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Eight forces shaping legal innovation in the Australian market

In their research paper, entitled State of Legal Innovation in the Australian market, authors Eric Chin, Graeme Grovum and Matthew Grace, from the Alpha Creates legal industry consulting firm, explain how the Australian legal sector is changing. They also reveal gaps in the market that are creating opportunities for innovative legal services providers.

The Australian legal services industry is a $23 billion market,¹ with 76,773 lawyers servicing 24.9 million people² and 2.2 million businesses³ in the country. The Australian legal industry is also mature, being driven by an increasingly sophisticated client market, the emergence of new competitive landscapes as viable alternatives, and the rise of LegalTech solutions. All of this is occurring within a market that is only growing by single digits.

Forces of change on the buy and sell sides combined with a stagnating market are fuelling hyper-competition⁴ for incumbents in the Australian legal industry. This puts innovation on the agenda of law firms and legal departments across the industry.

There are eight major categories of stakeholders that drive the Australian legal ecosystem. On the buy side of this equation we have the business to consumer (B2C) segment, represented by the 24.9 million people in Australia, and the business to business (B2B) segment, represented by the 2.2 million businesses in the country. On the supplier side of the equation, we have the incumbents – law firms that have been the traditional supplier of choice – and, increasingly, NewLaw firms, LegalTech firms and the Big Four accounting firms’ legal arms.

Law associations and law schools are also major stakeholders in the legal ecosystem as they provide end-to-end lifecycle training and education for lawyers. Finally, regulators also play an important role in setting the scene for the legal ecosystem through regulatory policies that either foster or impede the emergence of new types of legal service providers.

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¹ The Australian Law Management Journal is produced by the Australian Law Management Group of the Legal Practice Section of the Law Council of Australia
² www.lawcouncil.asn.au/almj
Forces shaped by buyers of legal services in Australia

Australia’s 24.9 million population is the B2C segment for legal services, with a lifetime of legal needs that span employment, tax, accidents, clinical negligence, property acquisition, disputes, divorce, family law and estate planning. The size of the Australian population has also grown by 25 per cent in the past decade, driven both by organic growth of the population and migration. A strong opportunity for lawyers is to tap into the underserved B2C market, in a country where we have one lawyer for every 322 people.

As consumers move their consumption online, the Australian online retail market has also seen its industry expanding from $17.6 billion in 2015 to $23.4 billion in 2017. While the majority of online commerce is driven by product-based industries, the services-based market is also growing. This sets the scene for consumption of legal services online and, as the B2C market becomes comfortable with buying services online, we are seeing the rise of LegalTech firms selling legal services online.

The B2B segment for legal services is the 2.2 million-strong business population in the Australian market, 94 per cent of which are small businesses that are too small to have a legal department or in-house lawyer. The small business market for legal services is reliant on its external advisers, whether they are lawyers or otherwise. A study by the Legal Services Board in the UK found that only 1.4 per cent of the small business population in that jurisdiction turned to lawyers for legal advice, with a larger percentage actually seeking legal advice from an accountant. This indicates a significant opportunity for Australian lawyers to tap into the underserved market of small businesses.

Big business in the B2B segment of the Australian market is represented by companies with in-house lawyers and legal departments. A study conducted by the Association of Corporate Counsel Australia on trends in the in-house legal segment in the Australian and New Zealand markets reveals:

1. Legal departments are starting to right-source to the most cost-efficient providers. The NewLaw segment of the market currently accounts for 9 per cent of legal departments’ legal wallets.
2. Legal departments are underinvesting in LegalTech and LegalOps, as only 4 per cent and 3 per cent of internal legal expenditures are allocated to technology and workflow, respectively.

This reflects the dominant theme of the past five years for corporate legal departments of having to deliver (and demonstrate) value to the business in the Susskindian ‘doing more for less’ world. The main levers used to achieve increased legal service delivery at a lower cost are two-fold:
1. Improved service delivery through the application of business process improvement methodologies to legal processes. The Corporate Legal Operations Consortium’s (CLOC) growth during the past few years, and its launch in Australia in 2018, have been a key source of information and support for in-house counsel looking to improve consumption of legal services; and

2. Disaggregation of legal services. High-value portions of legal work are increasingly being separated from legal matters and briefed to external legal service providers (whether they are law firms or non-traditional firms) while internal solicitors handle routine matter work and business as usual. The increased delivery of legal services to the business by internal legal teams has seen the ranks of in-house counsel increase during the past five years.

As the number and calibre of in-house counsels rise, so too does their capacity and capability to conduct increasingly complex work, creating a positive feedback loop that steadily increases the volume and scope of work being conducted in-house.

**Intensifying competition between Australia’s law firms**

Hyper-competition can be observed among the incumbents as law firms compete to grow in a stagnating market. In search of growth, Australian law firms have expanded geographically into interstate markets. The nationalisation of legal practices in the 1980s and 1990s that fused top-tier city-based banking and finance law firms created the top-tier firms we know today.

In the past three financial years alone, the Australian market has seen 16 office expansions across the country. A major driver of this is the client demand for national coverage and this is most evident for firms that were servicing insurance companies in Australia. Nine of the 16 office expansions analysed were driven by the law firm’s insurance practice.

Intensifying competition for clients and talent is also driving consolidation in the Australian legal industry. The volume of law firm M&A peaked in FY18 as 19 deals were consummated in the Australian market. Notably, the size of the deals, measured by number of partners involved in the merger, has decreased, pointing to a market with fewer large deals as consolidation intensifies. As the biggest market in Australia, consolidation can also be observed in New South Wales, with eight merger deals recorded in FY18.

The movement of partners between firms is often a reliable indicator of competition hot spots. In FY18 we saw lateral partner hires pick up again as 273 partners switched firms. The yearly breakdown reveals that FY18 saw the highest number of partners switching firms in the past seven years as the war for talent intensified.
As the biggest markets in Australia, it is unsurprising that Sydney (139), Melbourne (55), and Brisbane (44) recorded the highest number of partner lateral hires. Gauging the movement of partners by practice areas also reveals where firms are focusing their efforts for growth. Partners in the property & real estate and banking & finance practice areas were most in demand in FY18, as firms acquired expertise to capitalise on strong property deal flows and work arising from the recent banking Royal Commission.

Firms are also responding to changes in the market by investing in their innovation capacity, formalising the innovation role or establishing an innovation committee. Of the 50 largest law firms in Australia, 23 have formalised an innovation function by hiring or appointing an innovation specialist or by establishing an innovation committee.

Dedicated innovation roles at law firms are still a relative rarity in the market due to a combination of resource constraints and feasibility constraints.

**Australia’s LegalTech firms are growing in influence**

As one of the most competitively mature markets in the Asia-Pacific region, the Australian LegalTech market has been leading the way through the incubation of LegalTech start-ups and the adoption of LegalTech solutions.

The LegalTech ecosystem in Australia has been driven by a strong grassroots movement that saw the launch of Legal Hackers chapters in Brisbane, Perth and Sydney in 2017 and Melbourne in 2018, and the launch of the Australian Legal Technology Association (ALTA) in 2018.

LegalTech in Australia traces its origins back to 1988 when LawMaster, a legal practice management software provider, was founded. The market expanded rapidly between 2015 and 2018, as 60 new firms were established. As law firms grapple with challenges of innovating and adopting LegalTech solutions, education institutions like the Centre for Legal Innovation from the College of Law took centre stage to help law firm leaders navigate a highly fluid market.

General counsels are also supporting the emergence and growth of LegalTech. The Association of Corporate Counsel Australia has launched the Legal Tech Corner to provide GCs with simple and streamlined information on the ever-expanding LegalTech market. In addition, as mentioned earlier, CLOC has establishing a local presence in Australia for operations and technology professionals that work in legal departments to congregate and share best practice in legal operations functions.
**Multiple developments in a changing legal market**

A number of other forces are having a significant impact on the Australian legal market. First, the market has witnessed the rise of alternatives to the incumbent. NewLaw firms are businesses that use labour arbitrage at the centre of their business model in the delivery of legal services. Major examples of NewLaw firms include legal process outsourcing companies that leverage low-cost labour in offshore or onshore centres, lawyer secondment firms that provide contract lawyers to corporate legal departments and law firms, and fixed-fee legal service firms that use on-demand lawyers.

Second, since 2010, the Big Four accounting firms have announced their intention to grow their legal practice – this time with lessons learnt from failures of the past. Third, in recognition of the changing legal landscape, three of the eight law societies in Australia are responding. For example, the Law Society of New South Wales conducted a year-long study on the future of law and innovation in the profession in 2017 and has established its legal technology committee. The Law Institute of Victoria has also established its legal technology committee and is drafting research papers on the future of legal services. The Law Society of South Australia has established its own technology and law committee to examine the intersection of LegalTech and the law, and implications on regulation and lawyers.

Fourth, the market for legal education in Australia has also expanded rapidly in the last 25 years. In 1991, Australia was home to 11 law schools and that number has expanded to 41 institutions offering law degrees in 2018. While some scholars have parsed the social constructs that gave rise to Australia’s explosion of law faculties, others have made the more pragmatic observation that, following reforms in the 1980s, Australian universities began to operate as businesses. Whatever the reason, the result has been that we now have annual intakes of up to 16,000 law students at universities and other educational institutions in Australia.

Fifth, many of Australia’s regulatory bodies, including the Australian Securities and Investments Commission (ASIC), Australian Taxation Office (ATO), and Australian Transaction Reports and Analysis Centre (AUSTRAC) are proactively engaging with new FinTech, LegalTech and RegTech start-ups in a manner that embodies the Australian ‘give it a go’ ethos.

**Concluding thoughts**

The conclusions we can draw about the state of legal innovation in the Australian market stem from the eight stakeholders we have canvassed.

1. Buyers of legal services are increasingly sophisticated purchasers, thanks to swelling in-house counsel ranks and the application of business process improvement methodologies to legal processes.
2. Law firms are innovating their business models in attempts to differentiate in a hyper-competitive market. Much of this activity has manifested in M&A activity between firms and with lateral partner movements.
3. NewLaw firms are proving disruptive to the incumbents and are making steady headway into the wallet share of legal services clients. This has prompted many Australian law firms to create NewLaw-style service offerings, most of which deliver legal services or personnel to clients on an as-needed basis.
4. LegalTech firms are of strong interest to the market and are gaining good traction. This ecosystem has been driven by a strong grassroots movement that saw the emergence of Legal Hackers chapters in many capital cities in the last two years, as well as the launch of the Australian Legal Technology Association.
5. The Big Four accounting firms have firmly re-entered the legal market through lateral hires. They are also expanding into NewLaw and LegalTech segments quite rapidly.
6. Australian law societies are aware of, and in some cases keeping pace with, legal innovation activities in their jurisdictions that are having an impact on the way legal services are delivered and consumed.
7. Australian law schools are, similarly, acknowledging that change is afoot, and some are acting to align their curricula with the reality of legal practice in a post LegalTech environment.
8. Australian regulators are also alive to the changes that technology is bringing to regulation and to the application of law more generally. Many are working to shape regulatory frameworks to foster innovation, and to ensure that the Australian start-up economy is competitive, all while maintaining safeguards that protect the Australian population.

Each of these stakeholder snapshots combine to deliver a view of legal innovation that is also unfolding in other jurisdictions across the world. Australia operates within a legal framework that is conservative in its approach to change. While some within our industry may have misinterpreted the need for prudence as a licence for inaction, this view is under challenge, and often directly rejected by the buyer of legal services.

As innovation from new market entrants continues to deliver benefits to the consumers of legal services, we are seeing an industry whose incumbents are beginning to feel compelled to make changes to their service delivery models in order to remain relevant to their clients.

*Eric Chin is a Principal at Alpha Creates. He is a strategy consultant who works with law firms, listed law firms, LegalTech firms, NewLaw firms and corporate legal departments on strategy, M&A, market analysis, innovation and Asia.*
Graeme Grovum is a Principal at Alpha Creates. He is a legal technologist with 15 years’ experience in legal and financial services industries. Graeme has worked with one of Australia’s top-tier firms as Head of Innovation where he helped the firm through many innovation and technology initiatives.

Matthew Grace is a Principal at Alpha Creates. He is an innovation consultant with 13 years of professional experience in Australia and the UK working across different industries, including management consulting, financial services and the law.

www.alphacreates.com

Footnotes


4 Hyper-competition is a situation where incumbents in the market are unable to keep a competitive advantage long enough to extract extraordinary profits. This can occur because of a combination of very strong competition between companies, an evolving market, and relatively low barriers to entry.

5 Analysis and research by Joel Barolsky of Barolsky Advisors.

6 National Australia Bank, NAB Online Retail Sales Index: In-depth Report – September 2017, p.7; National Australia Bank, NAB Online Retail Sales Index: In-depth Report – September 2015, p.3


11 For more information about the Australian Legal Technology Association, you can visit the website: https://alta.law/

12 For more information about the Centre for Legal Innovation, you can visit the website: https://www.cli.collaw.com/

13 For more information about the Legal Tech Corner by the Association of Corporate Counsel Australia, you can visit the website: http://legaltechcorner.com.au/


17 In fairness to Mr Barker, he does not himself suggest reasons for the surge of law faculties, but invites readers to make their own assessments with the help of quoted observations such as this one from the Australian Law Reform Commission Report No 89: "Law faculties are attractive propositions for universities, bringing prestige, professional links and excellent students, at a modest cost compared with professional programs such as medicine, dentistry, veterinary science, architecture or engineering." See: Australian Law Reform Commission, Managing Justice - A Review of the Federal Civil Justice System, Report No 89 (2000) 117 [2,13]

18 We say 'up to' because it’s not clear (to us, at least). Our media claims that ~15,000 students graduate law school each year (see here: https://www.afr.com/business/legal/too-many-law-graduates-and-not-enough-jobs-20151020-gkdbx), while our Council of Australian Law Deans sharply retorts that the correct figure is only 7500 (see here: https://cald.asn.au/wp-content/uploads/2017/11/Factsheet-Law_Students_in_Australia-1.pdf ). Whatever the number, it is, in either case, referring to graduates and not new enrollees, which is certain to be higher.

19 FinTech stands for financial technology. FinTech are technologies and solutions geared towards automating and creating more efficient ways of providing financial services to the client.

20 RegTech stands for regulatory technology. RegTech are technologies and solutions that enhance the regulatory process for regulators.