

## Gaining Confidence in Alternative Billing

By Kris Satkunas

The tide appears to have turned in favor of alternative billing solutions. Amid the continued economic tumult, firms are responding as never before to client demands for more creative pricing. As these arrangements play out, however, some firms are likely to find the deals they've struck are less profitable than anticipated. Inevitably, such unwelcome results will stem from the fact that in pricing such matters, firms have failed to account for key variables.

The problem lies with the reflexive approach to matter pricing that still prevails at many firms, where partners often use a back-of-the-envelope method to structure an offer to a potential client.

There is a better way. Firms that model matter planning scenarios provide their partners and business development staff with the crucial ability to gauge up front how different approaches to pricing and staffing will affect profitability. Modeling allows firms to make adjustments before making their bid — and therefore price alternative billing arrangements with confidence.

### WINNERS AND LOSERS

A comparison between the traditional and analytical approaches to matter planning demonstrates how easy it can be to turn what could have been a profitable engagement into an end-of-year loss.

Say, for example, a law firm receives

---

**Kris Satkunas**, a member of this newsletter's Board of Editors, is the Director of the LexisNexis Redwood Think Tank and leads Redwood's research efforts in studying and formulating solutions to law firm management issues. She can be reached at [ksatkunas@redwoodanalytics.com](mailto:ksatkunas@redwoodanalytics.com) or 804-288-5185, ext. 222.

a request for proposal ("RFP") from a premier prospect for a large litigation matter. Unsurprisingly, the prospective client asks the firm for its best "creative" pricing. Through a contact, those at the firm know the prospect currently receives approximately a 12% discount from its current firm.

So those responding to the RFP know they must beat the current discount to obtain the work. The RFP team determines that the matter is likely to consume approximately 1,000 billable hours. A high-profile partner will do a majority of the work and will be responsible for billing the client. The rest of the work will be split among other partners and associates.

A series of discussions takes place between the practice group leader and members of the executive, intake and business development committees. They factor into their decision that the average client of the firm contributes a 25% margin. To ensure the firm obtains the business, a consensus is reached that the firm should offer a 20% discount.

The offer is made, and the firm earns the business. Are congratulations in order?

### MATTER PLANNING

Before making its offer, the firm could have run its proposed discount through a planning tool. Some firms have moved away from guesswork by developing homegrown spreadsheets for this purpose. They work, as long as they are maintained, but often don't find their way out of the finance department. More than 50 firms have moved to the next level and adopted the Redwood Planning application.

The exact tool a firm uses is less important than whether the firm goes through the process to examine up front how their proposals are likely to play out.

In best practice, firms even require the creation of staffing and pricing plans for new matters of a particular size or type. Here, we use the methodology behind the Redwood application to illustrate the importance of matter planning, but the process would be similar with a spreadsheet tool.

The planning application projects the profitability of a matter by capturing information concerning the billing rates of the attorneys expected to work on a matter (reflecting standard or discounted rates), the hours they are expected to work, and the anticipated collection realization rate (*see*, Scenario 1 on page 7). The tool takes into account how much attorneys are paid and how many hours they're expected to work, thereby calculating the hourly cost rate for each individual. (Note: cost rates for equity partners are handled uniquely, based on the portion of their compensation that is a function of their billable time.)

Firm attorneys, managers and business developers instantly can see how profitability is affected by changing the billing rates, the amount of hours worked by various members of the proposed team for a legal matter, as well as the projected realization.

In the afore-mentioned example, the firm would have had a margin of 18% — before offering its 20% discount (*see*, Scenario 2 on page 7). The 25% margin used to guesstimate that the firm could offer a 20% discount to the client was an average margin. So, without modeling the matter at hand, the firm structured an arrangement that created a margin of negative 2% even before overhead was factored in.

The news could be even worse. The planning application assumes 100% collection unless adjusted. If the firm instead loses 5% in write-offs it will have a negative margin of minus 7% on the

matter.

## BETTER MARGINS

The example illustrates the dramatic effect discounts can have on the bottom line. Firms easily can move from positive to negative territory simply by offering discounts. With today's economic pressures, the question becomes, how can you create pricing structures that are both profitable and meet clients' needs for alternatives to straight billable hour arrangements?

In our example, the firm could keep its proposed discount of 20%, but shift some of the hours to be worked from partners to associates, and actively manage the time spent by partners (*see*, Scenario 3 below). By shifting work down, the firm moves the matter's margin to 17%.

While this example may be a bit extreme — firms usually cannot shift hours from a senior partner to an associate — it's usually possible to adjust the staffing somewhat to improve the margin. Central to the argument for improving matter leverage — in new and existing matters — is the assumption that partners will push work down so they can use their time to nurture strategic client relationships, develop business, mentor other lawyers and drive other firm-building activities.

Particularly in the current economic climate, as firms urge their partners to ramp-up business development efforts, the ability to deploy associates more efficiently can result in freeing partners to bring in new business. However, firms that successfully improve matter leverage but do not ensure their partners are making efficient use of their time will suffer reduced overall profitability.

For the matter at hand, the firm also could improve the margin by addressing realization. The firm can increase realization by actively managing the

account to reduce write-offs, and perhaps even assigning the account to a different billing attorney (who might take a more active role in reducing write-offs).

## DEMONSTRATING CREATIVITY TO CLIENTS

A matter planning tool provides the flexibility to offer alternative pricing arrangements that meet clients' concerns for more cost-effective solutions, while helping the firm to more effectively manage its margin.

An alternative to discounting would be to offer a blended rate (*see*, Scenario 4 below). At a blended rate for all team members of \$300 per hour, the firm's profit margin would be 13% — a significant improvement from the minus 2% margin that resulted from the original offer. Of course, to ensure the blended-rate arrangement works, the firm would have to monitor the time worked by each team member to ensure partners with billing rates that are higher than the blended rate do not exceed their time budget.

A third pricing option would be to offer a fixed fee (*see*, Scenario 5 below). In the same example, at a fixed fee of \$325,000, the firm's margin would be 19%. Since the client would have paid nearly \$400,000 for the matter at the firm's standard rates, the client may welcome this arrangement. The ability to model this type of offer demonstrates flexibility to clients — and as importantly, graphically illustrates internally how alternative pricing can create an advantageous partnership, a competitive advantage and a healthy bottom line.

## WHY PLANNING MATTERS

The key to matter planning is the ability to foster dialogue between the billing attorney, the firm's financial and business development staff, and management. In

the example above, the firm would have lost money on the matter as originally structured, because it offered a significant discount on a matter that was to be staffed principally by a senior partner.

In addition to responding to RFPs for new work, a matter planning tool can help firms respond to requests from current clients for fee adjustments — an increasing reality in today's economy. For example, say a large corporate client requests new work, but at a steeper discount than it currently receives. A matter-planning tool can help the firm compare various options:

- A larger discount (moving hours to be worked among team members to maintain the firm's margin);
- Fixed fee/blended rate structures;
- Volume discounts;
- Pricing by matter phase; and
- Retainers.

Taking an analytic approach to matter planning enables firms to respond to client pricing pressure with greater confidence. The ability to construct flexible scenarios — and view the dramatic differences in profitability created by those scenarios — empowers attorneys and staff to offer more creative pricing precisely at a time when clients are demanding such solutions.

Importantly, a matter-planning platform is more than a tool to help firms respond to RFPs — it's a crucial component to ensuring profitability once a firm is hired. This type of tool helps firms plan for success — and then manage the matter to that plan — reducing the odds that unpleasant surprises lie ahead at the end of the year.

Reprinted with permission from the September 2009 edition of the LAW JOURNAL NEWSLETTERS. © 2009 Incisive US Properties, LLC. All rights reserved. Further duplication without permission is prohibited. For information, contact 877.257.3382 or reprints@customer.service@incisivemedia.com. #055081-09-09-03

Scenario: 1		Scenario: 2 (20% Discount)		Scenario: 3 (Adjust Staffing Mix)		Scenario: 4 (Blended Rate)		Scenario: 5 (Fixed Fee)	
Bill Rate	Hours	Bill Rate	Hours	Bill Rate	Hours	Bill Rate	Hours	Bill Rate	Hours
\$475	100	\$380	100	\$380	100	\$300	100	\$300	100
\$505	500	\$404	500	\$404	200	\$300	200	\$300	200
\$495	100	\$396	100	\$396	100	\$300	100	\$300	100
\$250	100	\$200	100	\$200	200	\$300	200	\$300	200
\$355	100	\$284	100	\$284	200	\$300	200	\$300	200
\$370	100	\$296	100	\$296	200	\$300	200	\$300	200
<b>Total Hours</b>	<b>1,000</b>	<b>Total Hours</b>	<b>1,000</b>	<b>Total Hours</b>	<b>1,000</b>	<b>Total Hours</b>	<b>1,000</b>	<b>Total Hours</b>	<b>1,000</b>
<b>Standard Value</b>	<b>\$ 447,000</b>	<b>Standard Value</b>	<b>\$ 447,000</b>	<b>Standard Value</b>	<b>\$ 393,000</b>	<b>Standard Value</b>	<b>\$ 393,000</b>	<b>Standard Value</b>	<b>\$ 393,000</b>
<b>Fees Billed</b>	<b>\$ 447,000</b>	<b>Fees Billed</b>	<b>\$ 357,600</b>	<b>Fees Billed</b>	<b>\$ 314,400</b>	<b>Fees Billed</b>	<b>\$ 300,000</b>	<b>Fees Billed</b>	<b>\$ 325,000</b>
<b>Fees Collected</b>	<b>\$ 447,000</b>	<b>Fees Collected</b>	<b>\$ 357,600</b>	<b>Fees Collected</b>	<b>\$ 314,400</b>	<b>Fees Collected</b>	<b>\$ 300,000</b>	<b>Fees Collected</b>	<b>\$ 325,000</b>
<b>Direct Costs</b>	<b>\$ 368,222</b>	<b>Direct Costs</b>	<b>\$ 368,222</b>	<b>Direct Costs</b>	<b>\$ 249,028</b>	<b>Direct Costs</b>	<b>\$ 249,028</b>	<b>Direct Costs</b>	<b>\$ 249,028</b>
<b>Direct Margin (% of Std)</b>	<b>18%</b>	<b>Direct Margin (% of Std)</b>	<b>-2%</b>	<b>Direct Margin (% of Std)</b>	<b>17%</b>	<b>Direct Margin (% of Std)</b>	<b>13%</b>	<b>Direct Margin (% of Std)</b>	<b>19%</b>