

PRICING AS AN ELEMENT OF YOUR MARKETING STRATEGY



By Dr. Sylvia Hodges

A lot has been said and written about pricing and alternative fee arrangements (AFAs) before, during and since the Great Recession. Clients supposedly want AFAs and predictability, but in the end all they really want is a good discount—or is it? Many lawyers argue at conferences and dinner parties that the law is too particular and unforeseeable to put a price tag on it.

On the other end of the spectrum, firms such as Valorem Law, Exemplar Law, Axiom, Riverview Law, and others built on new pricing models challenge the status quo.

AFAs are nothing innovative when seen in the broader commercial context . . . Other businesses have had to address the questions previously - law firms are just coming up to speed now. Many law firms are slightly behind the curve of what it means to be efficiently run as businesses. They just didn't have the same economic pressure,

says Stuart Dodds, Director, Global Pricing at Baker & McKenzie in Chicago.

He likes to refer to AFAs as “appropriate” fee arrangements.

Fact is, more and more companies are subjecting their legal departments to clear guidelines and budgets in the department's internal management. “Our experience in 2011 was that approximately 60% of the RFPs we received requested information on flexible pricing requests and AFAs, confirming flexible pricing as a priority with our current and prospective clients. They merit a significant emphasis within the Reed Smith marketing strategy,” says Matthew Laws, Reed Smith's Alternative Fee Arrangement Senior Manager in Pittsburgh.

Clients are increasingly data and metrics driven; their legal operations experts conduct detailed cost analyses; they benchmark themselves and their legal service providers. “Client's use of the procurement department and the involvement of the finance team has placed an additional emphasis on the pricing function within the marketing mix and the respective strategy of offering flexible pricing options,” says Laws. Clients expect that if you know your business, you know how long a matter should take and how much it should cost. “If you do something often enough, you should have data and have it analyzed,” said a client I recently interviewed. “If you don't, that's negligence.”

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Mark Chinn, Author of *How to Build and Manage a Family Law Practice* and *Systems, Checklists and Procedures for the Family Lawyer*, says that he wanted to create a firm that relied on systems and procedures

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that could almost function on its own. Naysayers warned him that 'you can't do that with legal services' as they are too complicated. Chinn stubbornly believes that "everything can be systemized if you put enough thought into it." The key is to find *a* way to do things by developing checklists, synchronizing what people do, and how they do it. A law firm has to function like an orchestra. "To be a good musician in an orchestra," Chinn says, "doesn't mean you can play what you want. Everyone needs to be on the same page. You follow the music and the director."

Most clients prefer flexibility in terms of rates and billing and many see AFAs as the answer, albeit not necessarily the panacea. Delivering "value" to the client is at the heart of the AFA discussion. And value can mean so many different things. That's why AmEx offers different cards—green, blue, clear, gold, platinum, or black, all with different features and benefits. If nothing else, AFAs make costs more predictable and 'budgetable' for clients. More often than not, cost certainty is more important to clients than merely getting the lowest price. In fact, if a price quote is extremely low, clients may worry that the low-cost provider may not deliver at that price. "There is no magic AFA," says Toby Brown, Director of Strategic Pricing & Analytics at Akin Gump. "But it needs to be a 'win' for the client and it needs to be a 'win' for the firm. Anything else won't work."

Above all, firms must improve trust by more closely

aligning their definition of value with that of their clients. AFAs can support this process. The ACC defined value as a combination of:

- A total focus on partnering/collaboration
- Rigorous cost-control (more than simply lowering cost)
- A commitment to risk-sharing and reward-sharing
- Longer-term relationships—continuity, predictability
- A focus on new skills, staffing, and lawyer development
- Lean, efficient, process-oriented management
- Continuous improvement/accountability
- Transparency through data

AFAs require a commitment to learn the intricacies of their clients' businesses, anticipate their clients' needs, and seek out close collaborations with the client. The larger effort requires honest communication, mutual flexibility, and openness to making tangible changes. "AFAs are as much about communications as they are about numbers. It is important to manage to the AFA, not just staying within the agreed-upon budget. If the assumptions change, lawyers need to be proactive about the communication with the client," says Michael Byrd, Director of Pricing Strategy and Legal Project Management at Mayer Brown in Chicago.

Critics of AFAs question their value to clients if they net just as much revenue and profit for the firm as would a billable hour arrangement. However, AFAs can have value to a client even if a particular matter ultimately costs the client the same amount it would have cost under the billable hour system. "You develop an estimate of value for the client," recommends Kevin Christian, Pricing Strategy Consultant and President of LogiPrice, Inc. "Ultimately, the price has nothing to do with the hours." The firm needs to price according to what it is that clients try to achieve. What is their objective, then ask them why. What factors affect this? Using hourly rates as a metric is measuring input rather than output. "Karl Marx's Labor Theory needs to go

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away,” says Ron Baker, Founder of Pricing Think Tank VeraSage. “Nobody cares how long it took you to get to a solution. What counts is what value you created.

Managing more efficiently and focusing on the output rather than the input, however, is still challenging for many firms. The recruitment and compensation models of law firms pose some of the biggest obstacles to embracing AFAs. The number of hours billed form the key performance indicator for individual lawyers and their practice groups at firms. Introducing AFAs can create disconnect between a

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firm’s actual fees on a matter and how it continues to evaluate and compensate the associates who work on it. Acceptance of AFAs is often mostly an internal struggle. The firm’s culture and the mindsets of its professionals and staff must be aligned with the AFA philosophy to make it work.

The purpose of an AFA is not to reshape a firm’s business model—although this is exactly what it might do in some firms—but to meet clients’ needs. “The traditional model adds a layer of cost, that firms like ours just don’t have,” says Andy Daws, VP, North America at Riverview Law. “The world is changing, some sit up and take notice. We run our firm efficiently, like any good business.” The issue is however, that “professions are not designed to change. They are designed to protect the status quo,” says Baker. “That’s the problem.” Mayer Brown’s Byrd hence sees change management to be as important to pricing as the numbers aspect. Chinn compares the thinking required to do billing by value versus billing by the hour with speaking different languages.

Among other things, firms must educate their lawyers to thoroughly understand cost structures and

develop sophisticated metrics for pricing and modeling AFAs. Christian uses a cause-and-effect chain for price modeling. Why does the client need to win the lawsuit? What happens if they don’t? He breaks it down logically, step by step, then attaches numbers to each stop. “It is definitely more complicated to price AFAs. What I recommend is a deeper conversation with the client about their value drivers – finding out what’s important to them and tailoring a pricing arrangement accordingly.” says Doug Woods, Pricing Manager at Ogletree Deakins in Atlanta. He recommends introducing AFAs with a client on a smaller-scale matter.

Patrick Lamb, Founding Member of Valorem Law Group and author of *Alternative Fee Arrangements: Value Fees and the Changing Legal Market*, advocates “chunking,” such as pricing a certain period of time, or phases of a matter. “A client might try to avoid a single, large flat fee to avoid feeling she has paid too much if the case settles early. To address this concern, you can price the different phases separately. When you do this, the all-in price is lower than the price of the various phases added together.”

This necessitates treating cases as projects, using project management concepts, and thoroughly examining historical revenues and costs to accurately forecast fees on future matters. It may even require new roles, responsibilities, and hierarchies within the firm. “We need to get away from the perception that everything is customized and special,” says Lamb. “Most firms’ data would show that a large portion of their work is not customized, and AFAs run counter to many firms’ view of themselves as offering highly customized services.”

Firms that have done their AFA homework tend to maintain or improve profitability when offering AFAs. Some firms have formed committees composed of practice group leaders and experts from different areas such as finance, knowledge management, marketing/business development, and IT, to analyze matters and improve predictability of matter costs. For many firms, this might necessitate embracing profound structural changes along the following lines:

- Data mining of practice management and knowledge management systems to create accurate cost predictions for matters

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- Developing and maintaining pricing databases, detailed records of costs on previous matters that can help firms create pricing models for future AFAs
- Developing metrics that monitor the profitability of AFAs
- Applying project management principles to matters the firm knows well and has studied to deliver efficient services.
- Training lawyers to manage within a budget and to structure AFAs properly
- Finding new ways to organize the firm, assess lawyers' value, and determine their compensation

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Chinn recommends that you need to understand why some cases cost so much. What are the factors that drive cost? The type of opposing counsel, the personality of the parties involved?

Who should do all the work? Opinions vary between having pricing teams, or as Baker calls them “value counsel”, hiring pricing experts who report directly to the executive director or managing partner, or pricing as a natural fit in finance or marketing. “Pricing is a marketing function and folds into the value proposition. You need to know what clients want. That’s marketing’s area,” concludes Dodds. “Flexible pricing within the marketing strategy has the role of expanding opportunities with new clients and current clients. By proactively assisting current clients to utilize alternative fees it avoids the need to explore flexible pricing outside the firm,” says Reed Smith’s

Matthew Laws. “Done right, AFAs can be both highly profitable as well as a powerful competitive differentiator to the legal buyer,” say K&L Gates’ David Bowerman, Director of Client Development and Matthew Prinn, Associate Director for business development in their article *Marketing’s Role in the Legal Industry’s Pricing Revolution*. Christian, on the other hand, recommends hiring PhDs in mathematics or related areas, for larger firms.

Marketing, finance, MBAs, PhDs, teams or individuals. Pricing is not easy. No one should attempt it alone, in particular if new to the topic. “That’s why actors hire agents,” explains Baker. “So they get better prices. We’re all terrible selling ourselves. There’s too much emotional baggage attached to it.” Rather than hanging on to doing things the way we always have and dismissing necessary change, let’s now focus on it, professionally.

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PRICING FOR A WIN-WIN PARTNERSHIP



By Henry Turner, Jr.

Clients want results, and as importantly, they want to know the amount they will be required to invest to obtain those results. Value fees infuse these concepts into the attorney-client relationship. Although they are commonly called alternative fees, calling them value fees is a much better way of describing them. The adjective “alternative” differentiates the fee from hourly billing, where a client pays for time regardless of result. That is an old model that has no place in the current marketplace. Value fees fundamentally alter the attorney-client relationship so that the attorney produces a result that is aligned with a client’s investment. As a litigator working for a business litigation boutique, Valorem Law Group, my experience is with value fees in commercial litigation. However, many of these points apply to value fees for transactional work.

1. How to structure value fee arrangements.

The number of value fee arrangements is limited only by the imagination, but they generally fall into two categories:

1. Contingency Fees; and
2. Fixed fees.

Contingency fees are familiar and often used by plaintiff’s counsel in personal injury cases. The mechanics are simple: the lawyer takes a percentage of the recovery as her fee. There are also “reverse contingencies” where lawyers receive a percentage of the amount saved. In a litigation context, this means that if a client has \$1 million in exposure, the lawyer gets a percentage of any resolution less than \$1 million. The structure can be graduated, such that the lawyer gets a higher percentage the greater the savings. In a non-litigation setting, I’ve seen this used in tax disputes where a property owner gets a tax bill, fights it with the local assessor, and the lawyer receives a percentage of the difference between the original and reduced tax bill (or nothing if the attorney can’t get it reduced). However, because there is risk of a complete loss, clients and outside counsel should look at contingency fees as an investment and scrutinize them accordingly. The idea is to minimize the cost of reaching the successful outcome while only taking the steps needed