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Gaining success in Legal Project Management and Alternative Fee Arrangements

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The Changing Legal Fee Landscape

The recent recession has been a major catalyst for change in the legal sector. A traditional sector that has been used to decades of high profits, increased salaries and soaring payouts has had to tighten its belt; and is now forced to undertake a strategic evaluation of how business must be conducted to ensure future growth. Fee income at the UK's largest 100 law firms fell by 3% to £13.7bn in 2009-10, according to CityUK, an independent body promoting competitiveness in the professional services industry.

As the global economic crisis persists, the trend of cost-cutting and consolidation in the legal services market continues in the UK. Businesses too are facing the brunt of the difficult economic climate and are under pressure to reduce legal costs, in turn driving down the professional fees of law firms. Law firms have no choice but to lower pricing and offer other creative pricing options alongside additional discounts that clients are now coming to expect. Undoubtedly, the prevailing hourly pricing model will soon become a thing of the past giving way to value-based pricing.

This shift towards value-based pricing has led to the popularity of Alternative Fee Arrangements (AFA) such as success fees, fixed-capped, tiered discounts, flat fees, etc. This allows for a more predictable fees structure, shifting "risk" back onto law firms. Through AFAs, clients expect to protect themselves from the possibility of law firms passing on any operational in-efficiencies onto them.

The market is therefore at a tipping point – law firms that are unable to embrace this change will find themselves withering away through natural attrition. They must make the leap to the new way of working, which isn't without challenges.

AFA Challenges for Law Firms

The biggest challenge that AFAs pose to law firms is the ability to predict cost and determine the right level of staffing to create profitable outcomes – while still delivering high quality legal services. It is difficult to accurately ascertain the effort or hours that will be required in delivering on different matters. Although the scope of some matters may be identical across cases, most have a substantial amount of variability, making them unique in their own right; which is perhaps why the billable hour approach has been the most prevalent method in the industry over the last 40 years.

This makes pricing extremely competitive. Firms must deliver services at the prices agreed, while performing the service profitably. Their inability to either agree a competitive fee rate or indeed deliver the quality service expected of them could potentially result in clients very easily taking their business elsewhere.

Typically in a law firm, both matters and projects are managed by qualified lawyers. However, the competencies and training of lawyers are different to those of project managers. The former are trained to deliver on intricate legal matters for clients, without too much focus on the cost of the effort it takes. Project managers on the other hand, take a more business-focussed view and manage effort in line with the scope and budget of the project in question. Therein lies the contradiction, which can potentially hinder firms' success in leveraging the AFA model.

Business Need for Legal Project Management

The increasing AFA trend has heightened the need for operational efficiency to maximise profitability in law firms. The typical cash-based profitability approach means that determining revenue/profitability based simply on a deduction of lawyers' salary from billings or collections is no longer an accurate measure.

In an AFA situation, when estimating price, firms need to be able to take into account factors such as the duration of the project, how the work can be performed in the most efficient manner, what level of personnel should be assigned to the project, and so on. By contrast, the traditional hourly billing method struggles to take these issues into consideration.

Another common measure of law firm health and success is profit per equity partner (PEP). Despite this metric's popularity among law firms, it is one dimensional in its approach and does not reflect key indicators such as client satisfaction, staff morale and motivation or sustainable profitability. Aside from the fact that PEP is usually calculated based on unaudited figures making its credibility questionable, but possibly its biggest drawback as a metric is that it is of little interest to law firms' client base. Why should clients care? It only highlights the financial interests of the partners of law firms, and entirely dismisses the quality of service delivered or the efficiency with which firms execute matters.

Further, PEP can easily be increased by reducing the number of equity partners, or as a result of lateral movements. Therefore, an increased PEP does not fully reflect the actual performance of the law firm. Similarly, PEP does not take into account personnel issues such as staff retention, work/ life balance, staff motivation or training required to enhance staff skills – all of which can greatly impact on the well-being or success of law firms.

Clearly, a more thorough approach to operational efficiency, performance and measurement is required – one that comprehensively takes into account all aspects of the legal business. Legal Project Management (LPM) is one such approach.

LPM may be the latest buzzword, but simplistically, it is the application of project management skills to legal matters and tasks, offering a consistent and common approach to measuring profitability across firms' operations. It provides a best practice framework that enables the application of project management standards to legal matters, presenting a structured approach to scoping, planning, pricing, executing, monitoring, tracking, managing and completing legal matters. This drives consistency of process across the organisation. In doing so, LPM enables organisations to deliver value to clients while maximising operational efficiency and profitability.

Adopting Legal Project Management

There is a lack of standardisation of pricing models in use today – exact quantum, percentage mix and relative profitability, each with varying definitions – in addition to different types of discounts offered. Often, firms are only able to estimate the percentage of these types of fees that are not based on hourly billing. While these issues have not posed a hindrance to law firms yet, the rise of AFAs driven by the larger industry-wide changes means that legal services providers require retrospective and real-time intelligence to facilitate profitable AFA pricing.

Law firms cannot accurately price their services without knowing exactly how much it costs to perform tasks and so must be armed with the right information to price with confidence. Firms should be able to pull up various types of work/task/phase codes, look at the corresponding hours, fix a price to that type of work and with a large enough population, prepare a probability curve. Presently, very few law firms have access to such granular level of information, and attempting to find it involves painstaking work to derive the data manually from hundreds of narratives on time entries. Consequently, determining AFAs on a large scale is a colossal task.

In addition, ensuring that the outcome of AFAs is decision-neutral for firms is imperative – i.e. firms must be comfortable in their clients' selection of AFA from a range of pricing options, regardless of the choice made. Simply put, law firms must make a profit on projects, irrespective of the pricing option chosen by clients.

Law firms must garner and harness business intelligence to help ensure AFA success. For instance, a client or matter may become less profitable solely because a highly compensated partner performed some of the work instead of a junior lawyer working on the task. Following LPM-related processes will ensure that such situations are acknowledged within a firm's case management. Similarly, when assessing partner profitability, a distinction must be made between a partner's profitability to the firm versus the partner's client's profitability to the organisation. All this contributes towards accurately determining AFAs.

Fundamentally, to lawyers need to think like business people to adopt LPM. They need to be involved in the overall planning; management of resources, budgets, schedules and deliverables; and communication activities internally and externally. As an example, McDermott Will and Emery[1], a US-based international law firm is using basic project management tools to re-engineer the way it does deals to streamline its M&A process, in order to reduce inefficiencies and costs. The firm has implemented a Deal Dashboard, a web-based collaboration and accountability workspace, to manage deals and to better communicate with clients. The Deal Dashboard enables counsel to corral all the moving pieces of a deal, so that everyone involved knows what needs to be done, by when, by whom and at what cost.

Today there are tools on the market that facilitate a LPM-enabled approach to legal business. Such tools provide both business intelligence and the analytics to help law firms gain business insight, analyse and monitor performance to support informed decision making. To illustrate, these tools enable superior reporting; provide key information that helps with pricing; help determine performance of partners and lawyers along with the profitability of client and practice areas; and track utilisation of resources – all of which provides insight into the business and highlights areas for improvement to increase profitability. Most importantly, such information can serve as crucial proof point to change the perception of clients or negotiate effectively for new business.

For many law firms, undertaking a LPM-led approach retrospectively for matters may be impractical, but now is definitely a good time to begin undertaking activity analysis for the future. Overtime, such an approach will facilitate accurate costing and provide insight into which type of AFAs are more profitable for the firm than others.

Summary

Change in the legal sector is inevitable. Law firms must react positively and creatively to the demands of a rapidly evolving marketplace. By combining technological advances with a project management-led approach, law firms will be able to limit the risks/unknowns related to the AFA model and be more successful with its implementation. Those who don't will experience falling profits or worse, find themselves priced out of the market.

Sources: 1 http://legalprojectmanagement.info/2010/05/law-firm-pm-watch-mcdermott-will-emerys-deal-dashboard.html#ixzz1URksgj47

For more information

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