



VALIDATUM®

CONTEMPORARY LAW FIRM PRICING
CHALLENGES & SOLUTIONS

GOVERNANCE & CONTROLS

ISSUES

Absence of pricing governance

Turnover vs Profit

COMMENTARY

Despite being the most important of the profitability 'levers', law firms' historical approach to pricing has often been ad hoc, relatively unstructured and lacking a coordinated firm-wide macro approach to pricing policy and execution.

Moreover, pricing tends to have been poorly resourced, characterised as an administrative function rather than a skill and levels of pricing autonomy have been accorded to fee earners to an extent that would be intolerable in other professions and fields of commerce.

Some firms suffer from a preoccupation with turnover at the expense of profit. There can be a number of reasons for this, some of which have more commercial legitimacy than others. For example:

- A desire to maintain or enhance an industry ranking based on turnover.
- Too many 'show pony' clients who look good on the firms' CV but whose work is marginally profitable.
- A desire, particularly over the last four years to keep a skilled workforce intact and avoid redundancies by taking on work that barely breaks even or is marginally profitable.

SOLUTION

Generally speaking a reverse engineered approach is best. The firm needs to consider its broader strategic objectives and then postulate what role pricing must play in driving those outcomes.

The best results are achieved when there is a seamless vertical integration between the strategic and policy settings developed by the firm's Board, down through the finance and marketing functions and ending with the lawyers at the 'coalface' who are the ones ultimately responsible for having the pricing conversation with clients.

Generally speaking, three things need to occur to address this issue:

- Financial education of the partners. We do not intend this comment to be pejorative but the fact is that financial literacy amongst law firm partners is highly variable.
- Revisiting at a strategic and philosophical level the relative importance to the firm of size, turnover, rankings, profitability etc.
- A sustained and committed investment in analytics capability.

ISSUES

Sub-optimal analytics capability

Price and market position disconnect

COMMENTARY

Historically, profitability margins on most legal work were such that there was little need for precision. Since 2008, margins have been savagely squeezed with the result that firms can no longer indulge a 'near enough is good enough' approach to managing margins.

Firms must now have a deep and robust understanding of precisely what profit/margins are generated by specific practice areas, teams, individual practitioners, individual clients and individual files.

There is a generally low level of understanding of the relationship between a firm's macro pricing strategy (if indeed it has one at all) and its market position strategy.

Marketing, branding, business development and pricing do not stand in isolation. There is a particularly strong nexus between pricing and marketing, and pricing and business development. In the last four years, many firms' pricing strategies have actually undermined its marketing and business development strategies and in so doing, damaged or diluted the firm's brand.

SOLUTION

Many firms have realised the importance of this and have endeavoured to fill the information gap. However, the law firm practice management software industry has until recently been slow to respond to this need.

As a result, firms have variously made do with spreadsheet functionality or internally developed bespoke software, neither of which in our view is particularly satisfactory.

Fortunately, there are now off-the-shelf products available that can also be customised for the firm's particular needs and where there is a demonstrable return on investment.

Everyone within the firm, including governance, management and the execution level (lawyers having pricing discussions with clients) need training to understand the interrelationship of these disciplines.

Lawyers working with clients in particular need to be assisted to develop a clear understanding of what messages the firm's pricing strategy conveys about the firm and about them personally. Lawyers can't be expected to manage something they don't understand.

ISSUES

Poor pricing induction

Misaligned reporting dashboard and meritocracy structures

COMMENTARY

Because pricing has historically been seen as primarily an administrative function (that is to say, a function of simply billable time multiplied by charge out rates), rather than a skill, there has been no perceived need to invest in pricing training.

Consequently, to the extent to which anyone in a law firm learns anything about pricing, it is by a process of informal osmosis and the passage of time; typically many years.

Most law firms have developed reporting dashboards that are intended to serve two primary functions; first, a diagnostic health check on the financial performance of the firm and second, to provide a number of important metrics that constitute essential elements of individuals performance reviews, remuneration and promotion.

However, a number of these metrics have the effect of driving sub-optimal pricing behaviour and in the worst cases, encouraging bad behaviour; for example, manipulation of time sheets to achieve a preconceived pricing outcome.

SOLUTION

Most firms have some level of new lawyer induction structure. To the extent to which this does not exist, there is obviously merit in doing so but the absence of an overall induction process should not be seen as an impediment to specific pricing induction/training.

Unfortunately, where pricing training and induction does exist, it often only serves to perpetuate less than optimal pricing practices and attitudes. It is therefore essential for firms to invest in putting their house in order with existing partners and staff first before attempting to introduce a pricing induction/training regime, whether for relatively junior lawyers or lateral partner hires.

Organisational psychologists have long taken the view that the people working in an organisation will behave in direct response to the way that they are reported upon, recognised, rewarded and remunerated. Not a difficult concept to grasp.

Firms need to take a critical look at their current reporting dashboard in order to develop a very clear understanding of what pricing behaviours current reported metrics are driving.

Most firms will find that undertaking such an exercise will disclose unsatisfactory pricing behaviours that have their genesis in current reporting regimes. Although it is a little simplistic, the answer lies in deciding what behaviours are desirable and then measuring and reporting upon those.

FACTORS “AT THE COALFACE”

ISSUES

Pricing: administrative function or a skill?

COMMENTARY

We have undertaken numerous firm specific surveys from which we can say with certainty that in excess of 90% of law firm partners consider pricing to be a skill rather than simply an administrative function. However, we have also concluded that while this acknowledgement occurs at an intellectual level, it does not manifest itself at a practical level.

If one acknowledges that pricing is a skill, then one must also acknowledge a number of other inevitable conclusions including; some will be good at it and some will be very poor at it and all will benefit from training and endless practice.

The failure to do so will result in firms consistently underperforming financially, irrespective of any other initiatives that may be successfully implemented.

SOLUTION

Lawyers need to substantially up skill in relation to pricing. Pricing is a curious amalgam of a variety of recognised mainstream academic disciplines including cost accounting, economics (macro, micro and behavioural), statistical analysis and psychology. An understanding of the rudiments of these disciplines is a necessary precursor to the development and deployment of industry specific pricing strategies that are fit for purpose.

The deployment and execution of those pricing strategies by individual practitioners is an enormous challenge. Unless a law firm makes a strategic decision to centralise the pricing function (which creates as many problems and challenges as it solves), there is no substitute for individual lawyers learning the requisite pricing skills.

ISSUES

Too much price autonomy, too little accountability

Inter service pricing – necrotising fasciitis

COMMENTARY

It is difficult to call to mind another trade, industry or profession that vests so much price decision autonomy in non-owners of the business.

When this is combined with a lack of pricing skill and capability, a lack of pricing training and a lack of pricing collateral and resources, the result is amongst other things, huge variations within the firm.

Moreover, variances in pricing and price negotiation capability result in some lawyers securing significantly better rates and better margins than others; not necessarily because that outcome is justified from a commercial or any other perspective but purely because of these variations in pricing capability and autonomy.

This is an issue that is particularly prevalent within mid-tier and large/international firms. Pricing differentials between different parts of the firm are a sufficient challenge in their own right but the situation is often severely aggravated by a lack of internal communication and the presentation of fait a compli pricing structures by one lawyer to another.

This can result in significant professional resentment and the unwarranted and unnecessary erosion of margins; essentially internal cannibalism of margins.

SOLUTION

The trick here is to find the most judicious balance between undue decentralisation that results in a loss of control and too much individual autonomy, and conversely, too much centralisation that results in operational inefficiencies.

Firms can benefit from the implementation of:

- A more rigorous pricing chain of command.
- A more structured approach to pricing committees and other supportive internal infrastructure.
- Greater individual and Service/Sector accountability for gross margins.
- A complete reconsideration of mandates and criteria for write-offs and any other discounting manifestation.

The answer lies in part in the more rigorous development of operational policies that articulate an intolerance of this sort of conduct.

A more structured approach to internal communication, developed and enforced by a properly mandated and resourced pricing committee goes a long way towards addressing this issue.

ISSUES

Bespoke legal solutions but no bespoke pricing solutions

COMMENTARY

The debate over the legal professions dependence on hourly billing has raged for the last 10 to 15 years. While there is disagreement about the pace at which it will give way to alternatives and what those alternatives will be, few would now disagree that clients are in various stages of disillusionment with hourly billing as one of the few pricing strategies that firms are able to offer.

In contrast with many other industries, professions and trades, the legal profession has one of the most unsophisticated and unimaginative approaches to pricing strategy. To be fair, this is hardly surprising since a historical lack of commercial impetus, a lack of interest from lawyers and clients and a lack of any pricing training (theory and practical) has not exactly created fertile ground for innovation.

As technicians, lawyers are adroit at developing bespoke technical solutions for their clients’ legal and commercial needs. In future, to satisfy the increasingly diverse expectations of clients, lawyers need to become equally adroit at developing bespoke pricing solutions.

SOLUTION

The failure to treat and resource pricing as a skill as detailed in a previous section has resulted in amongst other things, an unwillingness and an inability to develop a suite of pricing strategies. Consequently, practitioners are extremely limited in the range of pricing options they are able to provide clients.

The ability to develop and deploy a wide range of task specific and client specific pricing and payment strategies (of which hourly billing should be but one), invariably serves to mitigate the confrontational and adversarial nature of pricing discussions and gives the lawyer the confidence and skills with which to undertake a far more granular and nuanced pricing discussion.

However, firms need to first invest in pricing training and resources before they can begin to develop a suite of pricing strategies and encourage their lawyers to use them.

ISSUES

Lack of price negotiation skills

Lack of pricing collateral & resource

COMMENTARY

There is an inescapable irony in the fact that whether a lawyer is a litigator, or an M&A, finance, banking, family or private client specialist, we spend our entire legal career successfully advocating and negotiating on behalf of our clients, yet many lawyers are only moderately effective when it comes to negotiating their own fee.

There is a deeply flawed assumption that it is appropriate for all lawyers in a firm or at least all partners to have a large amount of autonomy when it comes to pricing. This assumption is predicated on another equally flawed assumption and that is that all partners are good at pricing.

Most firms lack much in the way of internal or external pricing collateral or resources.

Mastering pricing skills and knowledge together with the ability to negotiate price effectively will only achieve optimal outcomes if combined with precedents, templates and other collateral that supports effective pricing execution.

SOLUTION

As with all aspects of pricing, price negotiation is a skill. There is no doubt that some individuals possess personality traits, oral and written communication skills, age, wisdom and experience and other natural advantages.

However, one of the key elements to successfully price negotiation is confidence. Confidence comes from understanding and learning pricing theory, tooling-up with good pricing and analytics information and collateral followed practice ad nauseam.

Price negotiation is a skill that needs to be learned and mastered by every lawyer that is charged with the responsibility of pricing interactions with clients.

Firms need to implement a program of developing materials that support the pricing function. Necessarily some of these will be internal process, analysis and diagnostics material and some will be external.

Infographics can be a very effective method of communicating multi-faceted pricing information and choices to clients. Therefore, if the firm has internal marketing capability, these people should be involved in the development of the external pricing collateral.

ISSUES

Poor understanding of clients price drivers

COMMENTARY

Most lawyers say that they know their clients and the market and that they have an intuitive feel for what the client and the job will stand.

There is of course some truth in this but the customary lack of objectivity in the process and indeed the lack of any process will often compromise pricing results.

In our experience, even the most experienced partners cede margin unnecessarily through a lack of empirical understanding of the clients' pricing drivers.

SOLUTION

The development and consistent deployment of recognised pricing techniques such as price sensitivity analysis and price elasticity assessment should be undertaken long before any consideration is given to the fees to be charged to a particular client on a specific job.

In other words, individual lawyers must have the skills to price the client before pricing the job.

CLIENTS

ISSUES

Mutual information asymmetry

COMMENTARY

Simplistically, many of the pricing problems that exist between lawyers and their clients could be said to have their roots in poor communication.

Lack of communication which results in information asymmetry manifests in poor decision-making by both sides as important pricing and pricing related decisions are made on the basis of assumptions and inadequate information.

The result is pricing tension and suspicion, an unwillingness and/or inability to recognise, allocate and quantify price risk and the all too frequent end of job discussions around misaligned expectations and what quantum of write-off is appropriate.

SOLUTION

Our extensive experience in the pricing field leaves no doubt in our minds that a more interactive engagement of the client in the pricing process and greater transparency will invariably produce higher revenue and better margins and just as importantly, more satisfied clients.

Many lawyers are uncomfortable with this, taking the view that it is the firm's prerogative alone to determine pricing and that if one accepts that we are obliged to have a price negotiation with clients then information asymmetry should work to the firm's advantage. However, the current evidence would suggest otherwise.

A firms' pricing model should seek to largely eliminate information asymmetry. Doing so will invariably result in higher revenue, better margins, higher realisation rates, less pricing tension and conflict and more satisfied clients.

ISSUES

Incomprehensible engagement documentation

COMMENTARY

Most law firms' client engagement and pricing documentation is the antithesis of client communications best practice. The content is largely if not solely driven by compliance and risk management considerations with the needs of the client often being an afterthought.

As a result, law firms have often already alienated clients before they even get to the issue of pricing quantum.

SOLUTION

Without detracting from the need for or the importance of regulatory compliance and risk management, there is a great deal that can be done to make this phase of the process more client-centric.

While many would see this a worthy pursuit in its own right, there is a very important ancillary benefit and that is that our research shows that clients are more likely to accept a fee if it has been communicated the right way.

There is much that can be done to satisfy compliance and risk management issues while at the same time de-emphasising them in client communications and addressing the real issues that occupy clients minds namely:

- What are you going to do for me?
- What aren't you doing for me?
- Who is going to do it?
- When will it be done by?
- How much is it going to cost?

Some firms will say that they are doing this already but this often misses the point that it is not simply what information is communicated but how it is communicated that will significantly impact the outcomes of a price negotiation (see comments above about pricing collateral).

ISSUES

Lost business development capability

General Counsel & procurement

COMMENTARY

Most firms pricing strategies, to the extent to which any such strategies exist and are articulated, have been almost entirely focused on the preservation of existing client relationships. In other words, pricing strategies have been largely defensive and reactive.

In so doing, most firms have failed to grasp the fact that the development and deployment of sophisticated bespoke pricing strategies, tactics and options have the capability to constitute a central plank in a firm's business development strategies.

Put another way, smart pricing can be used as both a shield and a sword.

Many of the comments above under 'lack of price negotiation skills' apply to the rise of the power of in-house/General Counsel/procurement in relation to the purchase of legal services.

SOLUTION

For most firms, this will be a medium-term issue as the firm cannot hope to incorporate smart pricing as a business development tool until it has mastered the skills, put in place the requisite policies, governance and infrastructure and successfully deployed these with its existing client base.

They said, it is quite possible to begin this process in a tentative way after six months.

The success of this kind of business development strategy rests on the ability of individual (usually senior) fee earners to initiate conversations with prospective clients using the firms' extensive and sophisticated pricing repertoire as the icebreaker.

To engage effectively and forcefully with these 'professional' buyers of legal services, a whole new set of skills and tools are required ranging from behavioural diagnostic tools to understanding the different tactics required depending on which of the three categories of procurement sophistication the 'buyer' falls into.

The quality of the outcome is directly proportionate to the amount of preparation that precedes these discussions/ negotiations.

ISSUES

Un-triaged RFP Responses

COMMENTARY

In late July, LexisNexis® USA conducted a survey to attempt to quantify law firm RFP response efforts.

A surprising number of the survey respondents simply did not know the level of RFP activity under way at their firms. With 359 participants, almost 41 percent were unable to answer the first question quantifying monthly RFP activities.

Firms are devoting substantial resources at considerable cost to responding to RFPs and their ilk. As with any significant business development activity and indeed with any significant cost, the firm should have a good handle on the ROI of that time, effort, money and other resources.

SOLUTION

Many firms should never touch many of these invitations or temptations with the proverbial 40-foot barge pole. And if you are minded to do so, you should make sure that you are not being forced to do so on a platform of information asymmetry.

It is important to ask some reasonable questions that are designed to help you understand whether you are a serious contender or just someone else's play thing. Without this information you will never know whether you have a genuine chance or whether you have simply been brought into the process to drive down the preferred incumbent's pricing or to unwittingly participate in some charade.

Firms could save themselves a great deal of time, effort and cost and improve their strike rate by being a little more discriminating about which ring they throw their hats into once an 'opportunity' has passed your triaging process.

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