# The future of the billable hour and new approaches to pricing

17/06/2019

**Practice Management analysis: Peter Scott, legal consultant and former managing partner of Eversheds London and European offices, discusses changing client attitudes to pricing and what this means for the 'billable hour'. He says, though recording time spent on client matters is still useful, there are a range of alternative pricing models law firms should be considering.**

## Do billable hours remain the most common pricing model for law firms? If so, why do you think this is?

Clients are not interested in how long a matter takes a lawyer to complete—they are only interested in results. This is the primary reason why lawyers must add value to their clients, and how they do so. Achieving the result a client wants will be seen as added value and is ultimately what the client will be prepared to pay for.

The method of using the amount of time worked on client files—on an open-ended basis—for billing clients has been under pressure for many years. This pressure has also increased significantly since the beginning of the recession of 2008/9 and is unlikely to go away, as clients have the taste for other pricing models which provide them—in their minds—with more added value. This trend is likely to continue to a point where a commitment to pay fees based upon the hours spent with no caveats will largely have ceased to be the pricing model for instructing law firms.

Client attitudes in relation to pricing have also changed. Now, the most likely question posed to law firms at the outset of a matter will be: 'How much will it cost?'

Clients not only want value for money but also a degree of certainty as to their legal costs. This includes large corporate clients which are likely to have legal departments with budgets to manage. As a result, there is now an array of possible pricing formulae which clients may seek in order to both control the level of legal spend and to introduce price certainty.

Regulators have also now taken a keen interest in pricing certainty—as shown by the Price Transparency Rules introduced in December 2018 that require law firms to provide indications of price for certain services. In May 2019, the Legal Ombudsman has said that lawyers must provide their clients with a cost benefit analysis, so they can understand the choices available to them, as well as warning lawyers to be 'crystal clear' over charging structures—whether they are fixed fees or hourly rates.

The death of the billable hour has been a long time coming, but the end is in sight.

## What alternative approaches to pricing are law firms adopting or offering clients? What are the pros and cons of these alternatives?

Examples of a few alternative approaches to pricing in place of using the time worked on client files as a method to be used directly (and on an open-ended basis) for billing clients, and factors to consider, include the following:

- fixed prices
    - provides cost certainty for client but more risk for law firms
    - scoping of work is crucial



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- firms must be able to cost the work accurately
- a performance management approach is required to control costs

- quotes (with caps and collars)—this is a hybrid, as pricing is based on hours worked but within upper and lower pricing parameters
  - provides cost certainty for client but more risk for law firms
  - scoping of work is crucial
  - firms must be able to cost the work accurately
  - a performance management approach is required to control costs
- contingency fees (eg conditional fee arrangements)—involves a law firm agreeing to share in a percentage of any recovery, either on a wholly contingent basis or mixed with an hourly rate
  - is dependent on the ability to accurately predict outcomes at the outset
  - a performance management approach is required to control costs
  - this approach can tie up large amounts of contingent work-in-progress (WIP) which can cause cash flow problems
- retainer—involves a law firm handling all work for a client at an overall fixed price, or on basis of a mix of a fixed retainer and reduced, blended or discounted hourly rates
  - provides some cost certainty for client but more risk for law firms
  - firms must be able to scope and cost the work accurately
  - a performance management approach is required to control costs
- outcome bonus—this is a hybrid, as pricing is based on hours worked, but hourly rates are agreed either on a reduced, blended or discounted basis and then a pre-agreed bonus is paid on successful completion of matter
  - work must be accurately costed when agreeing rates
  - a performance management approach is required to control own costs to within agreed rates

## What do you think is the future of the billable hour? Does it still have a place?

The term 'billable hour' can be misleading. As a result, use of the term itself is losing favour and is being replaced by other terminology, such as 'matter related hours'.

This is because fee earners—when told to record all their billable hours—often assume the reason for recording time worked on a client matter is that it will all be billable to the client. As fee earners often feel not all their time worked on a client matter will be billable, they often don't record all that time—prejudging the final bill. The result of this misguided thinking is that law firms not only undercharge on client matters when billing on an hourly basis but also lose vital management information.

To illustrate how capturing every small unit of time worked on client matters can make a huge difference to the bottom line, law firms should calculate how much more revenue they would generate if each fee earner recorded and billed an additional 15 minutes per day. When I ask managing partners this question, they estimate that their 'leakage' rate (time which should be properly billed to clients but is not recorded) is between 15% and 25%.

For this reason, the term 'matter related hours' is now becoming more commonly used. Fee earners should be told that they must record all time which properly relates to a client matter and that the firm will then decide



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what should be billed to the client. This is likely to capture more time which is eventually billed to clients and ensures the capture of essential management information.

Notwithstanding that the trend is now that clients are no longer willing to pay fees on an open-ended basis which are directly based upon hours spent, there is still a place for recording matter related hours. This is not as a direct pricing model but as an important pricing and management tool.

As a pricing tool, recording matter related hours is important as time spent on a client matter is important in arriving at the right price to be charged for the job and to reflect how a law firm has added value to a client. Without full time records on past work, a firm will not be able to accurately scope and budget for work on matters in hand or similar matters in the future.

Time recorded on doing client work is also an important management tool for:

- accurate financial reports
- management of workloads
- budgeting for annual income
- monitoring how much work is 'coming through the door' and developing trend lines
- better managing client relations by creating WIP trigger points—eg monitoring against work stages, reporting to clients, generating client conversations, generating billing
- managing risk by providing a full record of what a firm has done for the client

## Billable hours have been commonly used as the key performance metric for measuring and rewarding fee-earning individuals. What are the pros and cons of this approach?

This approach is falling out of favour, especially with law firms that have developed more sophisticated and effective performance management techniques.

While hours worked on client matters may be one possible indicator of a person's performance, it is unlikely to tell the whole story and may be very inaccurate or misleading—eg caused by under recording or 'puffing' of time. On the other hand, full and honest recording of matter related hours which are billed and then paid is likely to provide better management information about a fee earner.

Cash generated and profitability are what should be measured—hours worked are just one factor in achieving those financial objectives. As a result, time written off on client matters becomes a more relevant measure of performance.

## What different approaches to performance measurement are you seeing in law firms?

Increasingly I am seeing law firms measuring and managing people's performance by using a Balanced Scorecard model (see: The Balanced Scorecard: translating Strategy into Action).

This implies performance is not only measured in terms of financial contributions by way of fees earned or hours billed, but also in terms of 'non-billable value-added activities'.

However, cash flow and profitability are paramount and it is unsurprising that financial performance is often prized (and rewarded) above all else.

A balanced scorecard approach will however focus not only on aspects of financial performance but also on the factors that influence or control financial performance—eg client relationships, firm growth and personal development.

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In particular, performance (and its measurement) should be driven by client satisfaction and needs. As client satisfaction is often said to be the only real test of success for law firms, evaluating client satisfaction and understanding what clients will require in the future—in terms of value for money, advice and service—will be critical if a firm is to set performance goals for its people.

Some examples of performance criteria used by law firms may include the following:

- client service—work
  - technical standards (including both legal and use of IT systems)
  - meeting client needs
  - communication/rapport with clients
- client service—management
  - income/profit targets
  - complying with agreed pricing disciplines/management of work
  - working capital targets/cash generation
  - group planning
  - service standards
  - file reviews
  - people/teams
  - risk and compliance
- business development
  - existing client development
  - cross selling referrals
  - managing client relationships
  - winning new clients
  - marketing the firm's image
- leadership and management
  - motivating people to perform
  - delegating and supervising effectively
  - providing support and direction to people
- collegiality/relationships
  - commitment to the partnership/participation in partnership affairs
  - personal integrity and relationship—internally and externally
  - firm-wide management

## Why are these changes beneficial to fee earners, firms and clients?

In today's competitive legal markets, a law firm must manage its performance, and this means that people need to know:

- what the key areas of performance are



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- what their performance goals in each area are
- how their performance will be measured and assessed in relation to these goals
- how their performance will be rewarded

If a firm's performance management can ensure that everyone in the firm performs to levels which will enable the firm to provide its clients with what they want—enhancing client satisfaction and winning and retaining more profitable clients—then that firm is more likely to be successful and profitable. Everyone wins.

*Interviewed by Andrew Muir.*

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