2025 Report on the State of the New Zealand Legal Market

A welcome return to stability

Thomson Reuters Institute

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The past five years has been a turbulent period for law firms in New Zealand, marked by significant fluctuations in financial performance. From 2020-2021, firms experienced a remarkable surge in profit growth, largely driven by a boom in transactional[1] demand[2] that saw profits increase at about 20% compound annual growth rate (CAGR). This period of relative outperformance compared to other global regions ended sharply with a dramatic deceleration, with growth reversing into contraction from 2022-2023. With two consecutive years of reduced profits, firms entered 2024 with the challenging task of reversing declines and clawing back to the peak performance levels experienced just a few years prior.

Fortunately for many law firms, the momentum began to shift in 2024 as the region's key transactional practice areas seemed to reach a demand nadir and began to see improved results. Despite the first quarter seeing one of the weakest overall demand and fee[3] results since the Thomson Reuters Financial Insights dataset[4] began in 2019, performance improved dramatically over the second and third quarters of the year which resulted in an improved profit position by the end of 2024.

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Providing a backdrop for these improved results, the New Zealand economy is gradually finding its footing as well following a period of high volatility and uncertainty that was spurred by the global pandemic. In fact, many law firms seem to be on a similar path with more moderate levels of cost growth and expanding top lines. A resurgence in transactional demand, coupled with this overall stabilization, and an underlying improvement of key macroeconomic indicators, suggests that the legal services industry may be trending towards normalization. However, some doubts persist.

The past year could indicate that New Zealand law firms have weathered the worst of the post-2021 transactional bust, potentially bottoming out and seeking to rebound. If current trends continue, 2025 may see an even stronger return to profit growth and an increase in profits per equity partner (PPEP) more in line with pre-downturn levels as firms capitalize on their practice leverage. Along with that positioning, however, comes significant risk as firms in this region continue to be more vulnerable to macroeconomic factors such as interest rates, inflation, and geopolitical uncertainties.

1 For the purposes of this report, transactional practices include corporate general, banking & finance, M&A, real estate, and tax practices.

2 For the purposes of this report, demand is defined as total billable hours worked. Demand growth metrics report the year-over-year change in total billable hours for the average law firm during the period examined.

3 Fees, or fees worked, is a firm's total billable hours for a given period multiplied by the average worked rate.

4 Financial data for this report is provided by Thomson Reuters Financial Insights. Data is based on reported results from 11 NZ-based law firms.

Historical context

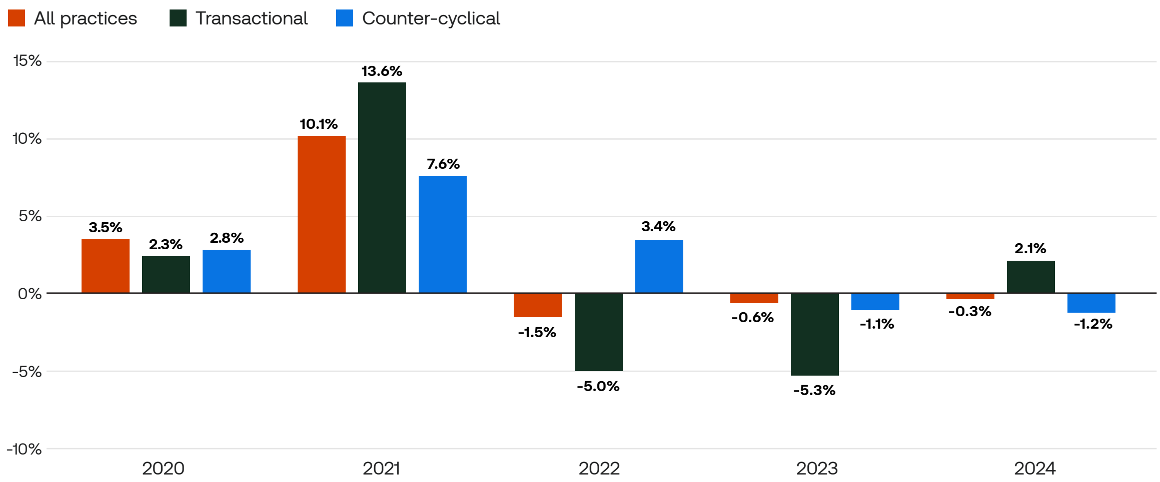
To fully understand 2024's results, it's essential to consider the recent historical context. In the two years of 2020 and 2021, New Zealand experienced average quarterly demand growth of 7.1% year-over-year. During this period, the region's demand and profit growth outpaced that of other regions such as the United States, Australia, and the United Kingdom by a substantial margin. However, following this period of rapid expansion, demand fell nearly as quickly as it rose, averaging a 0.8% contraction per quarter. These fluctuations were largely influenced by the performance of transactional practices, which peaked at 23.6% year-over-year growth in Q2 2021, and reached a low point of a 7.5% contraction in Q4 2022.

The swing in results for transactional practices was seen globally, but unlike other regions, New Zealand did not see the corresponding growth in counter-cyclical[5] practices from 2022 through 2023 that buoyed other legal markets around the world. This, in combination with expense growth that had leapt by 29% since the start of 2020, resulted in two years of profit, PPEP, and profit margin *declines* that left New Zealand law firms in a difficult position heading into 2024.

FIGURE 1:

Demand growth from 2020 to 2024

Year-over-year change



Source: Thomson Reuters 2025

Economic backdrop

Over the past three years, GDP growth in New Zealand has shown considerable volatility, with swings exceeding 6 percentage points annually. Now, projections indicate that GDP growth in the country is set to stabilise, likely to average around 2.3% in the coming years — which would be a higher mark than three out of the last five years. And inflation is trending towards the target rate set by the New Zealand Central Bank, leading to a forecasted decline in interest rates, which are expected to stabilize between 2% and 3%.

Together, these economic factors have contributed to a more normalized level of demand growth, particularly in interest rate-sensitive areas like transactional practices which provide the bulk of hours in New Zealand. Additionally, costs of providing legal services have normalized substantially, leaving firms ripe for margin expansion should top line growth continue.

5 For the purposes of this report, counter-cyclical practices include dispute resolution, workplace relations, insolvency, and insurance defense practices.

2024's return to normality

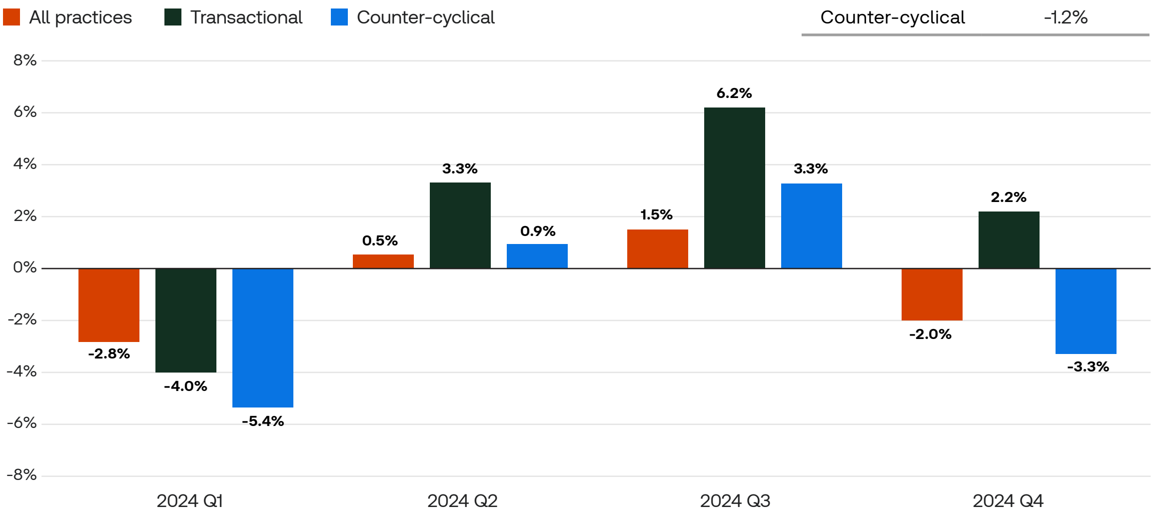
Although fortunes for the broader economy generally, and law firms specifically, began to turn in 2024, it was not immediate nor consistent. The legal market initially faced a broad downturn in Q1, but transactional practices spurred a recovery in the following quarters, leading to growth, particularly in Q3. However, this momentum cooled in Q4 primarily due to a decline in counter-cyclical demand, resulting in full fiscal year performance in 2024 that was essentially flat compared to 2023.

FIGURE 2:

Demand growth in 2024

Year-over-year change

Practice	2024 vs. 2023 Demand Growth
All practices	-0.3%
Transactional	2.1%
Counter-cyclical	-1.2%



Source: Thomson Reuters 2025

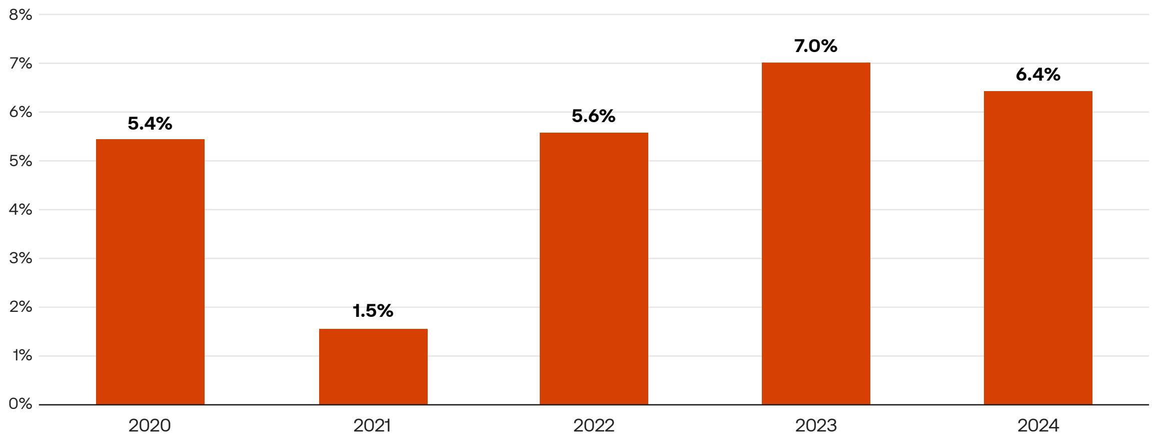
Outside of demand, 2024 saw another year of relatively strong worked rate[6] growth. Firms increased their worked rates by 6.4%, which expanded on top of the previous year's rapid increase of 7.0%. While it was technically a slowdown in growth from the previous year, this growth-on-top-of-growth suggests that the region's law firms are in a healthy position regarding their pricing power. This position is further underscored by the fact that 2024's worked rate growth was not accompanied by significant changes in realisation. In fact, the average firm improved both their worked and billed realization rates against standard rates compared to the previous year. Indeed, despite the roller-coaster journey of demand over the past four years, rate growth has provided a positive stabilizing force within the industry. This stability, coupled with the year's more normal demand, resulted in moderate revenue growth of 3.4% for 2024.

6 Worked rates are the negotiated rates as determined by the matter value. Worked rates are often referred to as agreed rates.

FIGURE 3:

Worked rate growth

Year-over-year change



Source: Thomson Reuters 2025

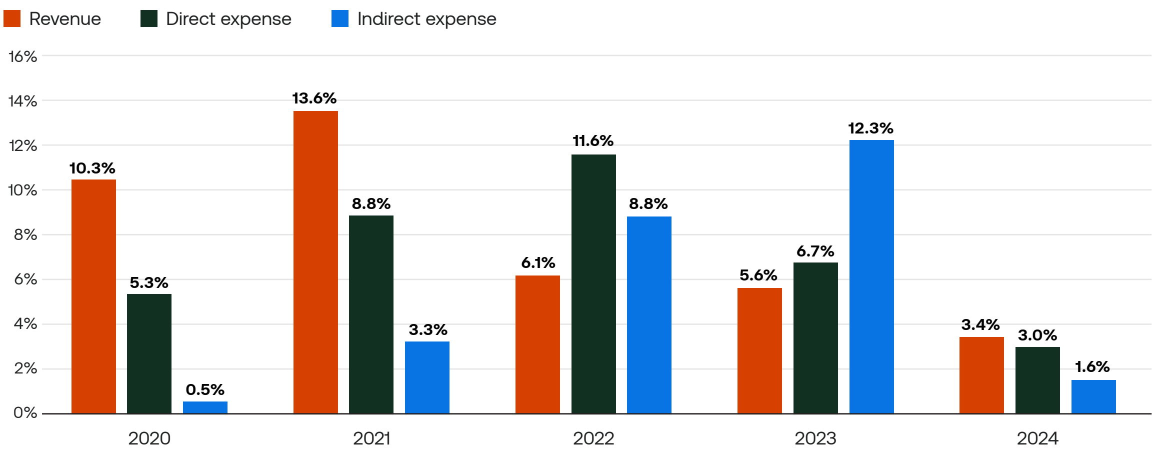
While law firms' top lines began to improve in 2024, perhaps the most significant factor for firms returning to profit growth was their improvements in expenses. Direct[7] and indirect[8] expenses increased by 3.0% and 1.6%, respectively, which was the first time since at least 2019 when both categories grew by less than 5%. The slowdown in indirect expenses, was especially notable, as it was a significant decline from the 12.3% pace of growth set in the previous year. This improvement was driven by pullbacks in recruiting and marketing & business development costs, while other areas simply maintained spend levels reached in 2023.

Direct expenses slowed from the previous year as well, largely as a result of slower direct expenses-per-lawyer growth. In 2024, direct per-lawyer costs increased by just 1.8%, compared to 10.1% and 5.6% growth seen in 2022 and 2023. Within this much slower growth, most of the direct per-lawyer cost growth came from increases in compensation to lawyers above the associate class, as associate compensation actually declined by 0.9%.

FIGURE 4:

Revenue & expense growth

Rolling 12-month change



Source: Thomson Reuters 2025

7 Direct expenses refer to those expenses related to fee earners, primarily the compensation and benefits costs of lawyers and other timekeepers.

8 Indirect (or overhead) expenses refer to all other expenses of the firm, including occupancy costs, administrative and staff compensation and benefits, technology costs, business development expenses, and more.

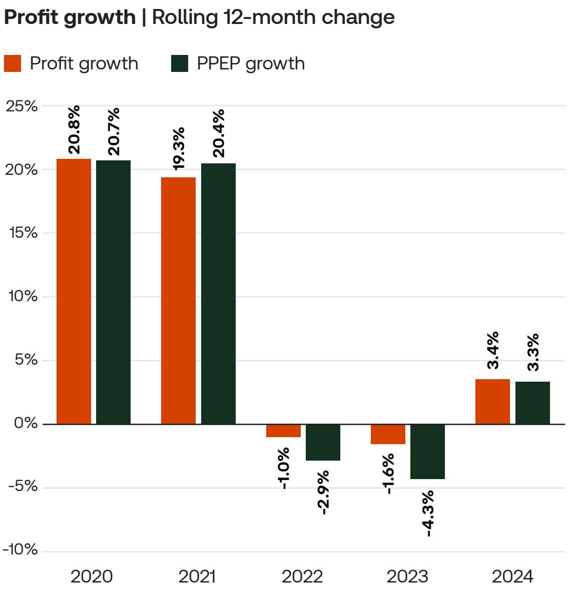
Firms are back in profit growth mode

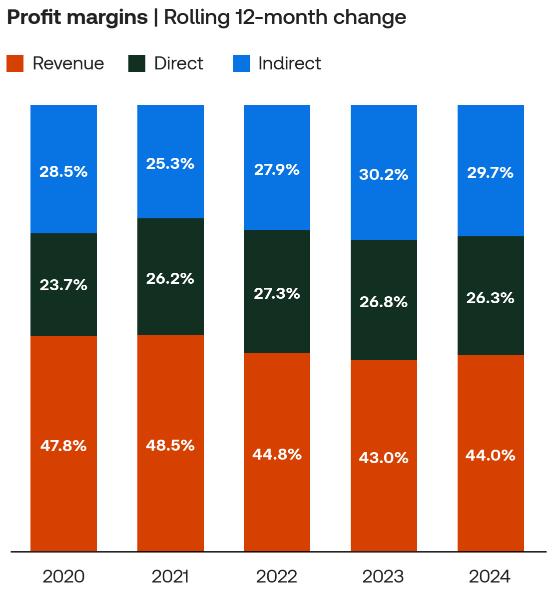
With expense growth under tighter control, law firms in the region enjoyed an average 3.4% increase in profits in 2024, compared to the previous year. This comes as a relief, and has largely reversed the effects of the past two challenging years, during which firms faced a harsh demand and expenses environment that led to a combined 2.6% *decline* in overall profits from 2021 to 2023.

During this difficult two-year period, margin compression became a larger concern. Profit margins fell to 43.0% in 2023, from 48.5% in 2021, primarily due to the simultaneous slowdown in revenue growth and uptick in indirect expense growth. Indeed, indirect expenses as a percentage of revenue increased by nearly 5 percentage points during this time. Despite these challenges, profit margins among New Zealand law firms have consistently been high compared to other regions. Even with 2023's 43.0% margin, the average profit margin for the region's firms surpassed the averages seen in the US, Australia, and the UK. That said, slowed expense growth in 2024 is now helping to stem any further declines, with the average firm in the region seeing a full percentage point improvement up to 44.0%. This positive trend helped translate into a 3.3% growth in PPEP through 2024.

FIGURE 5:

Profit growth & margin





Source: Thomson Reuters 2025

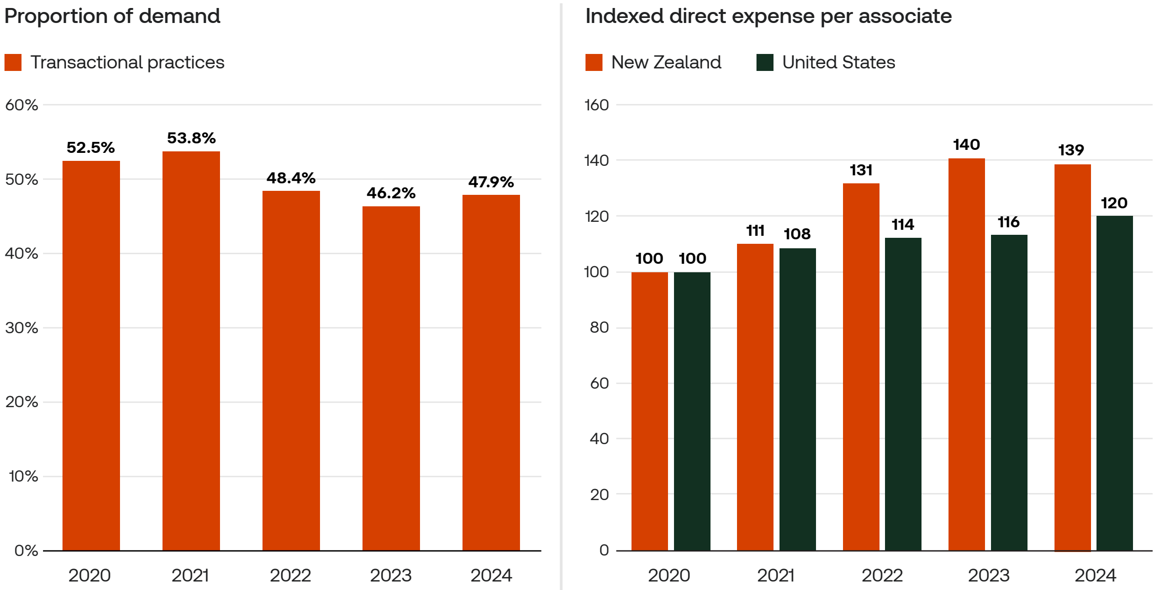
The positive momentum in demand, along with stable growth in rates and expenses, suggests a promising outlook for New Zealand law firms as they head into 2025. However, it is important for firm leaders to remain cautious, as potential risk factors could still impact this positive trajectory.

Possible volatile results going forward

As New Zealand law firms look to the future, they must brace for potential volatility in their financial results. The main structural concern for New Zealand firms is their heavy reliance on transactional demand to drive performance. Transactional practice work constitutes nearly half of the average New Zealand firm's worked hours, which is noticeably higher than other global regions such as Australia or the United States. More importantly, more than half of New Zealand's lawyers operate in transactional practice areas, which suggests that the region's focus on these practices is essentially built in rather than cyclical. This higher concentration of hours and capacity in these areas magnifies New Zealand firms' performance during favorable conditions, but also exacerbates their underperformance when times are tough.

FIGURE 6:

New Zealand firms are positioned for volatility



Source: Thomson Reuters 2025

As mentioned earlier, there are encouraging signs that transactional demand may improve in 2025, with potential declines in interest rates, an increase in M&A deals, and growth observed in other regions over the past few quarters. This could lead to New Zealand firms outperforming global firms next year — however, the inherent volatility of these results cannot be overlooked.

Another factor contributing to potential volatility is the still-elevated level of compensation for firm associates. The *war for legal talent* period of 2020 to 2022, was more intense in New Zealand than in other regions, resulting in a 31% increase in per-associate compensation (both junior and senior roles) during that time. If the market picks up again and faster headcount expansion is necessary, the cost of acquiring additional talent will be significant.

Conclusion

In 2024, law firms within the New Zealand legal market navigated a landscape of recovery and renewed growth, marking a significant shift from the challenges faced in previous years. After a period of volatility, the market has seen demand and expenses mostly stabilize, which has facilitated a return to profit growth. This resurgence is a positive indicator for law firms that have endured difficult economic conditions and margin compressions, offering hope for continued financial improvement.

However, the road ahead is not without its challenges. The reliance on transactional demand, while beneficial in periods of economic expansion, poses a risk of volatility, especially during times of economic hardship. This dependency underscores the need for strategic diversification of legal work to mitigate the impacts of cyclical downturns. Further, elevated compensation levels, especially for associates, continue to place pressure on firms' financial structures, necessitating careful management to ensure sustainability.

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Agility and adaptability remain crucial for sustaining momentum in this market; firms must be prepared to navigate shifts in the business cycle and adjust their strategies accordingly to maintain profitability. As the industry continues to evolve, the ability to balance growth with cost management will be crucial in sustaining the positive momentum gained in 2024.

By leveraging the lessons learned from recent years and maintaining a focus on strategic growth and efficiency, New Zealand's legal market can continue to thrive, even amid uncertainty. The foundation laid in 2024 offers a promising outlook, but vigilance and flexibility will be key for firms to capitalize on emerging opportunities and weather future challenges.

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