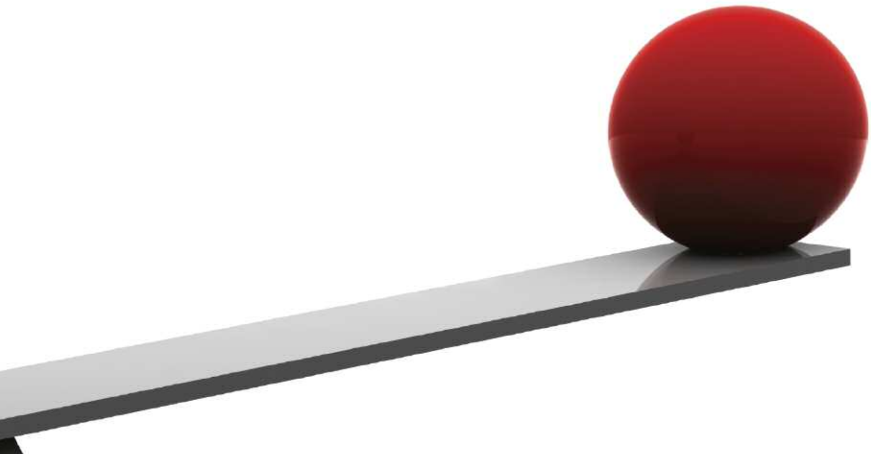
Regain Control of Pricing:

7 Tactics for Law Firms in 2011

In a growth industry, the sellers of services are always in a position of power when setting price. The recession, however, has shifted that balance of power to the benefit of the buyers of legal services. Law firms need to deal with some major pricing issues now or risk never regaining a level playing field for selling legal services.

By Ed Wesemann



For years, law firms and their clients alike have understood the inherent problems with the way law firms charge for their services. But for lawyers, charging by the hour is simple, requires little judgment or management, and effectively shifts the risk of inefficiency to the client. For clients, even those who are themselves lawyers, the legal process in America is a black science and attempting to relate outcome, or even activity, to price requires an effort that few general counsel have been willing to make.

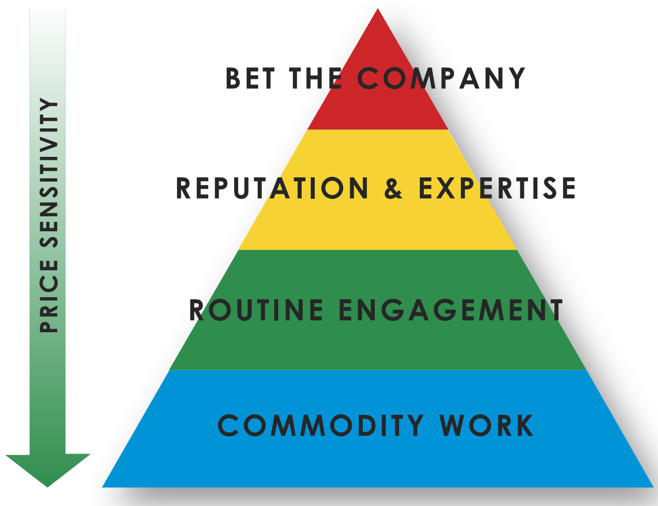
Further, the desire for confidentiality has limited clients' willingness and ability to trade much information about fees. And for many in-house legal managers, becoming too involved in the manner in which legal work is performed or the direct management of the lawyers who provide the services could result in the need to accept some level of accountability for costs or outcomes. And so the process of billing by the hour has gone on for decades.

Then along came the recession. The demands for efficiency by the boards of sophisticated corporate buyers of legal services empowered and motivated their in-house counsel to question fees and shop services among vendors. At the same time, law firm managers saw the potential for massive amounts of empty plates among their lawyers. Without the foundation of a pricing or cost model to fall back on, responding to the demands of clients was characterized by one firm as: "The answer is yes — now, what's the question?"

Now the dust is settling, and general counsel are starting to become aware of this new empowerment and ability to assert control over virtually every aspect of law firm relationships. Collectively, this is manifesting itself in developments like the ACC Value Challenge and the drive toward alternative billing.

Here are seven tactics that law firms can use to maintain a level playing field in working with clients to set price.

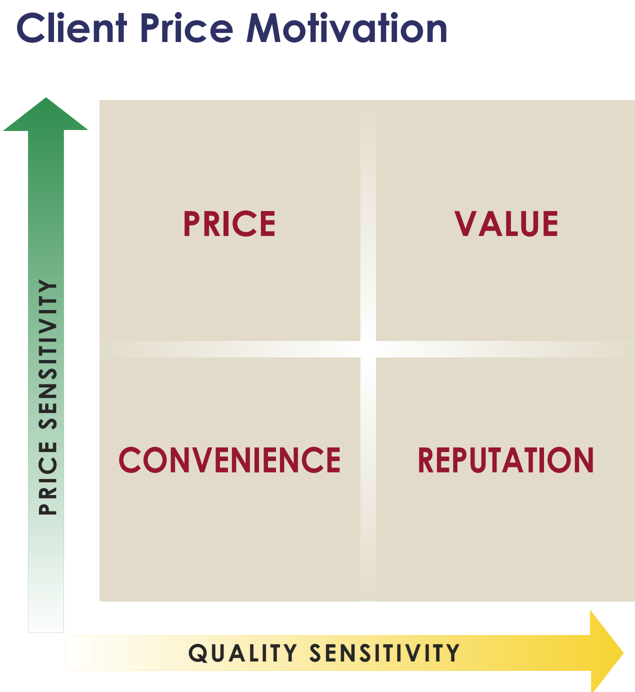
The Value of Legal Services



1. Understand the Value of Your Services. Within every law firm, there is a hierarchy of services, ranging from "bet-the-company" specialties performed by lawyers with few peers in your marketplace to commodities that could be performed equally well by just about any law firm in the city. In most firms, pricing is driven by the lowest common denominator, causing discounted prices for premier practices. Using a value pyramid, identify those practices where your firm has a unique capability (and honestly assess how unique it truly is). In most firms, that pyramid falls into four categories: 10 percent of practices are at the highest level, 15 percent at the next-highest level, and 75 percent are in the lower half. Oscar Wilde said, "These days, man knows the price of everything and the value of nothing." Develop a communication and invoicing system that ensures that clients understand the value involved in your services.

2. Proactively Introduce Alternative Billing. Gaining control sometimes means recognizing those elements that are beyond your control and positioning yourself to take advantage of them. Alternative billing might turn out to be precisely such a situation. Fixed- and contingent-fee billing can be tremendously attractive to both the law firm and the client, if introduced for appropriate matters. Introducing a form of pricing other than hourly billing can permit the law firm to control the circumstances in which it is used and give it a first-mover competitive advantage over other firms that may be working with the same client.

3. Rebuild Your Cost Structure. Most firms' response to the reduced availability of work and the squeeze of profits has been to cut operating costs and lay off associates. Here's a better alternative, especially for law firms that have watched their practices become increasingly commoditized: reconstruct the way your firm provides services, from the ground up. Firms that consider rebuilding themselves have been primarily concerned with the reaction of clients and law school recruits. But the experience in other industries that have retooled in this recession has been customer enthusiasm. As for law students, do firms really think that a reconstruction of their practice is going to have a worse impact on their reputation than layoffs and deferrals? Put everything on the table, including your office locations, your use of part-time and telecommuting lawyers, off-shoring, etc. Then reevaluate your pricing in light of your revised cost structure. The more your practice has slipped down the value pyramid, the more important this price restructuring will be.



4. Segment Your Client Base. All clients have some level of price sensitivity. For some clients, selecting counsel is all about price and has little to do with quality or capability, typically the case with commodity services. But most clients try to balance the highest capability with the lowest price. There are even clients who view price as a measure of quality and seek the best lawyers possible by paying the highest prices. Finally, there are "convenience clients" who, due to urgency or other special circumstances, are willing to be less aggressive on pricing than they would normally be. By taking the time to identify each client's circumstances, a firm can develop pricing that is flexible enough to match client satisfaction with firm profitability.

5. Dump Margin Busters. Even after you have taken aggressive action to rationalize your pricing, there will be some clients that are so price-sensitive that it is impossible to profitably handle their matters. Responding to a demand for fixed-fee pricing on complex cases with highly unique circumstances, or getting into hourly-rate bidding wars with other law firms, can be financially devastating. Worse, going after every piece of work, regardless of the fee structure, establishes a downward price spiral that will eventually destroy a firm. There are some clients whose extreme pricing demands your firm simply cannot meet. The sooner you recognize that fact and tell them to take their business elsewhere, the less money your firm will lose on them.

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6. Create a Loyalty Program. Use pricing to encourage stronger client relationships and to generate more business. Traditionally, law firms have looked at the pricing model upside-down from other businesses. Lawyers tend to charge their highest rates to their largest clients, while giving large discounts (either directly in fees or through write-downs of time or receivables) to small clients. Consider incentives for your largest clients like "most-favored-nation status," whereby no client receives a lower fee than a major client who gives the firm a lot of profitable work. CMS Cameron McKenna offers special discounts to clients that give the firm all their legal work.

7. Do Some Cost Accounting. Design a cost accounting model for your firm that allows your lawyers to make rational pricing decisions. The standard of profitability on pricing in most law firms is whether the firm achieved standard hourly rates — anything less is considered a loss and anything more is considered a premium. Instead, understand your break-even point at reasonable lawyer capacity levels. This doesn't take a big consulting study — odds are your CFO has already developed a cost model, but never saw any receptivity to the concept in the firm's management.

None of these tactics are magical. But until law firms address their basic pricing strategy and the fundamental models of how they want to charge for their services, they will constantly be in a defensive position when working with aggressive clients. It comes down to the old standbys of understanding what clients want and figuring out how to give it to them at a price that provides your firm with a fair profit.

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