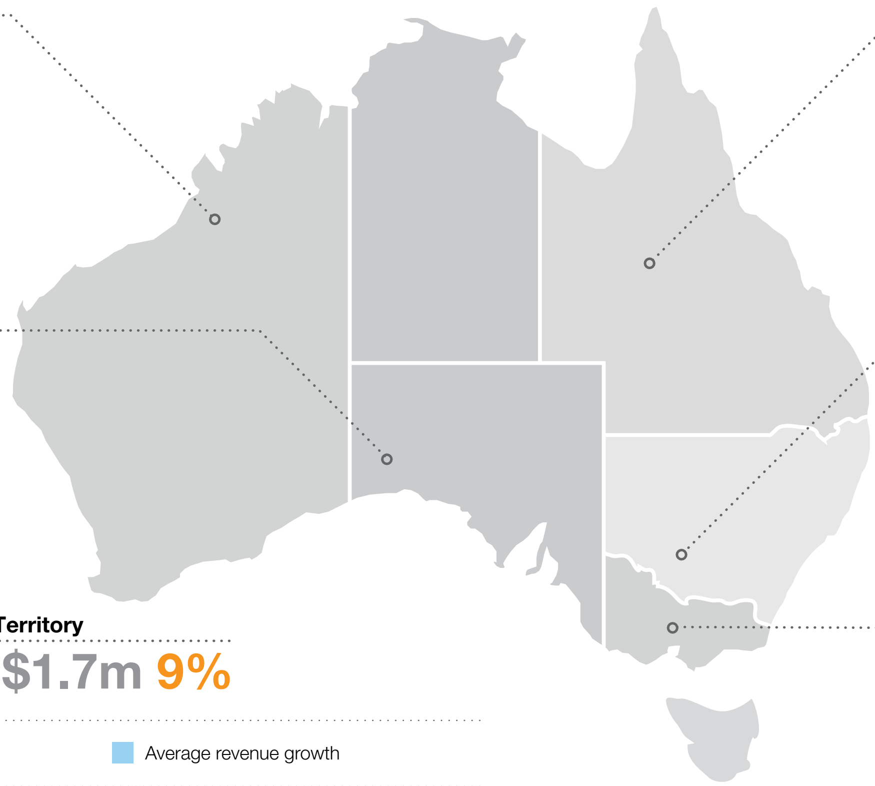
NSW firms have the lowest salary spend at 46% of revenue

State performance (excludes firms with FY2017 gross fees >$20m)

**Western Australia**
$4m
6%
$1.0m
-1%

**South Australia**
$11.4m
0%
$2.5m
12%

**Australian Capital Territory**
$8m 7% $1.7m 9%



**Queensland**
$6.1m
18%
$1.3m
10%

**New South Wales**
$9.8m
10%
$1.7m
25%

**Victoria**
$12.1m
11%
$2.7m
10%

Average fee revenue
Average revenue growth
Average profit
Average profit growth

# Achieving higher performance

## Large firms: What does a higher profit large firm look like?

For large firms with annual gross fee income over $20 million, size can be both a valuable competitive advantage and an obstacle to change.

The most successful large firms have embraced the challenge, using their scale and financial strength to invest in new technologies and re-engineer their processes for maximum efficiency. That includes harnessing back-office efficiency tools such as document management systems (which 91% of higher profit large firms currently use or plan to use) and accounts automation (82%), along with more far-reaching innovations, including decision dashboards (73%), data mining (54%) and predictive analytics (45%).

The result is a level of efficiency that has enabled higher profit large firms to achieve higher margins than their competitors, despite similar revenue per staff member ($209,594 versus $202,451).

| | **Higher profit** (17% or higher) | **Lower profit** (less than 17%) |
|---|---|---|
| **Number of staff** | **214.7** | **342.7** |
| **Average revenue** | **$45m** | **$69.38m** |
| **Revenue growth** | **7.2%** | **3.4%** |
| **Average profit margin** | **24%** | **11%** |
| **Profit growth** | **15.3%** | **3.8%** |
| **Charge out rates** | **Commercial law: $520**<br>**Litigation: $533**<br>**Property: $518**<br>**Employment law: $550** | Commercial law: $521<br>Litigation: $550<br>Property: $529<br>Employment law: $537 |
| **Firms intending to hire** | **82%** | **69%** |

# Achieving higher performance

## Mid-sized firms: What does a higher profit mid-size firm look like?

Mid-size firms (those with annual gross fee income between $4 million and $19.99 million) have been under pressure, squeezed between small, nimble specialists and larger practices with the financial resources to invest in innovation. Yet despite these challenges, higher profit mid-size firms have been strikingly successful at maintaining profitability in a challenging market. With highly efficient systems and a focus on keeping costs down, these firms achieved average margins of 37%, with similar fee revenue to their lower profit peers and around 12% fewer staff. Many have been assisted by investments in efficiency enhancing technologies, including document management and scanning tools (63%), electronic document signing (43%) and e-discovery (23%). They are also relatively likely to focus on a few key practice areas, often including specialties like family law where larger firms are less likely to compete. Where they do compete with large firms, in areas such as commercial law, property and litigation, their expertise gives them sufficient pricing power to achieve higher average charge-out rates than their top-tier rivals.

| | **Higher profit** (25% or higher) | **Lower profit** (less than 25%) |
|---|---|---|
| **Number of staff** | **43.9** | **50.1** |
| **Average revenue** | **$9.77m** | **$10.37m** |
| **Revenue growth** | **2.7%** | **7.4%** |
| **Average profit margin** | **37%** | **13%** |
| **Profit growth** | **3.8%** | **18.9%** |
| **Charge out rates** | **Commercial law: $534**<br>**Litigation: $538**<br>**Property: $537**<br>**Employment law: $515** | Commercial law: $503<br>Litigation: $515<br>Property: $489<br>Employment law: $502 |
| **Firms intending to hire** | **63%** | **80%** |

# Achieving higher performance

## Small firms: What does a higher profit small firm look like?

With greater opportunities for rapid expansion than their larger peers, small firms (those with annual gross fee income less than $4 million) achieved some of the fastest growth rates and highest profit margins in our survey.

For these firms, generating higher margins was all about focusing on a few key practice areas while staying lean and efficient. Higher profit firms reported an average margin of 46%, despite lower headcounts and lower average revenues, reflecting rigorous attention to streamlined processes, disciplined revenue collection, and effective cost control.

They also tended to be specialists, earning a high proportion of their fees from relatively few practice areas. That enabled them to exercise greater pricing power, with significantly higher average charge-out rates than their lower profit rivals. It also enabled them to hone their systems to operate with maximum efficiency, rather than spreading their resources over a larger number of disciplines.

| | Higher profit (26% or higher) | Lower profit (less than 26%) |
|---|---|---|
| Number of staff | 8.3 | 11 |
| Average revenue | $1.07m | $1.56m |
| Revenue growth | 14.2% | 9.7% |
| Average profit margin | 46% | 12% |
| Profit growth | 21.6% | 12.8% |
| Charge out rates | Commercial law: $468<br>Litigation: $467<br>Property: $441<br>Employment law: $497 | Commercial law: $453<br>Litigation: $456<br>Property: $421<br>Employment law: $457 |
| Firms intending to hire | 53% | 55% |

# Three trends shaping the industry’s future

### 1. Resilience

Our 2017 survey shows that legal decision makers are optimistic about the outlook for both their own firms and the industry as a whole, despite ongoing and deep-seated structural change. This suggests many firms are successfully adapting to a changing market, re-engineering their business models for sustainable success.

## What changes do firms believe will impact them most?

In the next 12 months:
Clients seeking more competitive prices **67%**

In the next three years:
Low-cost virtual firms **49%**

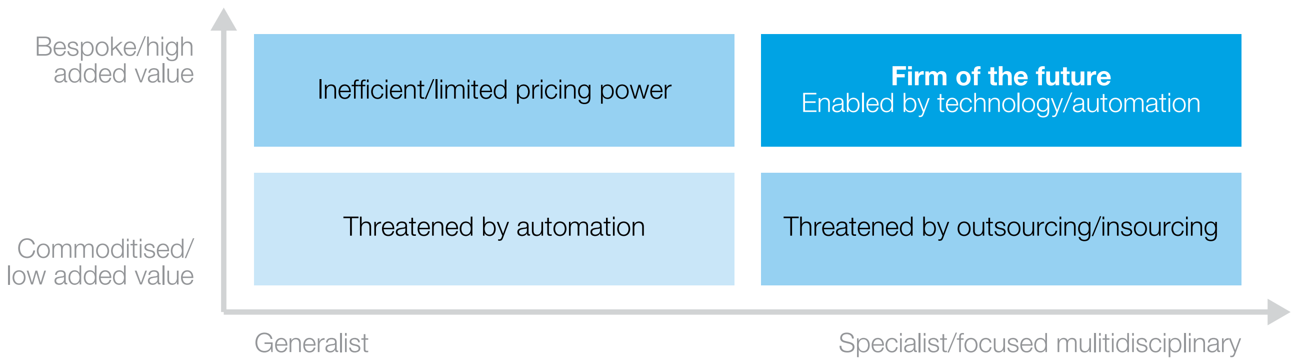
### 2. Technology

The adoption of new technologies has accelerated rapidly since our last survey, especially among large firms. And while efficiency-related technologies are already helping some firms reduce costs and maintain profits, we have yet to see the full impact of potentially much more disruptive innovations, from data analytics to artificial intelligence. That means firms who have yet to begin their innovation journey need to begin planning now.

### 3. The firm of the future

As the market evolves, we begin to see the firm of the future taking shape. While each tier of the market is evolving on its own distinctive path, the general outline is clear: lean, highly efficient businesses, with well-developed technologies servicing one or more carefully selected target markets.

Positioning your firm for future success



# Best practice

## Success through specialisation

**Five tips** from Macquarie and One Rabbit* for attracting high-value clients by cultivating a unique identity.

**1.**
**Identify your strengths.**
Analyse your firm's performance to determine the practice areas and specialisations where you have particular expertise and can add most value at lowest cost.

**2.**
**Define a unique identity.**
Determine how to position yourself in the market in a way that differentiates you from your competitors.

**3.**
**Cultivate an entrepreneurial mindset.**
Be curious and willing to experiment with marketing and service delivery.

**4.**
**Showcase your expertise.**
Position your staff as experts by sharing knowledge online and through targeted client communications.

**5.**
**Test and learn.**
Use data analytics to track the content and service offerings that attract the highest levels of new business.

Read the full case study

*One Rabbit is a specialist professional services marketing agency.

# Financial performance

# Fees

## Mid-size firms under pressure

In a challenging market, most firms have succeeded in growing or maintaining fee revenue, with only one in five saying fees decreased last financial year.

Large firms were most likely to have increased fees, with 67% growing revenue in FY2017, while small firms once again reported the largest increases, averaging fee growth of 12%. But a significant minority of mid-size firms are under pressure, with 30% reporting falling revenues.

Change in gross fees

| | Increased | Stayed the same | Decreased |
|---|---|---|---|
| **2017** | 59% | 20% | 20% |
| **2015** | 62% | 23% | 15% |
| **2013** | 62% | 22% | 16% |
| **2011** | 70% | 18% | 12% |

**Average fee growth FY2017 v FY2016**
Large firms: **+5%**
Mid-size firms: **+5%**
Small firms: **+12%**

# Billing

## Fixed fees in favour in some practice areas

The gradual transition away from billable hours as a preferred pricing method has continued over the last two years, although at an almost glacial pace. In 2017, 33% of firms said they planned to use a method other than billable hours as their primary pricing method, up just two percentage points since 2013. 61% of firms said fixed fees would be their preferred method for pricing property law matters, while 17% of firms intended to use value-based pricing for mergers and acquisitions.

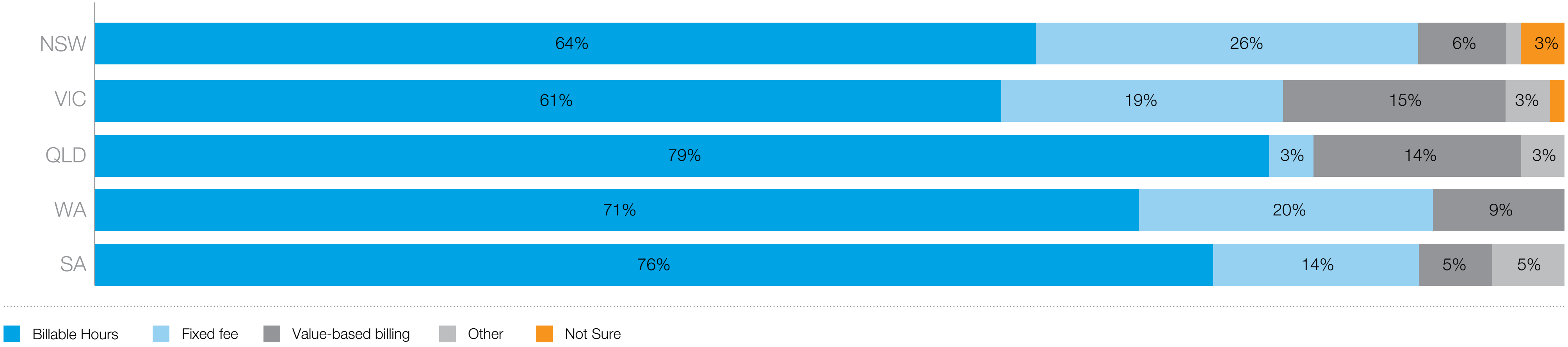
New South Wales firms were the most likely to prefer fixed fees, with one in four saying that would be their preferred pricing method. But value-based billing was most popular in Victoria (15% of firms) and Queensland (14%).

Pricing method by practice area

# Billing

## Fixed fees in favour in some practice areas

Pricing method by state



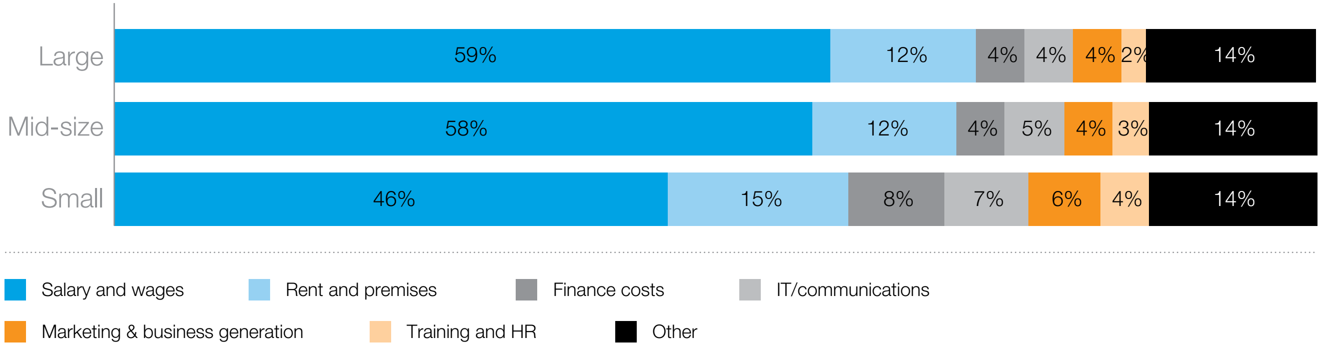
# Expenses

## Salary costs continue to dominate

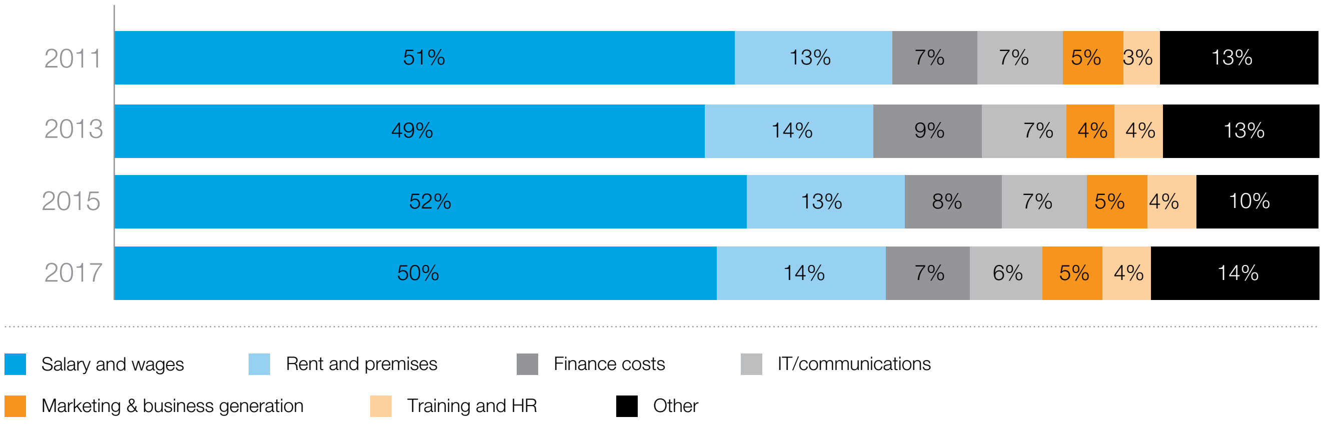
While firms of all sizes have been trimming costs to maintain profitability, the overall expense profile across the market is largely unchanged from earlier benchmarking surveys, with salaries and wages accounting for half of all spending.

As a result, limiting salary spending can make a significant difference to profitability, at least in the short term. Higher profit small firms, in particular, have been successful in reining in their wages bill, spending an average of just 44% of revenues on salaries, six percentage points below the market average.

Expenses by firm size




Expenses by Year



# Profit

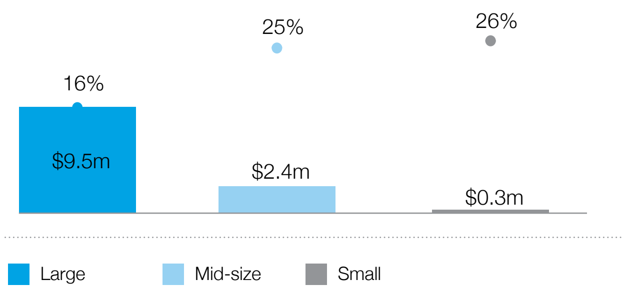
## Large firms consolidate, small firms accelerate

One in two firms increased profits in 2017, holding steady from 2015 — an impressive result in a market in transition. While small firms reported both the largest average profit margin (26%) and the largest average profit increase (16%), large firms were the most likely to have lifted profits in FY2017, with two in three improving on the year before. In contrast, 31% of mid-size firms saw profits decline, further evidence that the midmarket needs to act now to create the foundations for sustainable success.

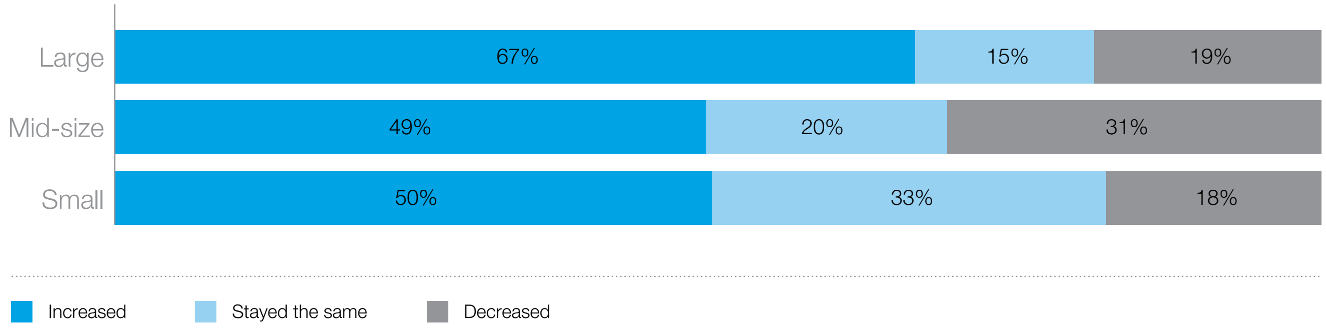
### Change in profit, 2011 - 2017

| | Increased | Decreased | Stayed the same |
|---|---|---|---|
| **2017** | 51% | 21% | 28% |
| **2015** | 50% | 23% | 27% |
| **2013** | 57% | 18% | 25% |
| **2011** | 67% | 22% | 10% |

### Average profit by firm size




### Change in profit by firm size



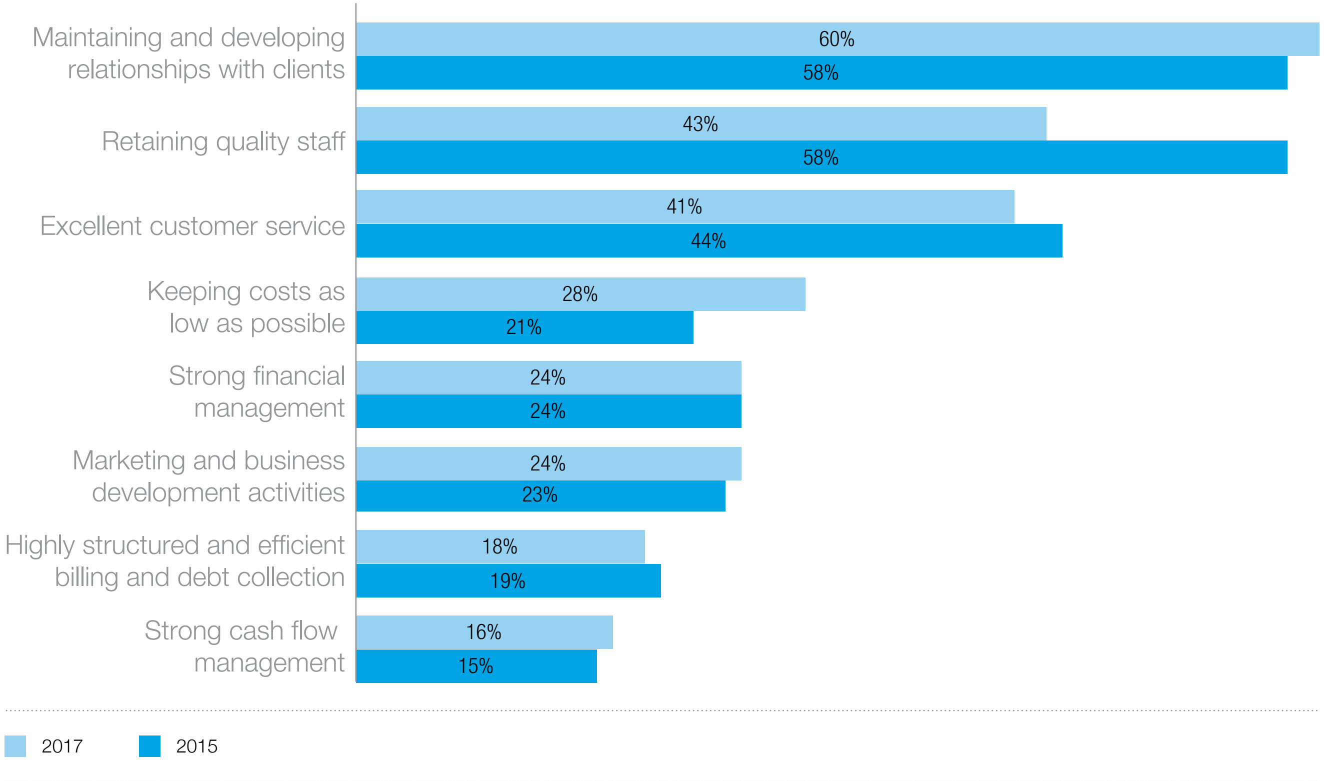
# Profit drivers

## Focusing on financial management

As the drive towards efficiency intensifies, firms have re-assessed the factors most likely to help them sustain and improve profitability. While strong client relationships and excellent service remain top priorities, firms have become relatively less focused on staff retention and more concerned with cost control and financial management.

Across the market, 28% of firms now say keeping costs low is important to improved profitability, up from 21% two years ago, while higher profit large firms are particularly likely to say strong financial management is essential to their success.

Aspects of service with the most impact on profit



# Profit drivers

## Focusing on financial management

Top 3 drivers according to higher profit firms

| Large | Mid-size | Small |
| --- | --- | --- |
| Maintaining and developing relationships with clients (82%) | Maintaining and developing relationships with clients (60%) | Maintaining and developing relationships with clients (61%) |
| Excellent customer service (64%) | Retaining quality staff (57%) | Excellent customer service (50%) |
| Strong financial management (55%) | Excellent customer service (43%) | Retaining quality staff (39%) |

# Best practice

## Financial management

## **Business efficiency tips** from Brad Hamilton, Associate Director, Macquarie Bank

**1.**
Efficient financial management is essential for every firm — but it's especially critical for firms specialising in areas like property, family law, wills and estates, who manage trust funds and large volumes of controlled monies.

**2.**
Without an integrated payments platform and accounts system, finance teams are forced to deal with the inefficiencies of paper-based records and duplicated effort. That makes is difficult to scale when volumes increase.

**3.**
The solution is a seamless workflow incorporating digitised records, online authorisations and automated data exchange between management, banking and accounting tools.

**4.**
In particular, integrated practice management software and banking platforms are critical to maximising efficiency and building the firm of the future.

*Talk to a Macquarie relationship manager about DEFT payment options for your firm

# Technology, operations and client service

# Technology

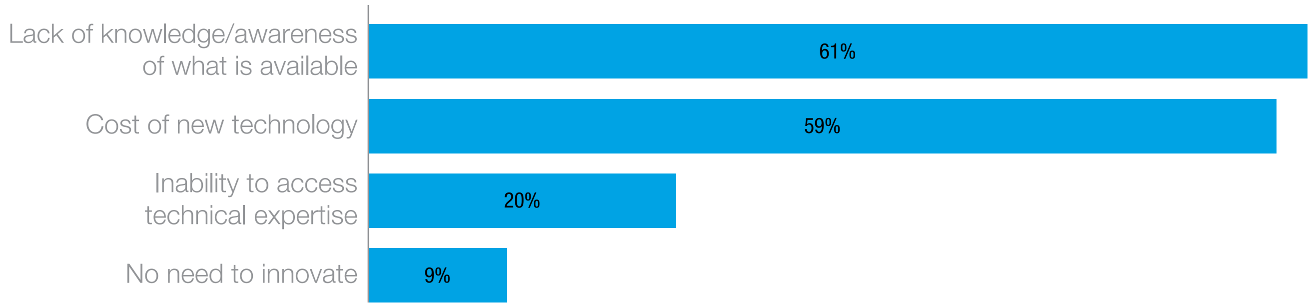
## Adoption takes off

Since our last report, the adoption of new technology has accelerated rapidly, especially among large firms.

Yet while some technologies, like time-tracking tools have almost become the cost of entry, others, like artificial intelligence, are still in the early stages of exploration. But while advanced technologies have yet to become a key driver of higher profits, our survey shows they are a clear area of focus for larger and more profitable firms, suggesting they are likely to become a significant competitive differentiator in the future.

So, while small and mid-size firms are more likely to be focused on back office efficiency tools like accounts automation and workflow software, many large firms are also investing in innovations like data mining, predictive analytics and expert systems.

Barriers to adopting technology




**Top 5 technologies in use today**

1. **Time recording tools: 67% of firms**
2. **Document management and scanning tools: 48%**
3. **Workflow tools: 32%**
4. **Electronic document signing: 29%**
5. **Accounts automation: 28%**

**Top 5 technology investment areas over the next 3 years**

1. **Electronic document signing: 30% of firms**
2. **Accounts payable automation: 20%**
3. **Workflow tools: 20%**
4. **Electronic contracts: 20%**
5. **Accounts automation: 19%**

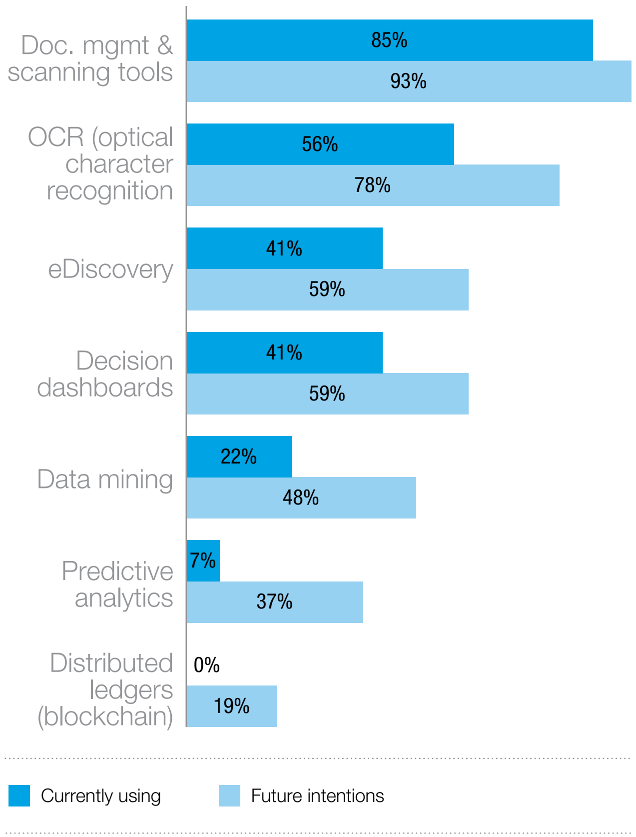
# Technology investment

## Large firms

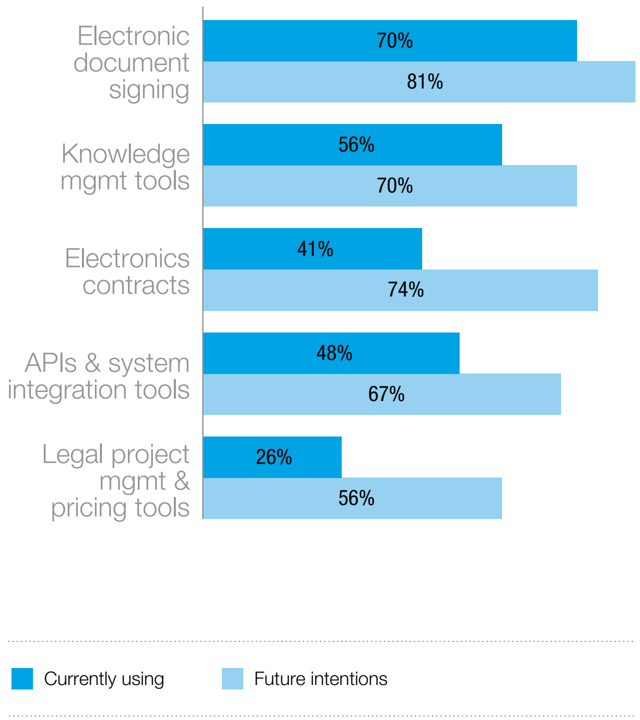
Large firms are the clear leaders in both current and planned technology adoption. 100% of the higher profit large firms in our survey said they were harnessing new technologies, often with a focus on efficiency-enhancing tools, including document management and scanning systems (91% already using), workflow tools (91% using or planning to use) and accounts automation (82%).

Large firms also lead the market in investigating the potential of data analytics, with higher profit practices creating decision dashboards (73%), using data mining (64%) or harnessing predictive analytics (45%).

Current and future technology usage
Large firms: **Data analytics**




Current and future technology usage
Large firms: **Management and system integration**

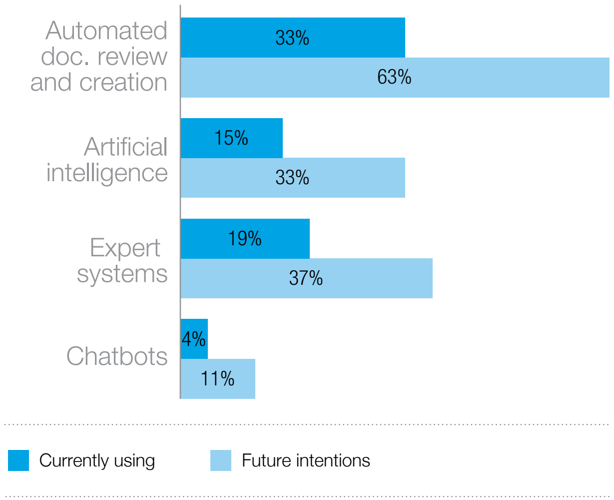


# Technology investment

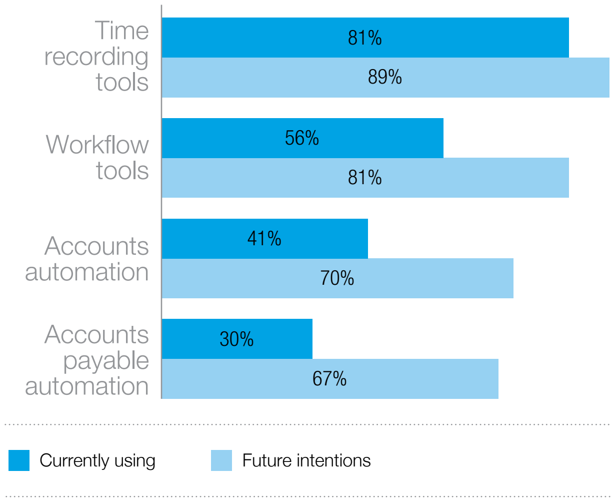
## Large firms

Notably, lower profit firms are more frequent investors in a number of innovative but arguably less mature technologies, such as artificial intelligence (38% of lower profit firms using or planning to use, versus 27% of higher profit firms) and automated document review and creation (69% versus 55%). One possibility is that at least some of these firms are more focused on long-term sustainability than immediate profit, willing to sacrifice margins in the present to invest for the future.

Current and future technology usage
Large firms: **Artificial intelligence**




Current and future technology usage
Large firms: **Back office automation**

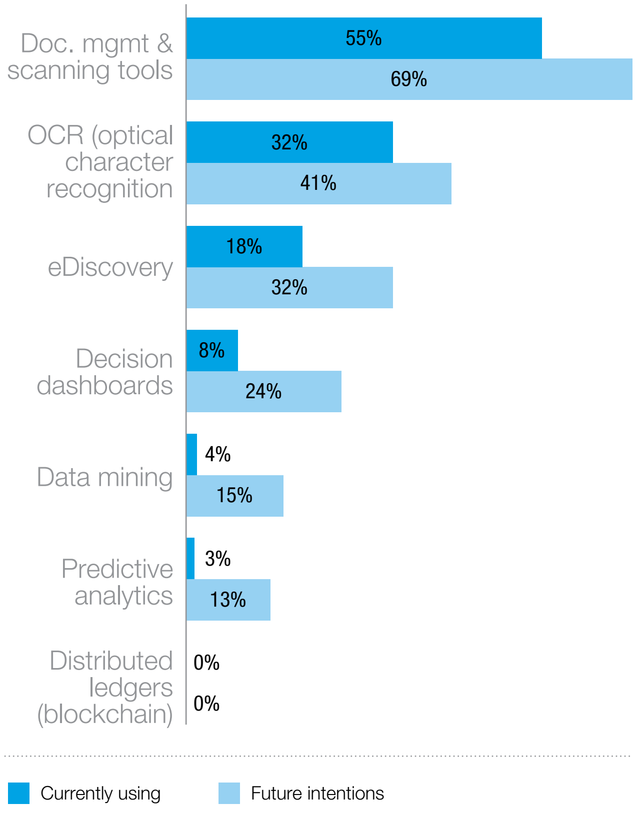


# Technology investment

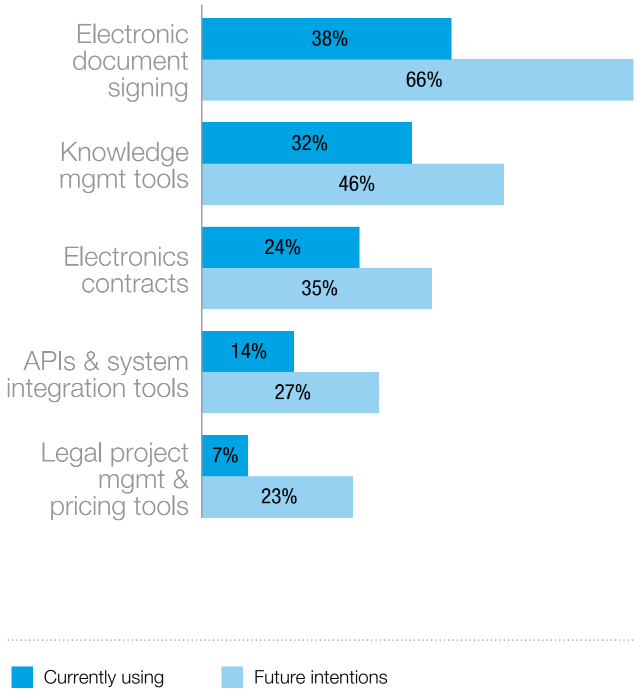
## Mid-size firms

Although slower to adopt new technologies than large practices, mid-size firms are still significantly more likely to invest in technology than their smaller peers. Higher profit mid-size firms are poised to make significant investments in efficiency enhancing innovations like document management and scanning tools (set to be adopted by 77% of higher profit mid-size firms within three years), electronic document signing (66%) and accounts automation (57%).

Current and future technology usage
Mid-size firms: **Data analytics**




Current and future technology usage
Mid-size firms: **Management and system integration**

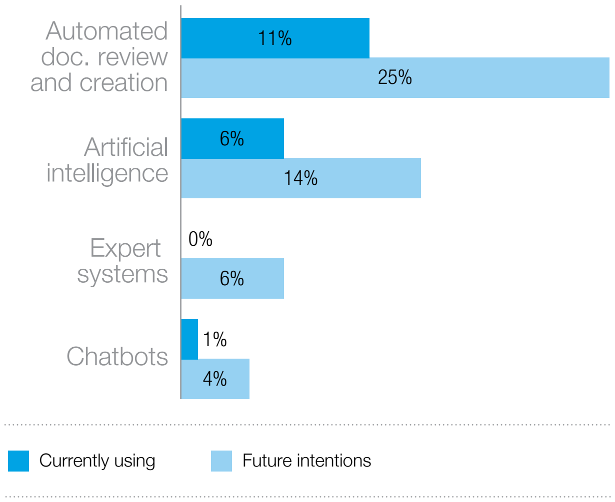


# Technology investment

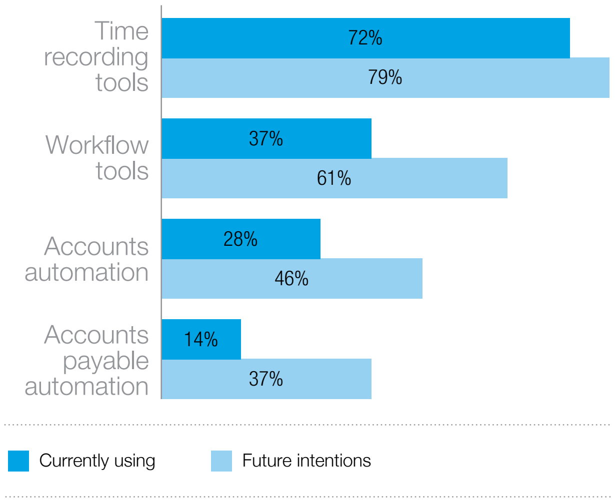
## Mid-size firms

However, only a small proportion intend to invest in legal project management and pricing software, with even fewer exploring more advanced technologies such as artificial intelligence and predictive analytics. Asked what prevented them from using new technologies, mid-size firms who identified themselves as falling behind or able to do more were most likely to say that they lacked knowledge about what is available (64%) or that it cost too much (53%).

Current and future technology usage
Mid-size firms: **Artificial intelligence**




Current and future technology usage
Mid-size firms: **Back office automation**



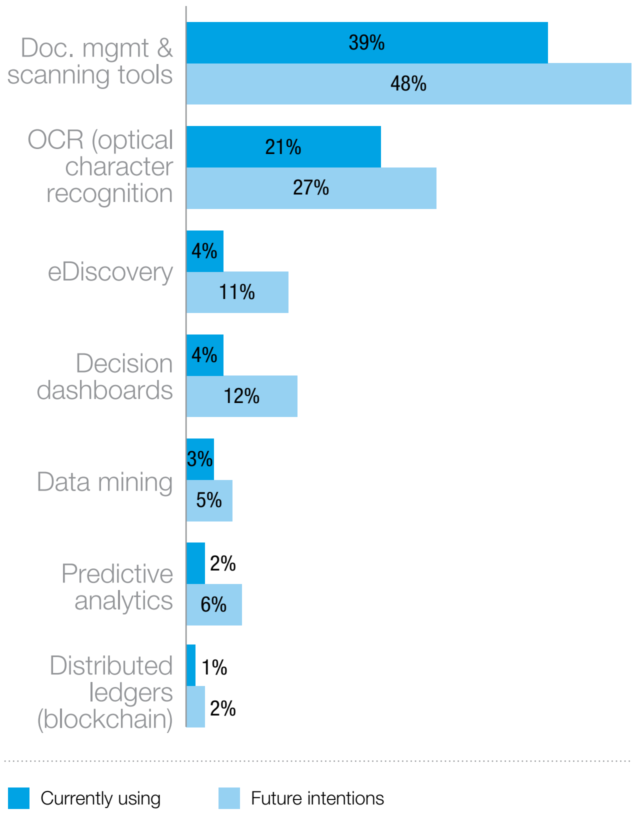
# Technology investment

## Small firms

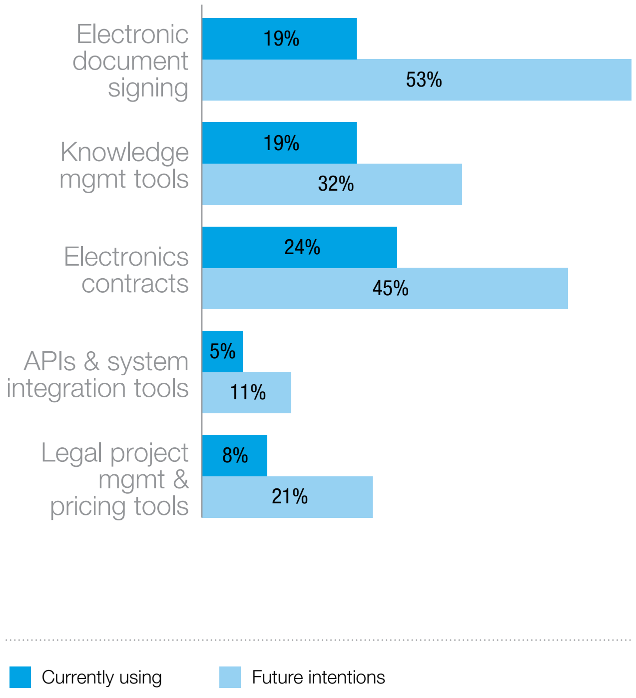
Small firms were both least likely to be currently using new technologies and least likely to be planning future investments. 24% of higher profit small firms said they were not currently using any of the new technologies listed in our survey, while 44% said they had no plans to adopt new technologies in the next three years, underlining the link between cost control and profitability among smaller practices.

Nevertheless, many small firms are already using back office automation software, while a significant number are getting ready to harness integrated document management tools, including electronic contracts and document signing.

Current and future technology usage
Small firms: **Data analytics**




Current and future technology usage
Small firms: **Management and system integration**

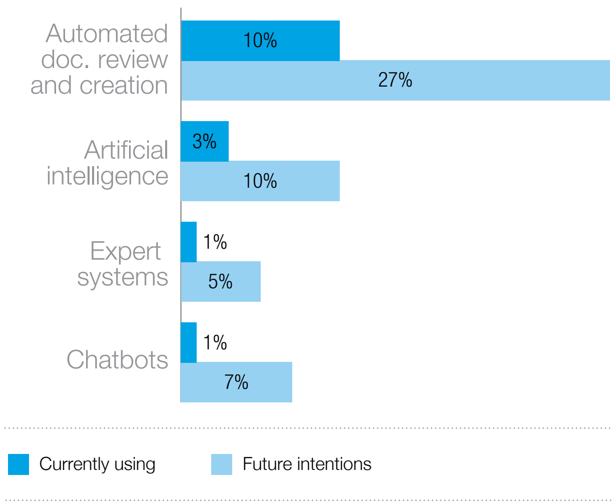


# Technology investment

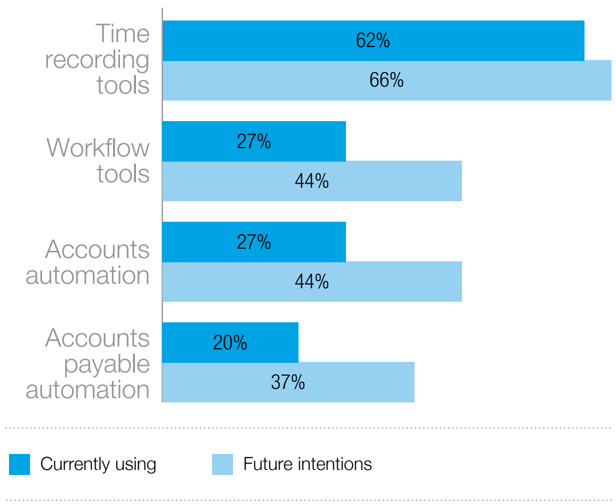
## Small firms

Expense was a common reason for small firms to avoid investments in technology, cited by 53% of small firms who agreed that they could be doing more to adapt or were falling behind. 63% also said they were stopped by a lack of knowledge of the available options. Given the growing affordability and accessibility of cloud-based solutions and software as a service, this lack of knowledge seems to be a key barrier to technological adoption, potentially leading many firms to overestimate the cost and putting them at risk of being overtaken by better informed competitors.

Current and future technology usage
Small firms: **Artificial intelligence**




Current and future technology usage
Small firms: **Back office automation**



# Case study

## Transforming legal practice with artificial intelligence (AI)

Developed in 2016, Allens' Real Estate Due Diligence App (REDDA) has helped one of Australia's most prestigious law firms save thousands of hours of lawyers' time in real estate due diligence, with significant benefits for the firm, its clients and its staff.

"We've got happier real estate lawyers, the work product is much more consistent … [and] we've achieved time and cost savings of around 30%."

Beth Patterson, Chief Legal and Technology Services Officer, Allens

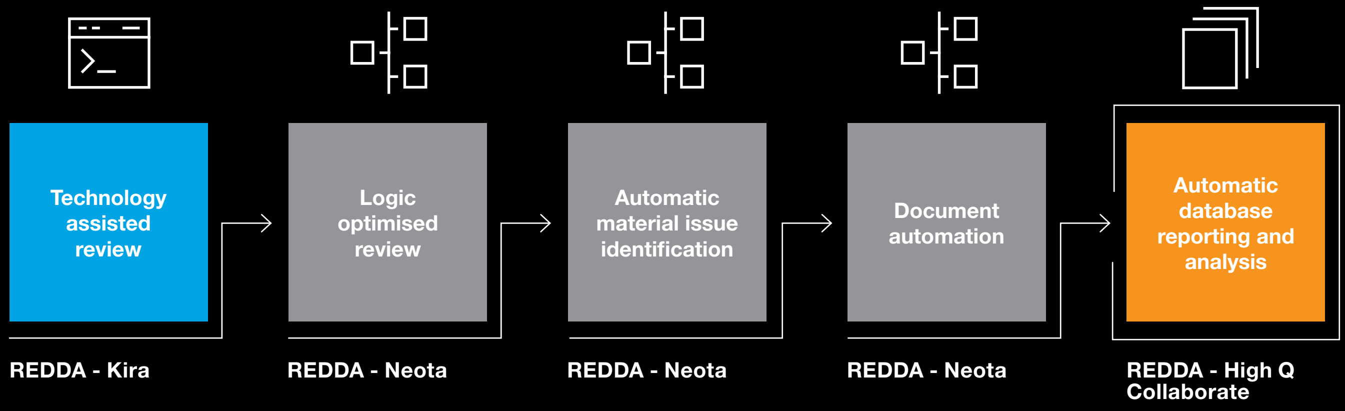
### How REDDA transforms the due diligence process

REDDA integrates three systems in a single solution:

– Kira, a machine-learning application, to identify key data in complex documents

– Neota Logic, an artificial intelligence (AI) system, to apply encoded decision trees to the data

– High Q, an online collaboration platform, to generate reports and share data with clients in real time.



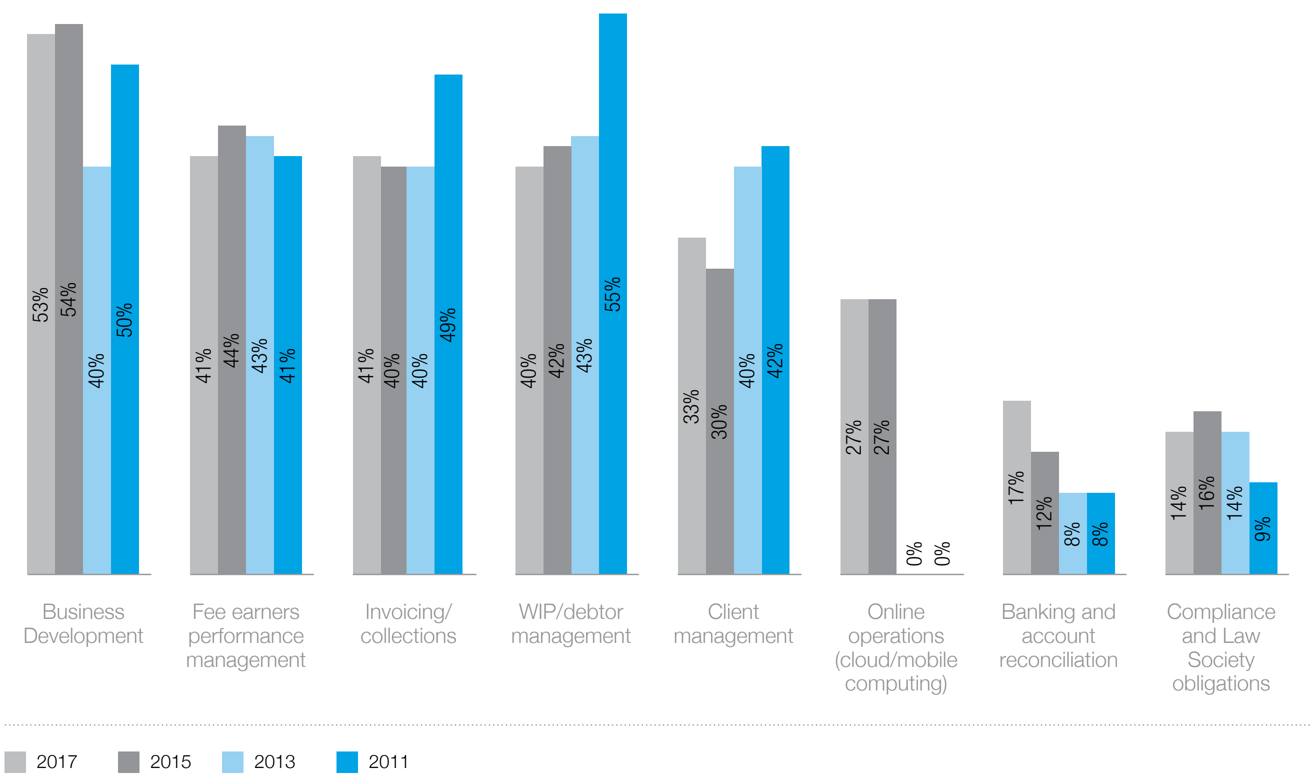

Read the full case study

# Business efficiencies

As in 2015, more than one in two firms remain focused on improving the efficiency of business development, in an environment of contracting demand and heightened competition. But firms are also increasingly likely to seek better ways to manage existing clients (33%), improve invoicing (41%) and streamline banking and account reconciliation (17%).

**35% of firms now collaborate with clients online, up from 23% in 2015**

Areas where firms are seeking efficiencies

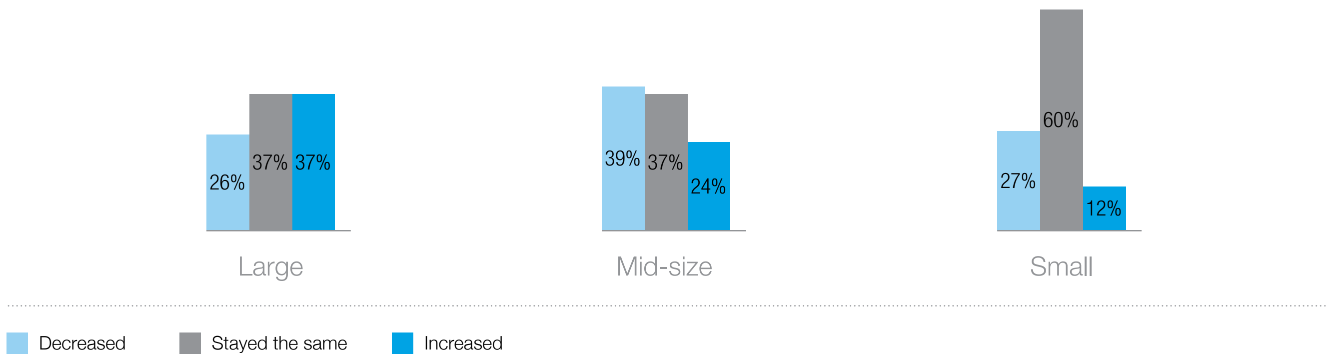


# Debtor days

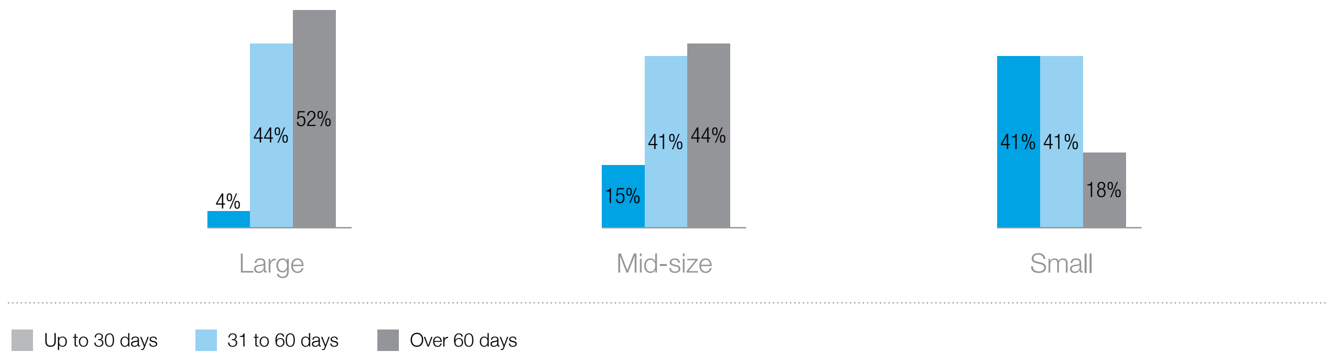
Small firms have largely kept debtor days stable over the last year, while 39% of mid-size firms have successfully driven them lower. But large firms have seen a significant blowout since 2015, with more than a third reporting that debtor days have increased, and one in two saying they now average more than 60 days. These firms are likely to face heightened working capital requirements at a time when cash flow is tightening and investment requirements increasing.

**20% of large firms with increased debtor days say they have relaxed credit collection policies**

## Change in debtor days by firm size




## Average debtor days by firm size



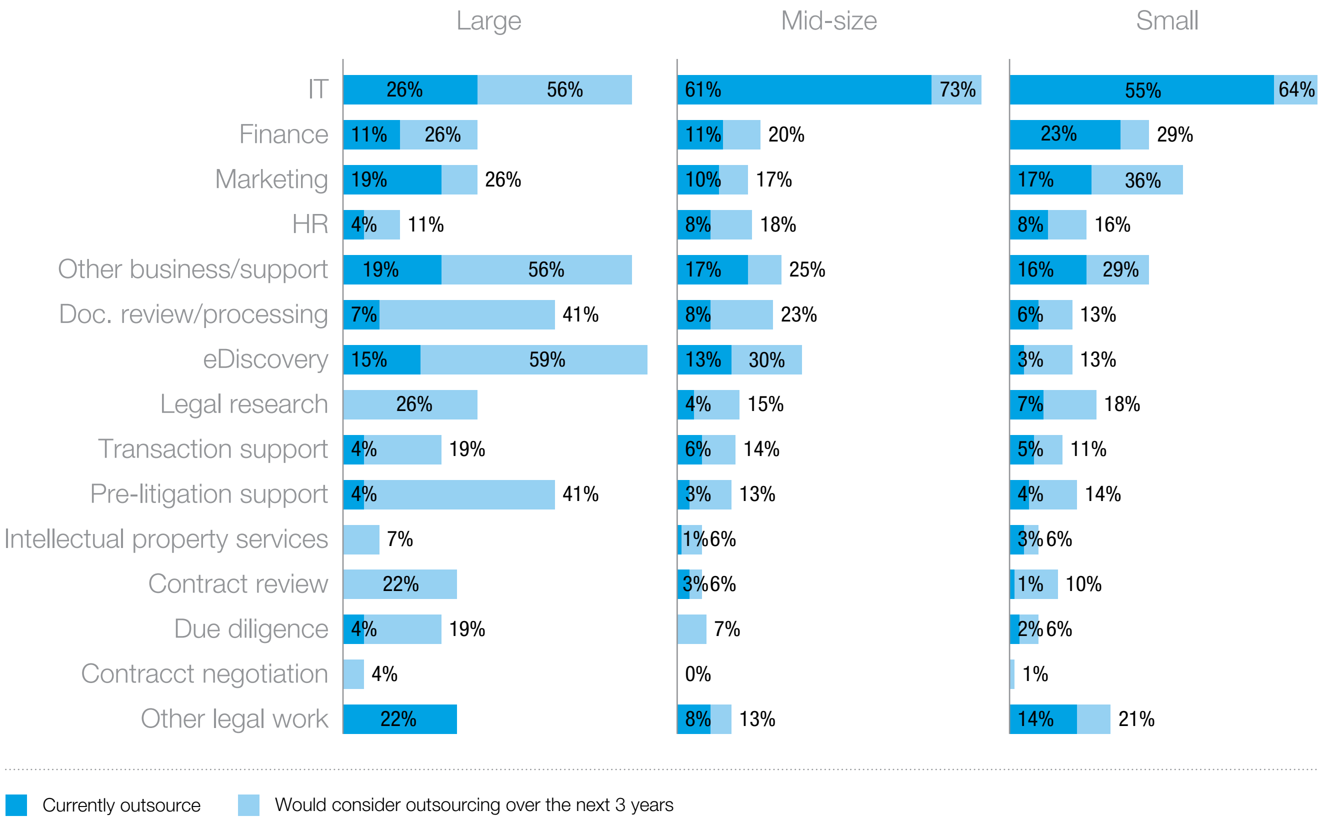
# Outsourcing

The use of outsourcing continues to broaden, with firms seeking the most efficient method for executing non-core activities, enabling them to focus on higher value-added services.

Although back-office functions such as IT, finance and marketing remain some of the most frequently outsourced areas, large firms are increasingly open to outsourcing a variety of low-margin legal work, including pre-litigation support (with 41% of large firms either currently outsourcing or open to doing so), legal research (26%) and contract review (22%).

Meanwhile, e-discovery has become firmly entrenched across the market, with 59% of large firms either currently outsourcing it or willing to consider do so within three years. In fact, large firms are already more likely to outsource e-discovery (15%) than back office functions like finance (11%) or HR services (4%).

## Current and prospective use of outsourcing

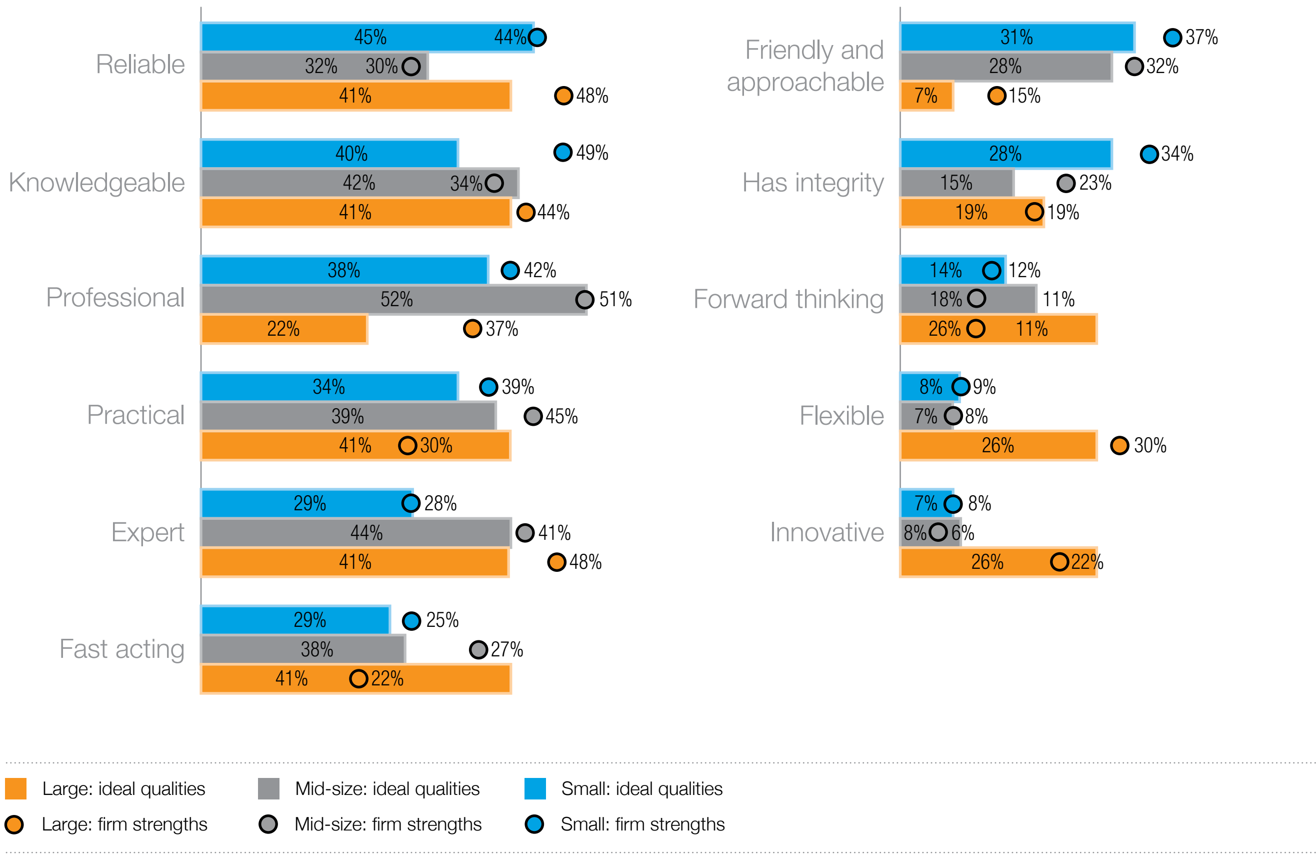


# Adapting to a changing market

## In pursuit of the ideal

Asked to name the qualities clients seek from the ideal firm, firms of different sizes revealed strikingly varied perspectives, reflecting the differences in both their clientele and their strategic outlook. Along with reliability, knowledge and professionalism, small firms placed a premium on being friendly and approachable — and rated themselves highly on those qualities. Mid-size firms emphasised professionalism, expertise, knowledge and speed, although some rated themselves poorly on being fast acting. And large firms were more likely than their peers to say clients value firms that are innovative, flexible and forward thinking — qualities their investments in technology and new business models are designed to embody.

The ideal and the reality



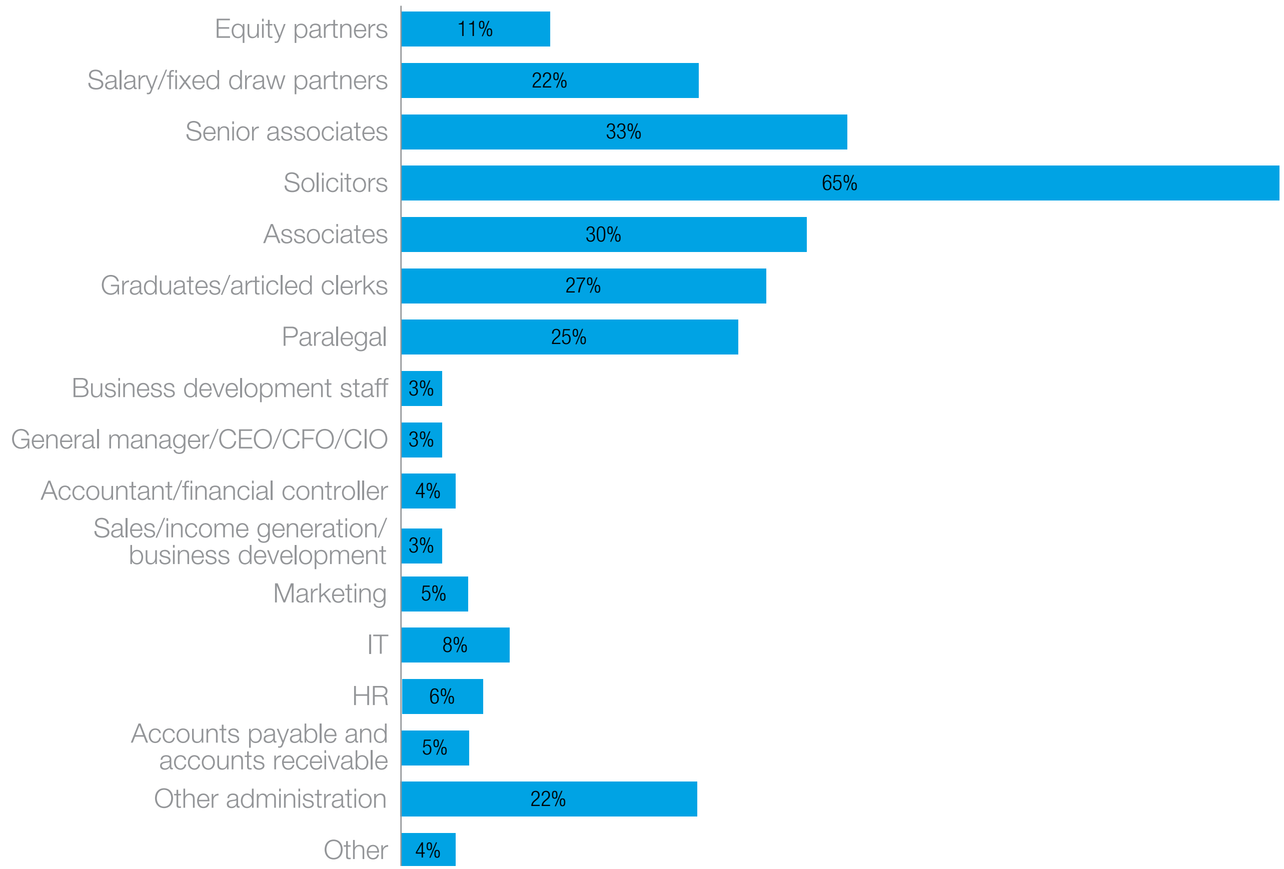
# People

# Hiring intentions

## Seeking cost-effective fee-earners

60% of firms plan to hire new staff in FY2018, the same proportion as two years earlier. The focus remains on cost-effective fee-earners, including solicitors, senior associates and associates. Yet, in a market where organic growth is hard to find, there are also signs that larger firms will continue to accelerate growth by luring partners with an established clientele. 50% of large firms and 40% of mid-size firms say they plan to recruit salaried partners this financial year, while 35% of large firms and 14% of mid-size firms will also seek equity partners.

Hiring intentions in FY2018

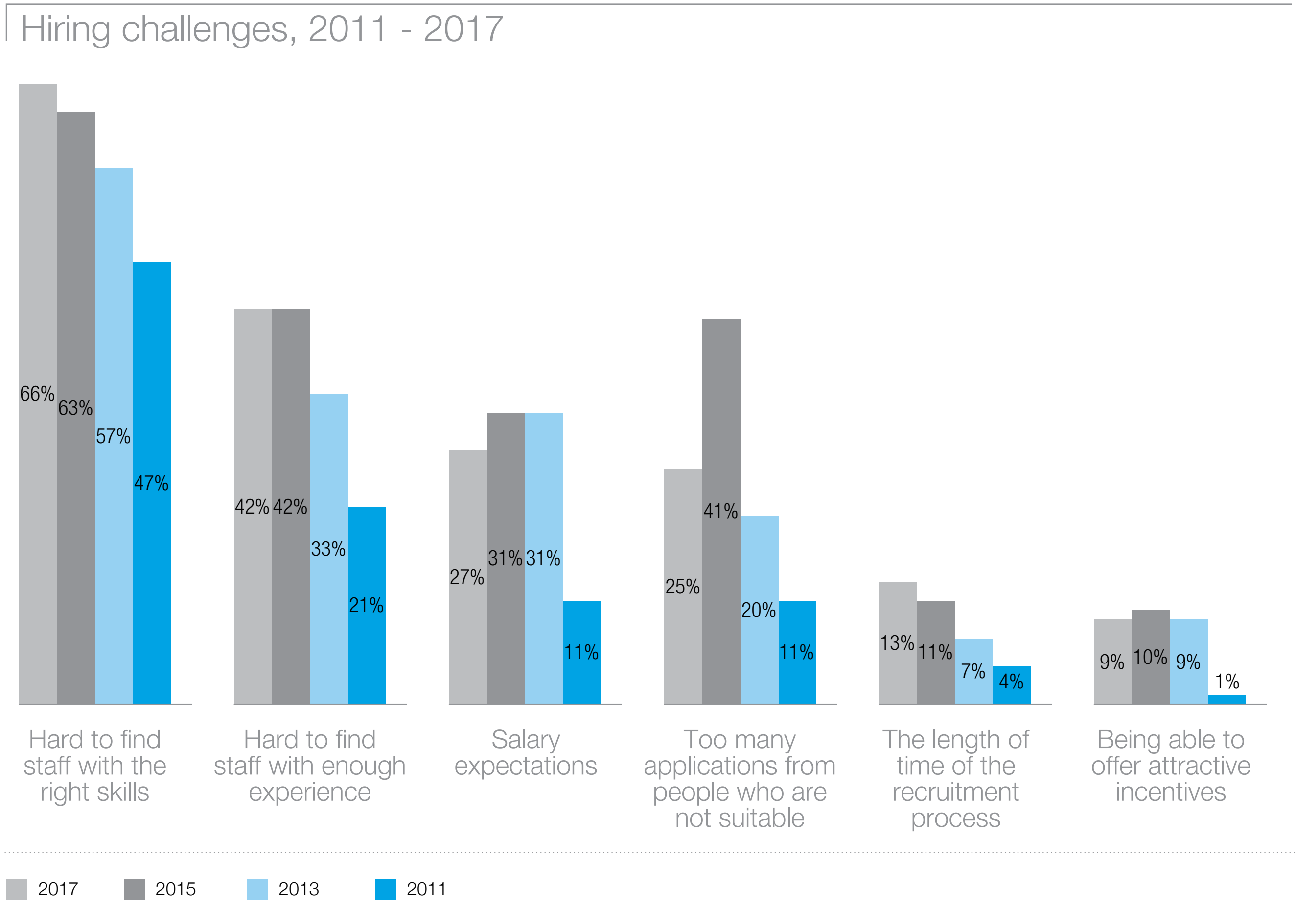


# Hiring challenges

## The skill shortage continues

Despite a flood of new graduates coming to market, firms continue to say it is becoming more difficult to find the people they want.

In an environment where efficiency is at a premium, and entry level legal work is increasingly being automated or outsourced, it seems a large number of firms are competing for a limited pool of experienced staff. Large firms in particular say that they find it difficult to find people with the skills they need — and that applicants' salary expectations are too high for these cost-conscious times.

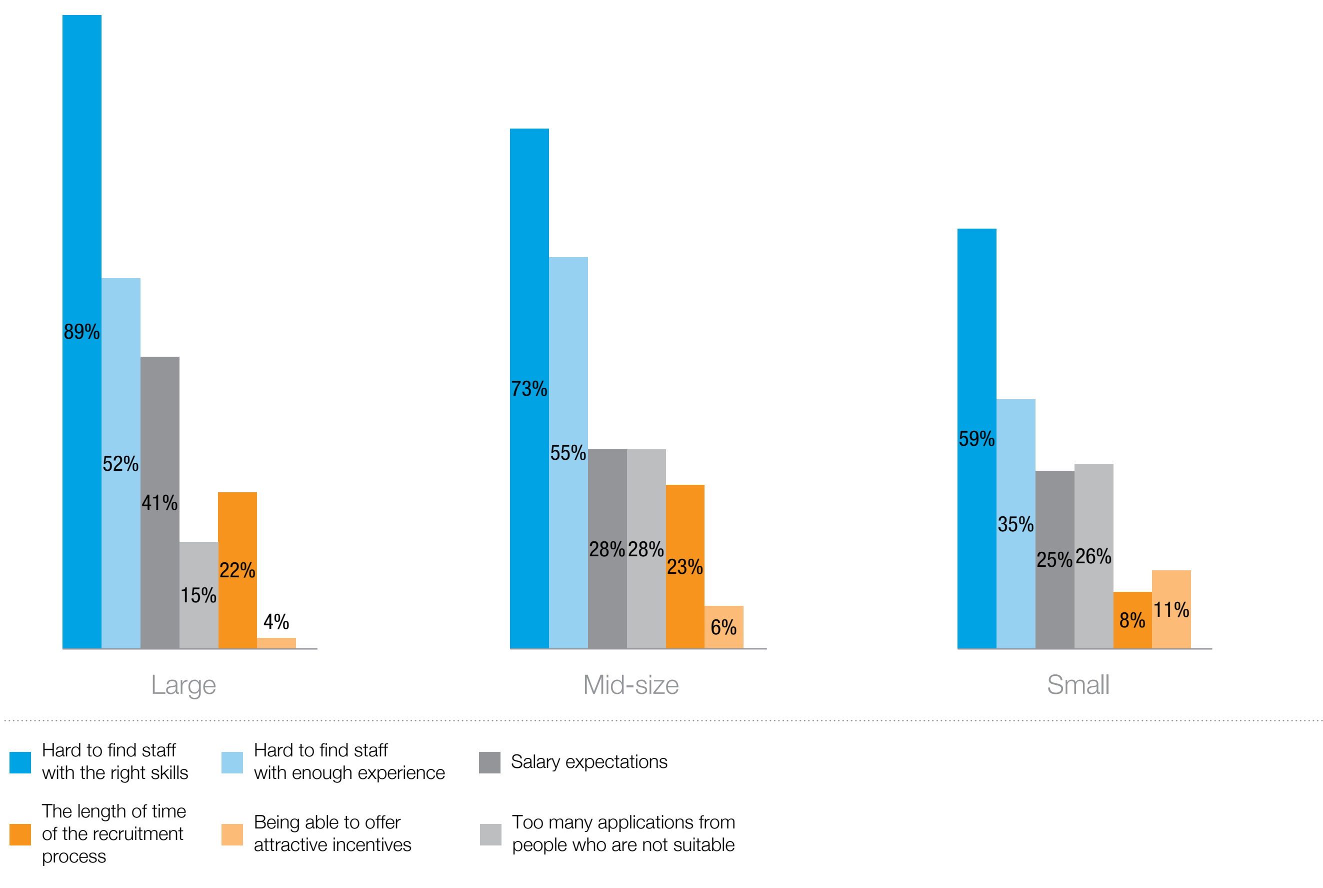


# Hiring challenges

## The skill shortage continues

**Firms tell us they are increasingly seeking staff who combine legal and technological skills, giving rise to new roles like Legal Engineer and Legal Technician at the convergence of law and computer science.**

Hiring challenges by firm size



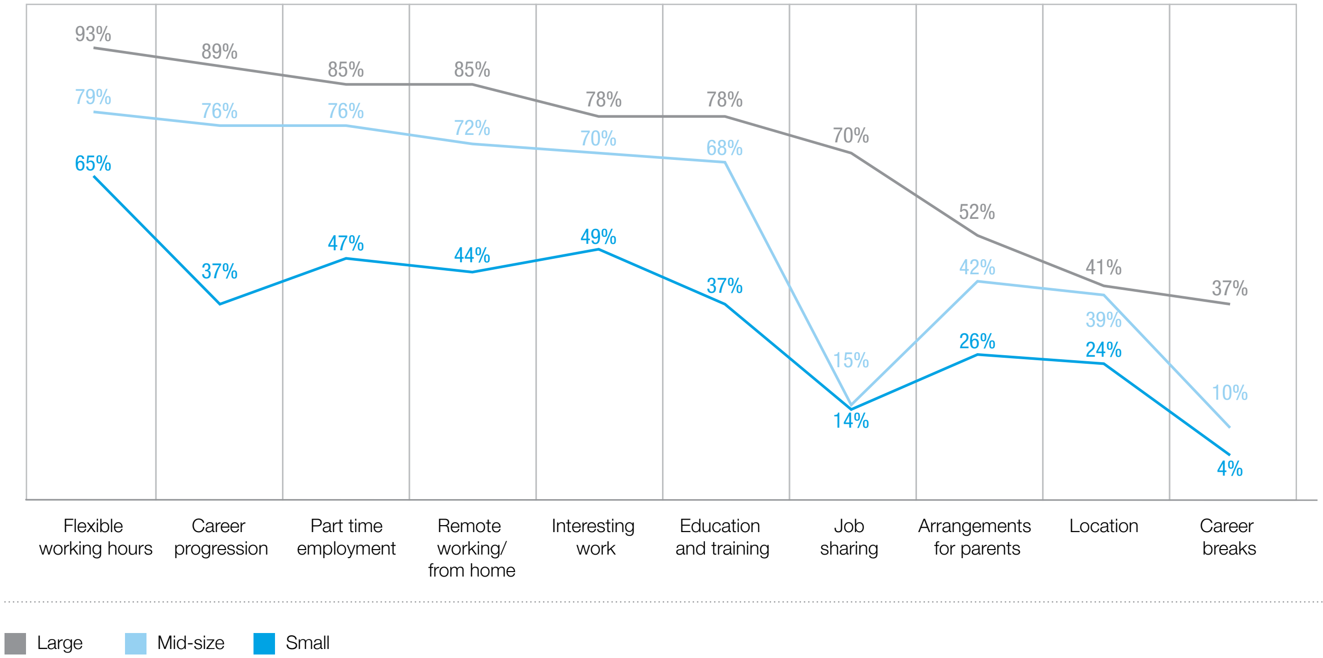
# Retention

## Flexibility is the new normal

Given the challenges of securing skilled people and the significant investment of time and money required to replace them, it is not surprising that staff retention remains a key issue.

Most firms now offer a variety of non-salary incentives, including flexible working arrangements, training and career opportunities. Large firms in particular leverage their scale to afford staff greater choice, although two in three small firms also offer flexible working hours, while 44% enable staff to work remotely.

Retention strategies by firm size



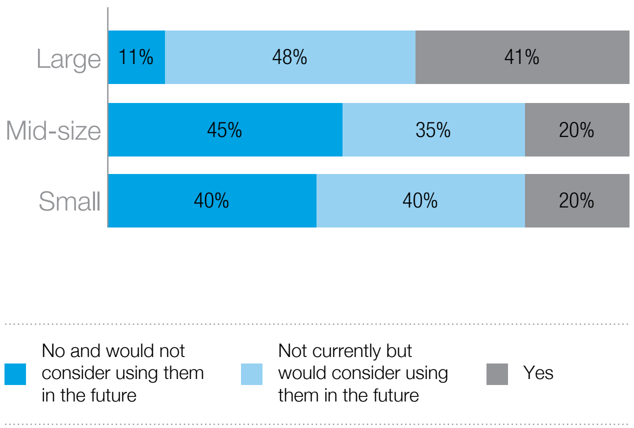
# Resource management

## Outsourcing and the rise of the flexible workforce

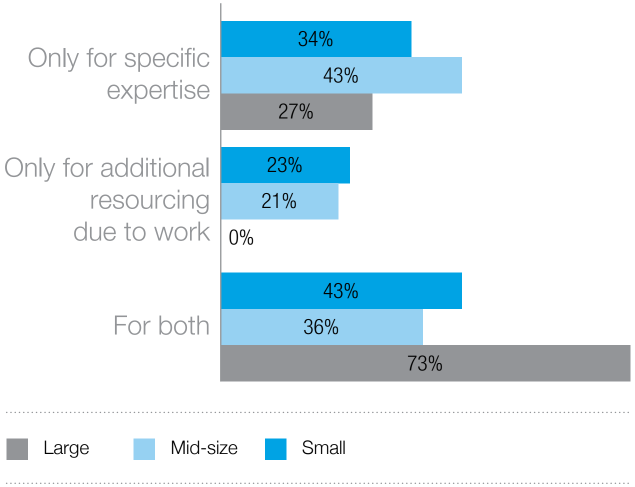
With skilled staff in demand and cost-conscious clients demanding ever greater value and flexibility, firms are increasingly turning to outsourced or contract lawyers to fill resource gaps. New business model organisations like Crowd & Co and Lawyers on Demand have become established players in the legal market, both competing against and partnering with established firms.

In our survey, 41% of large firms said they currently used flexible, contract or outsourced lawyers, with another 48% willing to consider doing so in future. Among large firms already using outsourced staff, 73% said they did so to access additional resources with specific expertise.

Use of flexible, contract and outsourced lawyers by firm size




Reasons for engaging



# Outlook and future growth

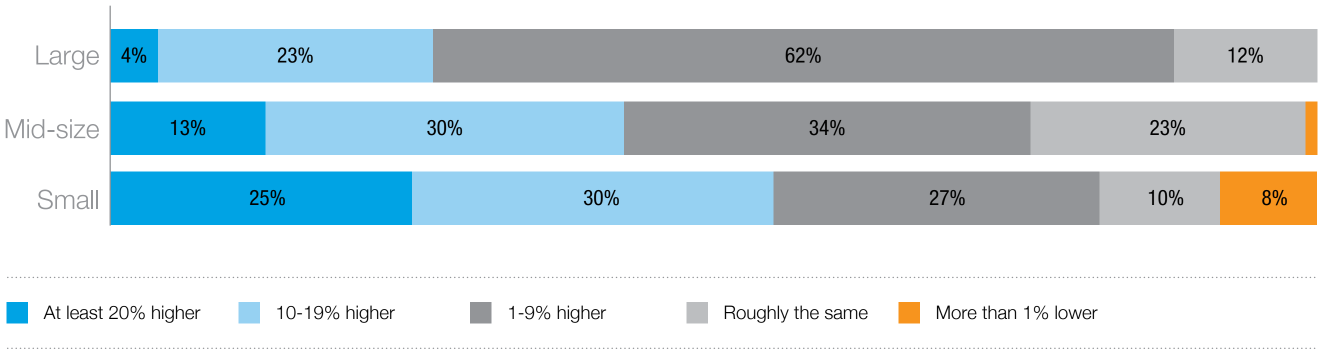
# Revenue outlook

## Eight out of 10 predict further growth

81% of firms expect their gross fees to rise in FY2018, with one in five predicting an increase of 20% or more.

Small firms, with the greatest scope for future growth, are most likely to forecast a 20%-plus increase, while 62% of large firms expect a steadier growth rate of 9% or less. In contrast, mid-size firms are relatively cautious in their outlook, with around one in four anticipating that fee revenue will remain static or decline this financial year.

Forecast change in gross fees by firm size, FY2018



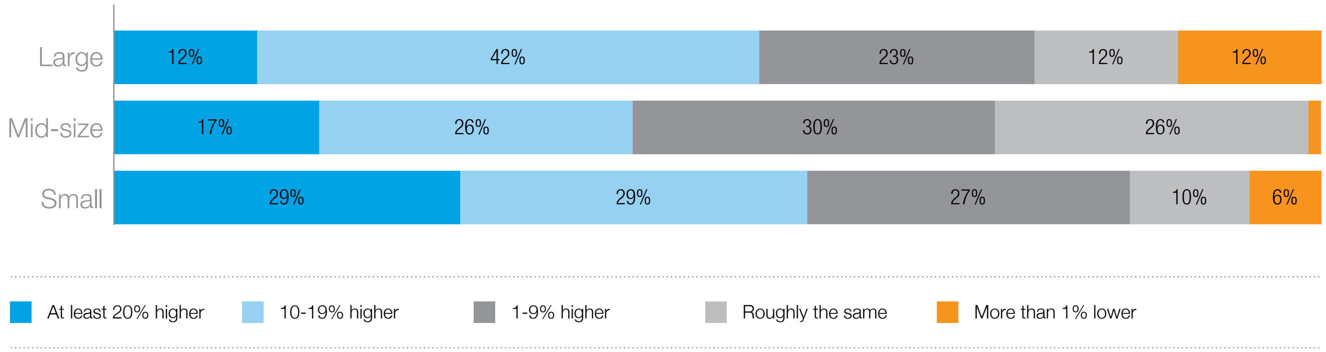
# Profit outlook

## The efficiency dividend

The profit outlook is even more positive, with 94% of firms across the market forecasting that profits will rise. Interestingly, 54% of large firms expected profits to grow by 10% or more in FY2018 — double the number predicting that fees would increase by the same magnitude. That suggests many anticipate further efficiency gains, perhaps as a result of their investment in technology.

Other large firms appear to be planning additional investments in FY2018, with 12% anticipating that profits will edge lower, even with stable or increasing revenues.

Forecast change in profits by firm size, FY2018



# Industry outlook

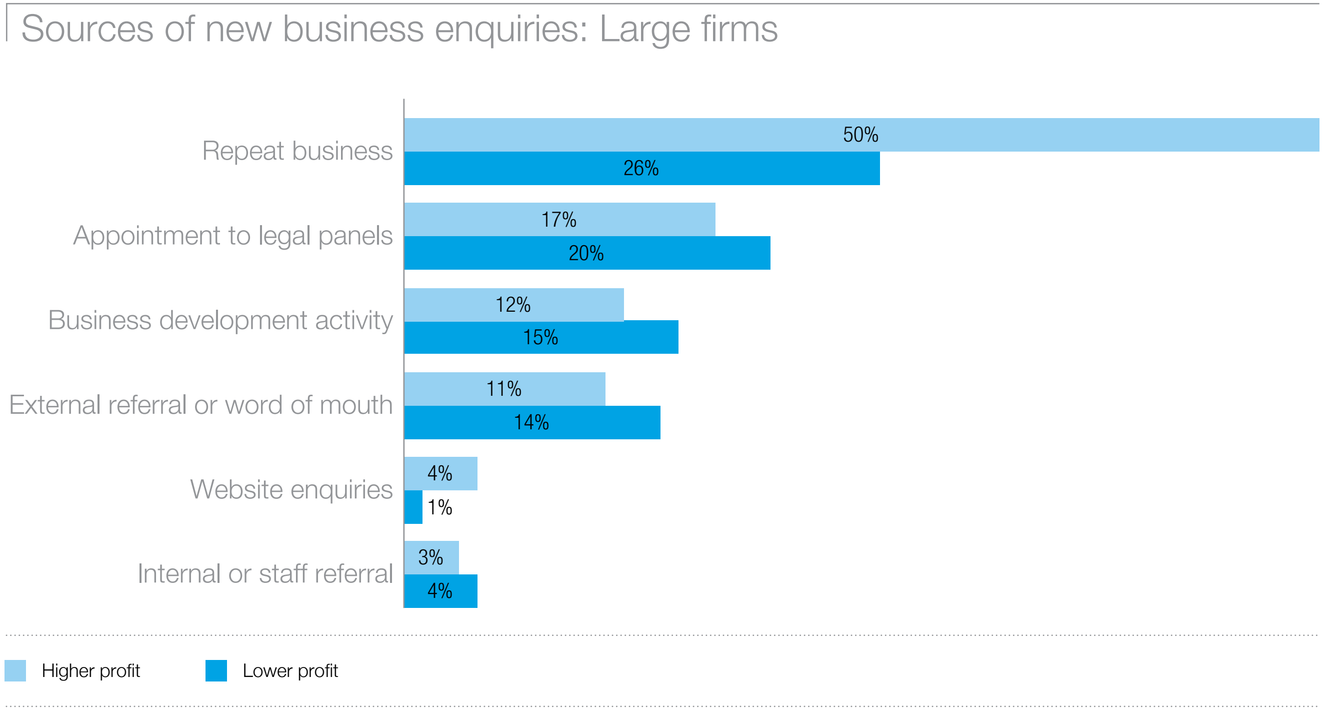
## Green shoots in the west?

Asked for their perspective on the industry as a whole, survey participants were much more circumspect than when forecasting the outlook for their own firms. Most expect conditions to remain the same over the next 12 months. Despite a recent economic downturn in the wake of the mining investment boom, Western Australian firms were by far the most positive, with one in four expecting business conditions to improve.

Industry outlook by state

# New business opportunities

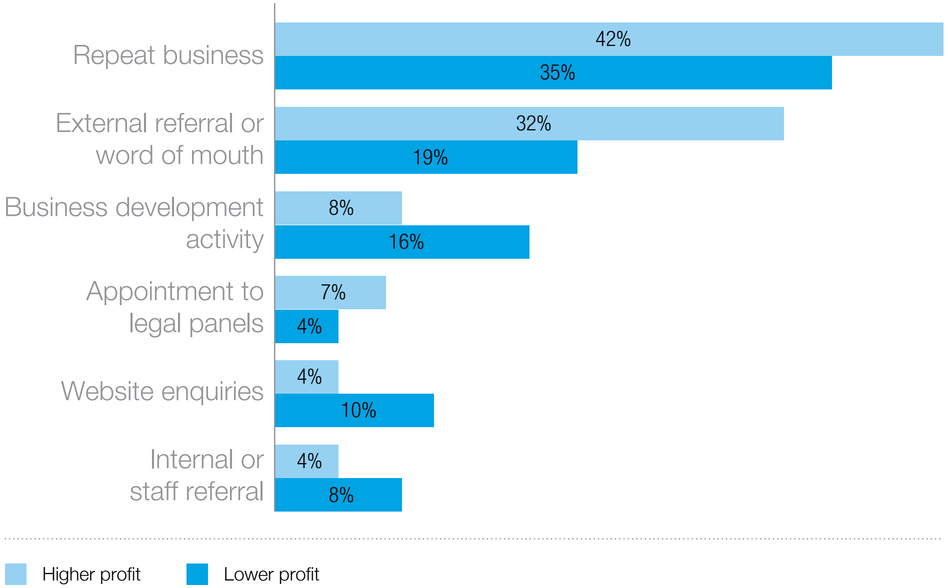
Across the industry, client referrals and repeat business remain the dominant sources of new opportunities, especially among small and mid-sized firms. But as firms grow in size, the difference between higher and lower profit performers becomes more marked, with high profit mid-sized and large firms excelling in converting existing relationships into ongoing opportunities. Higher profit large firms, in particular, are much more successful than their lower profit competitors in gaining repeat business.



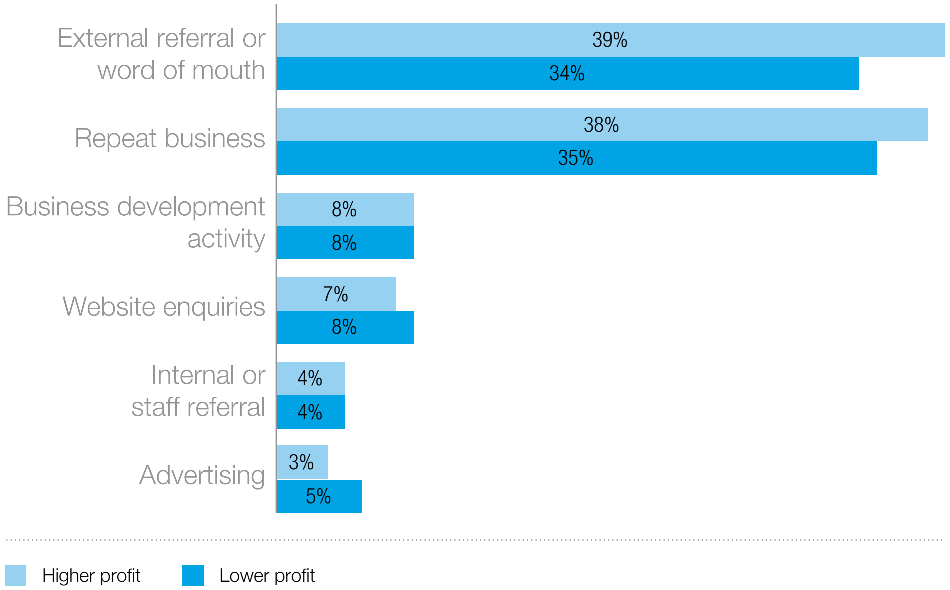

**Higher profit large firms are almost twice as successful as lower profit firms in gaining repeat business**

# New business opportunities

## Sources of new business enquiries: Mid-size firms




## Sources of new business enquiries: Small firms



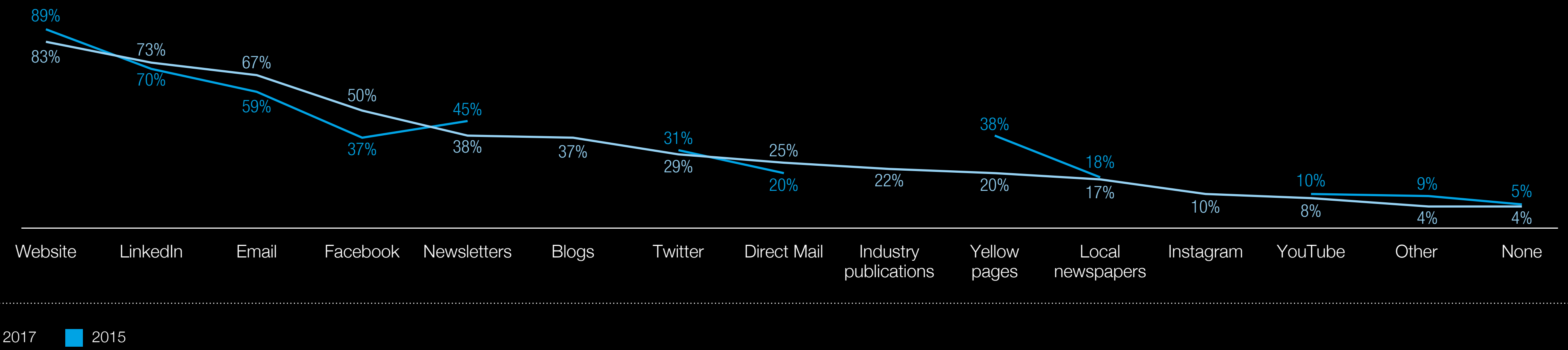
# Case study

## Marketing: Online dominates

Cost-effective digital channels continue to dominate firms' marketing activities, with one in two now using Facebook, two-thirds using email marketing and 73% on LinkedIn. In fact, firms are now three times as likely to use Facebook as a local newspaper. 37% also use content marketing (blogs) to showcase their expertise.

"In a perfect world, [prospective clients searching for information on a legal issue] would land on a blog article by a partner in the firm on that topic. That's how the digitally-empowered buyer decides who they want to work with … [by] getting a taste of the expertise that person has around the issue." — Jonathan Roberts, Director, One Rabbit

Marketing channels used by Australian law firms




Read the full case study

# Succession planning

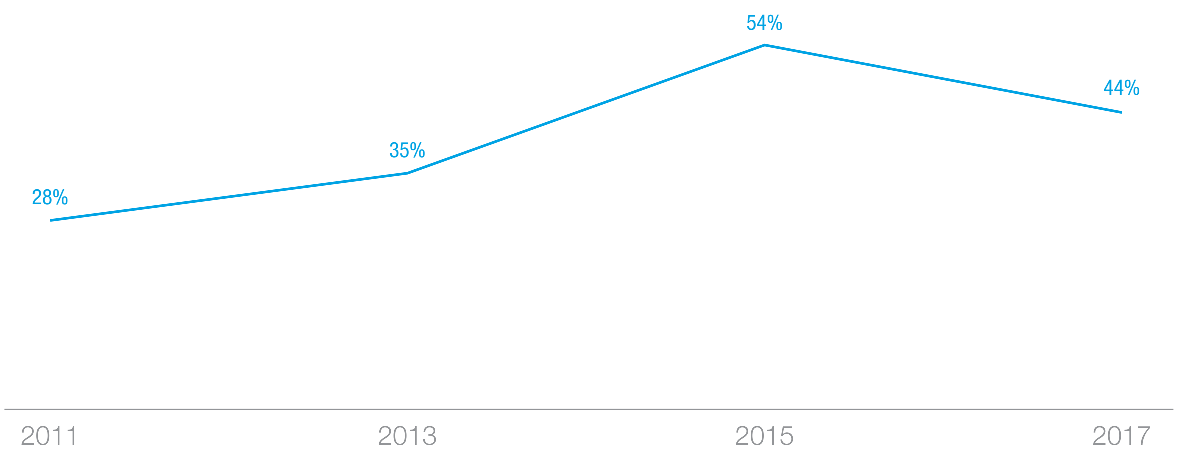
## Realising value for the future

After years of successive increases, the proportion of businesses with succession plans fell to 44% in 2017, down from 54% two years earlier. Among those without a succession plan, 39% say it is not the right time, while 29% say it not a priority at the moment. Around one in five say they are too busy working, suggesting a perhaps understandable focus on the immediate future in a challenging market, albeit one that could have long term costs.

Among the 44% with plans in place, selling equity to existing staff remains the preferred option for 71% of firms, although 17% intend to transition to a new owner without a payout, up 2% since 2015.

**65% of small firms have yet to create a succession plan.**

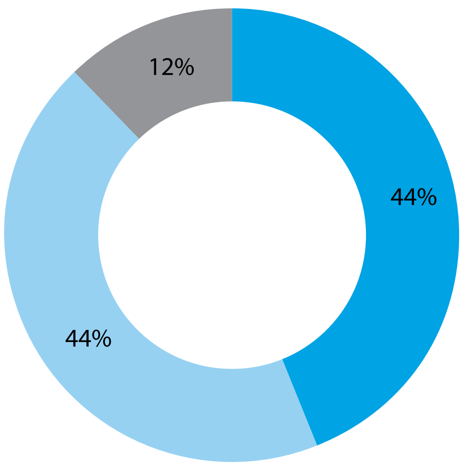
Firms with succession plans



# Succession planning

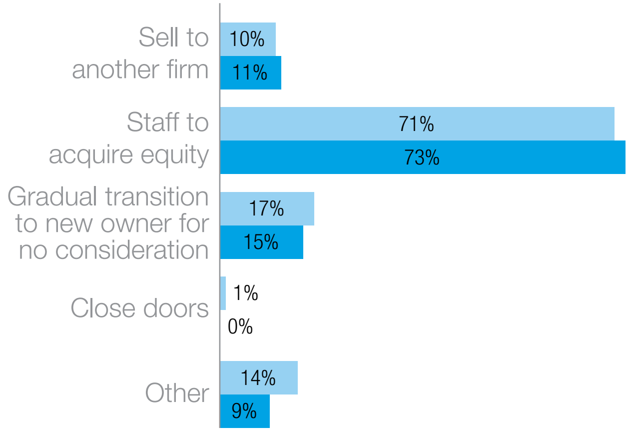
## Realising value for the future

### Succession planning



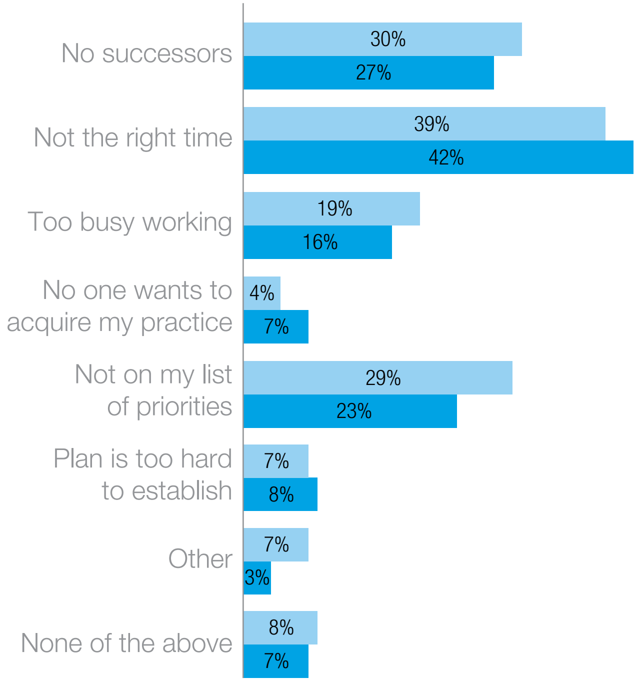

Yes No Not sure

### Yes




2017 2015

### No




2017 2015

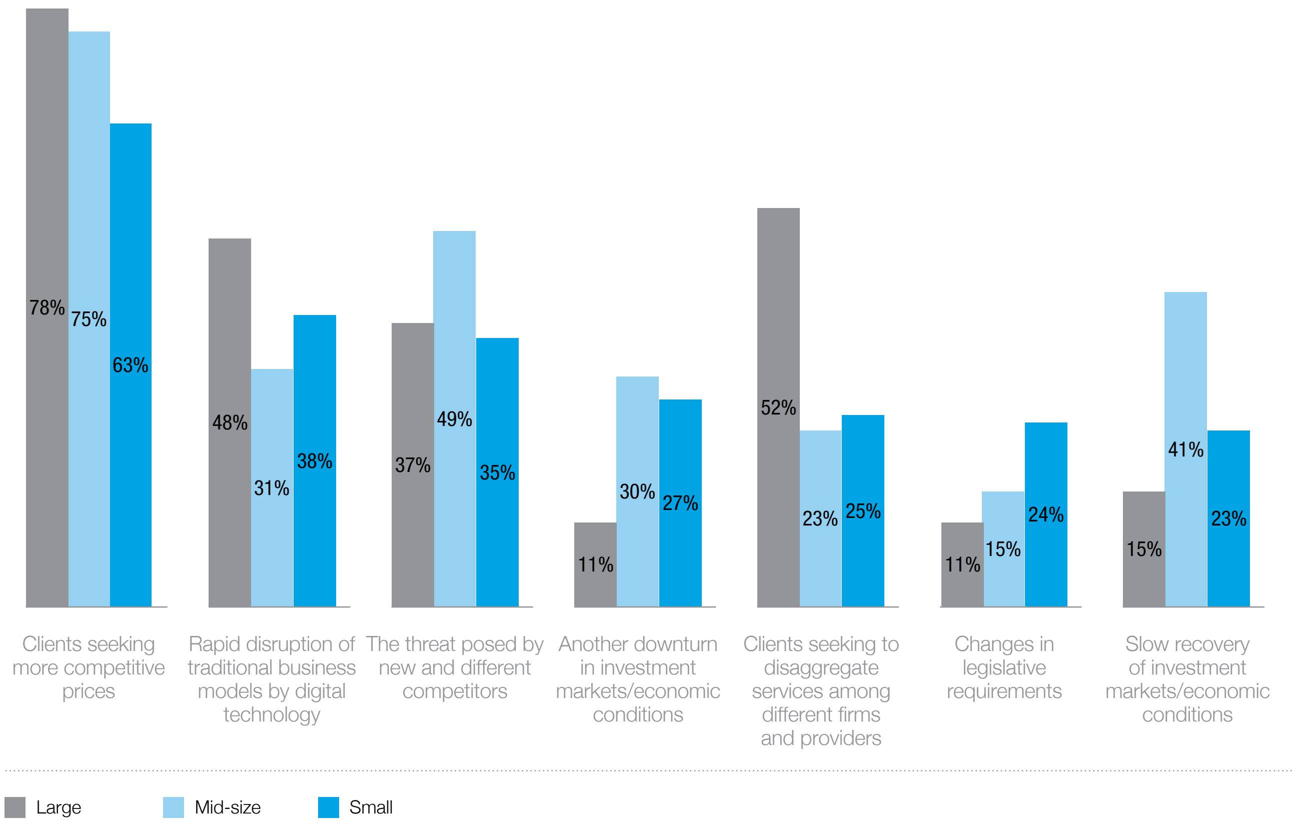
# Performance drivers

## Navigating a market in transition

Firms of all sizes are feeling the stresses of a market in transition.

Large firms in particular believe they will continue to be impacted by client-driven pricing pressure (78%) technological disruption (48%) and disaggregation (52%). Mid-size firms are also concerned about new business model competitors (49%) and the state of the economy in general (41%). All firms see maintaining profitability and attracting new clients as two of their biggest challenges, although 59% of large firms and 55% of mid-size firms also view staff retention and recruitment as a key performance driver.

Factors expected to impact performance

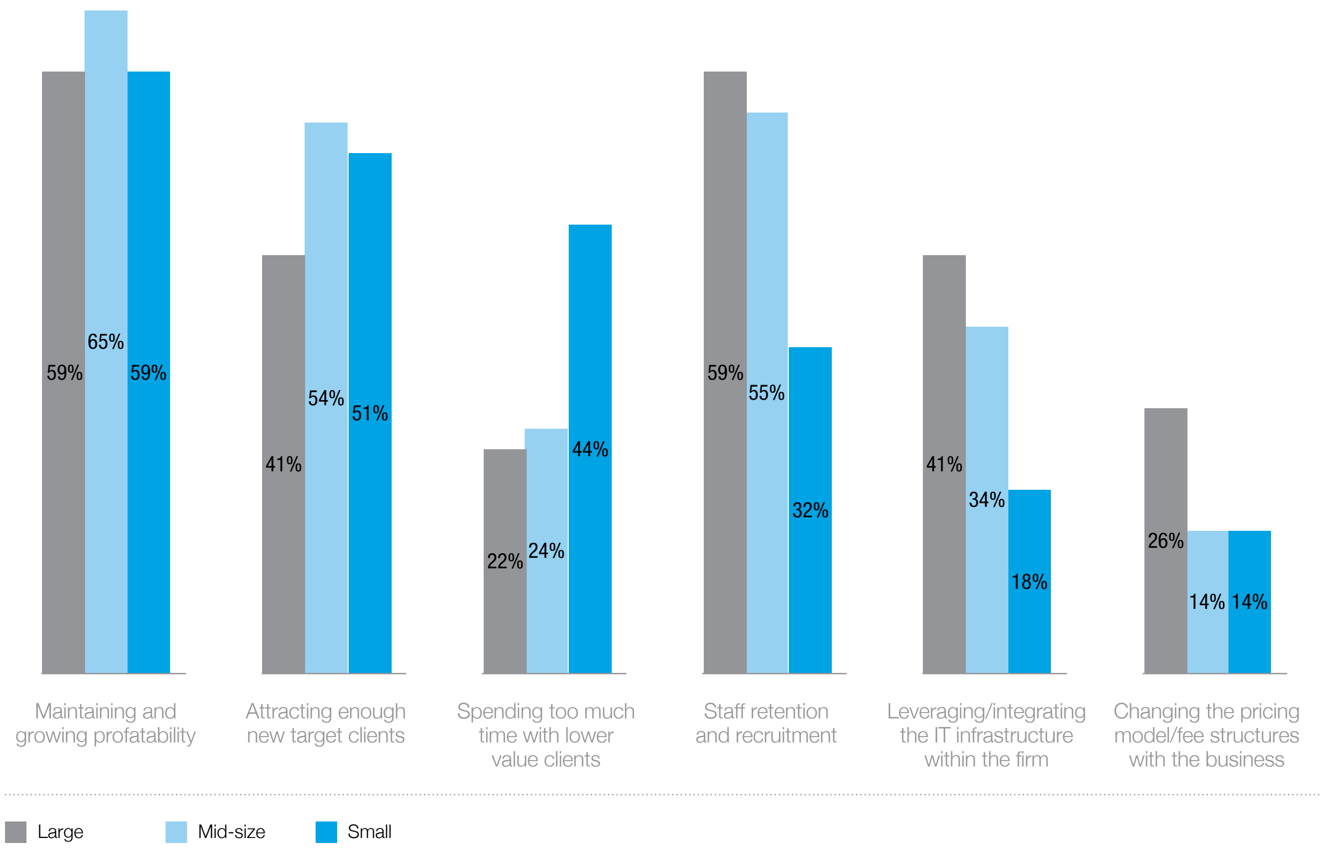


# Performance drivers

## Navigating a market in transition

Interestingly, the proportion of large firms concerned about the impact of changing their pricing model has more than halved since 2015, from 56% to 26%. While this finding should be treated with caution, given the expanded sample of large firms in our 2017 survey, it also supports the view that large firms are successfully meeting the challenge of creating a more appealing and sustainable structure for the future.

### Factors expected to impact performance



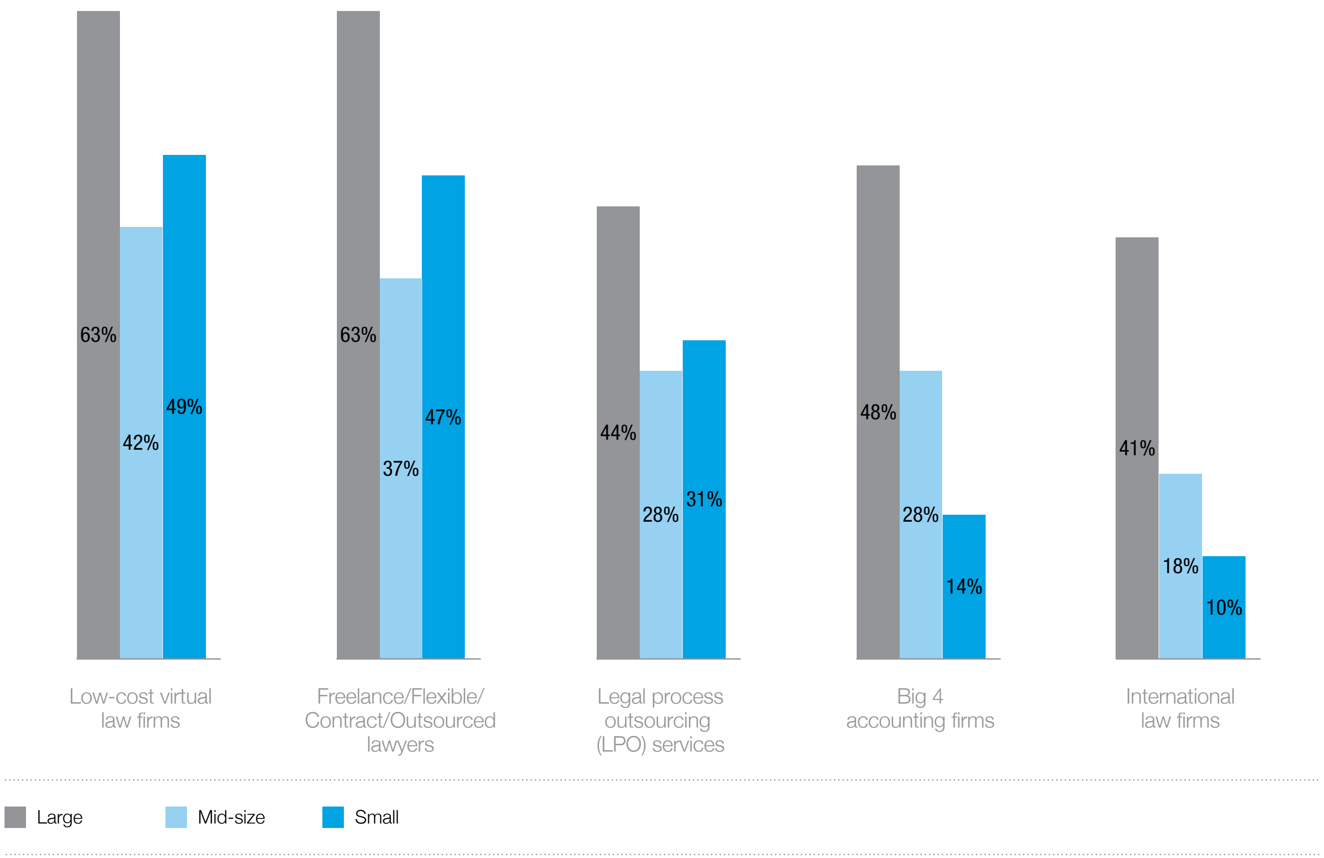
# Competitive threats

## Technology fuels disintermediation

Perceptions of competitive threats have shifted as the market evolves. Two years ago, large firms were most concerned about their rivals among the big four accounting firms (63%). Now firms of all sizes see low-cost virtual firms and outsourced lawyers as their main threats, as technological innovation makes it easier for clients to reduce costs by bypassing traditional providers. However, higher profit firms are noticeably less concerned by these rising competitors.

**Large firms concerned about low-cost virtual competitors:**
**Lower profit: 81%**
**Higher profit: 36%**

Competitors expected to impact performance over the next three years



# Focus areas

## Driving new business, improving efficiency

Firms are set to continue improving business practices across a wide range of areas in the year ahead, with a focus on enhancing efficiency and driving new business. Small firms (46%) and mid-size firms (61%) are most likely to prioritise business development, while firms of all sizes see skill development as an essential part of their strategy. Meanwhile, large firms are focused on making the most of their increasing investment in technology, with 78% saying they will focus on integrating digital technology to improve the delivery of legal services.

**Large firms focused on cash flow management:**
**Higher profit: 82%**
**Lower profit: 38%**

Focus area for the next 12 months

# Best practice

## Building the firm of the future

**Five tips** for adapting to a market in transition from Dr Stephen Moss, Chairman and Managing Partner, and Justin Whealing, Partner and Legal Services Manager, Eaton Capital Partners.

**1.**
**Embrace innovation.**
Be open to change, so you can flourish within the emerging market framework. And be responsive — if revenue or profit margins are dropping, look to do something about it immediately, because it won't just go away.

**2.**
**Put people and culture first.**
Law firms are only as good as the people who work in them, so you need to create a performance culture that rewards quality. Go beyond traditional management techniques and take the time to really understand what people want.

**3.**
**Nurture leaders.**
Find strong leaders who understand that law is the business of people, not just numbers, and who are willing to pursue innovation.

**4.**
**Be targeted.**
Work out the areas you want to target and go about it in a very serious methodical way. Don't spread yourself too thin by striving to be a generalist.

**5.**
**Harness technology to support your strategy.**
Technological change is set to transform the way we practice law — but technology needs to be at the service of strategy, not the other way around.

If you'd like to learn more about putting our best practice insights to work in your firm, contact me and my team.

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## Office locations

# Important legal notice