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Chapter 7:

How a sound matter pricing strategy can elevate law firm profitability

By Jack Kingston, account manager, BigHand

In my 20 or more years of working with the legal industry and supporting its financial leadership, no subject has come to light more often than elevating profitability. Firms are looking for advanced data to better understand their business and how they can make their firms more profitable. Advanced BI and software programs are coming to the forefront to help firms digitize their data and reporting initiatives, resulting in better use of time through advanced data visualization. Getting this data to the stakeholders is important to the leaders in the finance function, in terms of data enablement and preserving their sanity by not being asked to create ad-hoc reports. One can only measure what one can see, and firms seek to enable their stakeholders with data to make sound business decisions. Firms continue to evaluate profits based on client, department, fee earner, and practice group levels, using various methods of proper profit calculation (like FTEs or just hard costs). This is a direction of travel and forward-thinking firms are already there, but a lot of firms are still focused on vanity metrics like billable hours/revenue, whereas profit is much more important.

One highly used analogy is that revenue is vanity and profit is sanity. There is no right or wrong way to automate a profitability journey, it just must be defensible and make sense to the firm. The hard costs of a resource are quite simple to quantify, like salary, 401K, and benefits calculation. Where firms struggle is when considering if they look at profit as a combined firm or if they'd like to do it by office location. Considering the cost of real estate is much higher in a major US market like New York or San Francisco vs an office in Nashville or even Boise, Idaho, there is much to consider. Would the Boise office exist without the national presence in New York? Or should Boise be treated as a true satellite office without consideration of the larger costs of the New York flagship office? You can see a case for either scenario, but firms must be diligent about their understanding of the profit metrics. These are just a couple of high-level examples of what law firm leadership is looking at when considering their profit calculations.

One major blind spot – is the work you are doing making you money?

No other area of the business of law has seen more attention to profitability metrics than at the matter level, where firms are looking at staffing and rate structure costs. Oddly, a pricing strategy within legal is a relatively new phenomenon, despite sounding like a very logical starting point when onboarding a new piece of work. Gone are the days when a lawyer or legal assistant would price a piece of work in a vacuum or provide a low rate "just because" or for legacy reasons. Firms need to get in touch with their data to maintain a sound culture of profitability as they move forward in their journey. Legal clients are shopping for services, so why should the firm not consider making a rate that is attractive to its bottom line?

Firms are now looking for experienced pricing professionals who are supported by technology to dig into the data. These professionals are also digging into the rates to see if they have been raised, and if they remain competitive in the market in which they play. Many larger and even mid-market law firms are hiring entire teams dedicated to both pricing and legal project management. There has also been a cultural shift at many of these mid-sized and large law firms to a keener eye toward financial awareness. Lawyers are being compensated on profits more than ever before, taking some attention off the billable hour, all this despite more firms increasing the targets for billable hours in 2023. Never has getting the full rate set been more important to the bottom line of both the firm and the partner.

Bringing in the best matters for your firm

All pieces of legal work are not created equal, and firms need to understand the underlying metrics to be intelligent about the work they are bringing to the firm. There might be a very good reason for bringing on a lower margin piece of work for reasons like client attraction or retention; however, all work cannot be loss leaders. Firms need to understand what areas of business are contributing to their bottom line and what areas of work are easily repeatable with good profit metrics. Firms need to consider what types of matters they wish to bring into the fold and what clients are truly driving profits forward. Lawyers of today are not just practicing law, they need to be better business people and understand why their efforts support the firm from a financial perspective. These decisions will impact the health of their firm, and in turn their compensation.

Leveraging past data to make sound business decisions has become an enabler throughout the industry. Having the proper technology stack to support sound business decisions and save valuable time with pricing and project planning is seen as critical. Areas of importance within the technology stack are proper real-time consistent reporting, supported by easy-to-understand visuals and exportable data sources to ensure ongoing client communication. In the past, firms have been doing these tasks via legacy tools like Excel. While Excel is a powerful and useful tool, it cannot navigate to a practice management system to consider exception rates that may exist for a particular client. Excel can also frustrate users with broken formulas or not enable users with previous versions of budgets, which exist in most modern technology stacks. Answering RFPs is an arduous task and using automation to solve this has been critical. Firms can use the data to understand if the piece of work is worth bidding on and how they should quote the work to the customer.

The industry is seeing that most major firms require all new matters to start with a top-end budget, which Excel just could not solve in a meaningful way. Enter a tool for automating the process where graphs can be leveraged to understand the matter at a first glance, but also to provide the data as pricing leaders dig deeper into all phases of the matter. Ensuring that data is coded the proper way plays a large role in leveraging historical data for use in future budgets. To quote a too often used cliché, "garbage in, garbage out" – the coding of the proper phase and task is gaining traction for use on future work and budgets. Lawyers are using phases like the L100 UTMBS code (discovery) as a dumping ground, which does not bode well for leveraging data for future use or from the client billing perspective. The industry is seeing a push towards artificial intelligence to read these narratives and code the work properly. This is done using things like narratives to ensure the work is properly coded and one area of business is not having the dumping ground situation referenced above. The benefit of a situation like this is two-fold in that the data is there for future use and fewer e-bills get rejected by the purchasers of legal services. This is especially true for firms with a large insurance practice where e-bills and proper coding are paramount. A rejected e-bill can add to the work-to-cash cycle and negatively affect the collections effort, which leads to a negative impact on the firm's realization percentage and possibly affects bonuses and the financial wellbeing of the firm. For every period a firm waits on its collections, the likelihood of collecting all the outstanding amounts lowers, making this an area of profit leakage.

Differing approaches for payment of legal services

Purchasers of legal services are asking for alternative fee arrangements (AFAs) or flat rates for legal services. For example, a client might request that a piece of work be done for 100K, leaving the firm with a blind spot on how to price the work. By using technology, the firm can put in a top-level amount and begin to put resources in place to complete the work. This activity will tell the firm how profitable the work will be based on who is doing the work (either specific people or levels, like an associate or partner, for example). Technology will also enable the firm to do "what if" scenarios, moving their resource around to see what the best staffing model should be. They can then use that data to price future pieces of work by creating a template or versions of said templates. In addition to special fee arrangements, clients are also asking for special rates or rate exceptions. Moreover, they are also asking for more scope and shadow billing of said AFAs to keep on top of what they are paying for their legal services. Unlike in years past, these clients are becoming savvier and shopping around for better rates or scopes of work. Past loyalty models and staying with just one firm are largely a thing of the past. Things like reduced demand, staffing challenges, and economic headwinds are also having an impact on loyalty and client retention. Recently, I sat in a focus group of financial leaders from law firms who said they use several firms for differing scopes of work. This differs greatly from having one sole provider for your enterprise of legal services, meaning firms must be more flexible and adaptable when pricing or answering client RFPs.

An industry-leading technology company specializing in legal productivity, BigHand ran a survey, titled "Improving client engagement to safeguard profitability",[1] gathering 800 responses from senior legal finance roles, CEOs, managing partners, FP&A, and finance systems roles from law firms of 100+ lawyers in the UK and North America. The survey produced some eye-opening statistics about client and firm perspectives, including:

- Half of the firms report their clients demanding real-time financial updates (yet less than four percent of these firms are providing these updates).
- 44 percent of firms globally are producing matter budgets.
- Almost all firms are reporting increased billing realization when a budget is assigned to a matter.

To stay competitive and profitable with happy and engaged clients, law firms must understand the impact of taking on an AFA and produce the staffing model that makes the most sense. When pricing by the hour (bottom up, in industry speak), allocating the right number of hours to the right resource or resource level is seen as best practice. Giving the right work to the right person at the right rate will help firms stay competitive in a challenging market. This will also help firms retain talent by giving the proper work to the proper people and helping partners with their leverage percentages. Firms should also be asking themselves questions like, "Are we giving the right rate to our customers", "What are we going to collect" and "What can we do to reduce write-offs or write-downs". Having the proper technology stack can help these pricing professionals answer these critical questions. It will also help firms conduct a "write-off" review process to ensure future matters are modeled most profitably, or "what if scenarios" on each of their matters by moving resources in or out of the projects. In the same report mentioned earlier, it was noted that:

- 70 percent of firms globally have seen an increase in write-offs over the previous year (more than half have seen these write-offs increase by ten percent).
- 69 percent of firms plan to invest in legal pricing solutions.

This matter-level data will enable firms to make sound business decisions, which will result in less profit leakage. Having technology in place is a great safeguard to prevent leakage and increase profits across the enterprise of mid- to large-sized law firms. Pricing professionals are not cheap resources, with most making more than 200K per year. Enabling these costly resources with technology will enable them to do their jobs better and help firms leverage the human capital investment made in these pricing professionals. These pricing professionals are also helping the partnership with client communication by speaking with the clients directly. Having data at their fingertips from an automated system that provides the data will greatly help these professionals with messaging valued clients. The cost of the average pricing and planning tool is a fraction of the cost of a single pricing body, making automation software and solutions a virtual no-brainer. Simply put, automation can help a firm save on the cost of adding more data analysts or pricing professionals.

Matter-level discounts are yet another area of leakage of profit and a large blind spot for law firms. In the past, a partner or firm would provide an overall discount to a client simply because it was the norm. The firm had no true understanding of how the discount would impact the bottom line. A pricing tool – which many leading software companies offer their clients – can show the firm the KPIs and how a discount truly affects the bottom line. By arming the firm with this simple data point, the firm can decide if the discount is worth the impact on the bottom line or if a new rate needs to be negotiated. The software solutions sold to law firms help the firm service their client while understanding the benefit a new matter will bring to the table.

Another benefit to properly pricing and planning matters would be to drive collections. As law firms increased their rates with big law rising by record highs in 2023, scoping legal services is critical. These rate raises were seen as a break from the norm of basic economics due to the decrease in demand in 2023. Clients are pushing back on scope overruns but generally are agreeable to paying the increased rates, even if said rate increases were not desirable. If a firm wants to keep its realization percentages high, it needs to ensure they are delivering proper scope and staying out in front of changes and overruns. Leveraging an alert system as part of the technology stack will also enable pricing directors and matter-responsible lawyers to stay aware of their projects by providing clarity when a phase or task reaches a certain threshold of completion. This way, the pricing directors or relationship-owning lawyers can communicate the potential overrun and still manage to keep their collections efforts high. Increasing visibility will keep the stakeholders informed and allow them to take proper action to keep their collections levels high and help reduce lock-up in the firm.

Yet another market shift in the past 18 months has been that purchasers of legal services are demanding more diversity from their legal services providers. Firms can leverage technology not only to plan and price matters for profits but also to measure DEI statistics. It is not only important for people of diverse backgrounds to receive the work, but to ensure people of diverse backgrounds are getting career-advancing work. Not only will these metrics satisfy the clients of law firms, they will also help firms retain the talent they have. When a major manufacturing or insurance client is asking a law firm for DEI information, a firm should be able to access this quickly and, more importantly, accurately. A quick search on Glassdoor reveals that the average salary of a legal associate in a major market like New York is close to 200K, often more. Retaining these associates is critical to the bottom line since onboarding and ongoing training are costly to the firm. Having technology help enable retention remains a hot-button subject in the business of law and pricing and DEI is a natural progression to advanced reporting metrics. Firms are also going towards being "Mansfield Certified",[2] which is a structured certification process to ensure that all talent at a law firm has a fair and equal chance at advancing to leadership. The rule focuses on broadening the talent pool for consideration, including those historically underrepresented in the legal profession, and is a major driver to doing business with a firm. Having an equal share of both the volume and the quality of the work remains critical.

In conclusion, leverage technology to help you and to bridge the gap. It will help bring better value to your clients and increase profits and compensation. By understanding the impact, your firm can make wise business decisions, prevent leakage, and grow organically with your clients.

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