

PETER SCOTT CONSULTING

Briefing Note November 2017

Stop Triple Discounting!

Law firms are often guilty of what can be called *Triple Discounting* –

1. **Not pricing for profit** for a combination of reasons, including inadequate scoping and budgeting as well as lack of knowledge and skills, and fear of losing work;
2. Making the problem worse by then **not managing the work for profit** as well as failing to capture all matter related hours (for both budgeting and billing purposes) and writing off time during the course of a matter; and then
3. Finally when billing the client, **writing off** the value of recorded time regarded as not recoverable when the price has already been doubly discounted by 1 and 2 above.

These three failings can seriously damage a law firm's financial health.

Taking each of these in turn

1. Price work for profit

Accurately pricing legal services is often overlooked as a major dynamic of law firm profitability, more emphasis being given to the other factors which impact on profit. This is, I suspect, due in part to several factors –

- to the straightjacket lawyers have created for themselves by becoming slaves to what are perceived as market hourly rates (when they have no clear idea whether those hourly rates will make them a profit or a loss);
- lack of knowledge as to what is involved in carrying out work for a client and its cost to a firm; and
- in the case of many lawyers, an embarrassment in 'talking about money' with clients.

If we look at some of the typical problem areas in law firms today which are causing reduced profitability, it can be seen that they are all related in some way to the pricing of work. For example

–

- A poor understanding of clients' needs

- Insufficient or a lack of work scoping – possibly one of the most serious financial management shortcomings in many firms today
- A lack of knowledge as to the ‘costs of production’
- A lack of knowledge of how to accurately budget for work
- A desire to ‘win work’ on any basis
- A lack of communication with clients ‘about money’
- Inefficient management of work to an agreed or indicated price

Any one of the above can result in substantially reduced profitability, increased risk and damage to client relationships.

Pricing work requires in particular the need to develop techniques –

- to profitably price and win the work
- to negotiate prices with clients
- to strengthen client relationships

Consider the questions below

How does your firm price its work?

Do you quote hourly rates and provide an estimate based on those rates? If so, it begs the question – *‘How do arrive at your hourly rates and your estimate?’*

Or, do you consciously think about the profit you want to make on a job and then price that job with a view to achieving that desired profit margin?

Do you exercise any controls over how your partners price their work or are they more or less free to agree with clients whatever they want?

What are your partners’ prime objectives when quoting for work? Are they –

- just to keep busy?;
- to meet their billing targets? (which measure only turnover rather than profit and may be the basis for reward); or
- to consciously build your firm's profitability by achieving a given margin in doing the work?

If some of your work is based on hourly rates then consider how much more profit you would make if you were to increase your hourly rates by £20 per hour for all fee earners and you fully recovered the £20?

Example

30 fee earners, each averaging 1000 matter related hours per annum

= 30,000 man hours X £20

= £600,000 additional revenue

If you were only able to recover say £10 per hour and not the full £20, you would still make an additional £300,000.

Worth doing?

Alternative pricing models

There are in place of the open-ended hours based approach, now a multitude of alternative pricing models, including

- fixed fees
- unit / menu pricing
- outcome bonus
- holdback
- contingency fee
- equity payment
- retainer
- stepped discounts
- blended rates

Each of these different pricing models will carry a different risk for a law firm and the client, and as risk to the law firm increases then there is a greater need required to control pricing and for performance management of the work to control costs.

Scoping work

This is the aspect of pricing where, from our experience with law firms, much more work needs to be carried out, because at the moment it is often not being done, or at least not being carried out in any systematic or methodical manner.

Why is scoping work so important?

- Detailed scoping of work is an important part not only of managing profitability but also of managing client expectations and ensuring continuing client loyalty.
- Scoping a job in detail will enable a firm to better manage its financial risks by reducing the risks of under - pricing its work and so help to ensure it does not make a loss on that job and on every similar job. And if price is the major factor for the client, it will provide the firm with the parameters and flexibility within which it can work when negotiating the price to win that work.
- Something which is often ignored when pricing work is the *risk* involved in doing certain types of work or acting for certain clients or types of clients. Asking relevant questions in order to adequately scope work will reveal factors which are unlikely to be taken into account by a standard hourly rate applied within a firm across the board, including for example –
 - The amounts involved in relation to a matter and, on a worst case basis the potential loss to the client if it all goes wrong relative to a firm's P I cover?
 - Is it novel work?
 - The firm's expertise / experience on a daily basis of carrying out that kind of work?
 - How busy are the partners / other fee earners who are involved in that type of work and is there available manpower to deal with the matter?
 - The identity / nature of the client?

If the risk / reward correlation shown by factors such as these indicates that the risks involved are too high in relation to the potential fee then these risk factors should be built into the price to reflect those risks if the firm is to safely and profitably take on the work. Alternatively, a firm might decide, given the risks highlighted by the scoping exercise, not to take on that work.

One of the techniques which firms can develop to help them better scope work is to 'dissect' a number of earlier files on similar matters in order to find out exactly what is involved to execute that type of job. Having done that, a firm should then 're-engineer' the work required to carry out the matter, by questioning the necessity and effectiveness of each step with a view to arriving if possible at, from a client's point of view, a better and more cost effective way of carrying out the work.

Templates to then guide future scoping of similar jobs can be produced and these should in turn facilitate easier and more effective budgeting of the work.

Budgeting for work

Scoping a job effectively will enable a firm to know what will be involved in executing the work which will make it easier to plan how the work is to be carried out, the expertise and experience required and who will need to be involved. This will in turn require that when managing the work, strong delegation skills by partners are applied if the full benefits of 'leverage' are to be achieved and profit maximised.

The natural places to look when considering scoping and budgeting for a job are as explained above, previous files involving similar matters. However, previous files need to come with a '**health warning**' because relying on them can seriously damage your financial health, as explained below.

2. Capturing matter related time

To avoid budgeting for work based on the 'discounted' pricing shown by earlier files, if earlier files are to be used then they should be used with caution because the lack of full recording of all matter related time on files is a problem with which many law firms seem to struggle.

The reasons for lack of time recording are varied and the 'leakage' attributable to this, whether pricing is based on an hourly charge out rate or fixed prices, can make a serious dent in profitability. However, the chances are that many of your fee earners are 'losing' at least 30 minutes per day of time they are actually working on client files but for whatever reasons, are not recording. Capturing just small additional amounts of matter related time can substantially increase profitability as this example shows -

30 fee earners each working 220 days per annum = 6600 man days

6600 man days X 30 minutes = 3300 hours per annum

3300 hours X £200 per hour = £660,000 additional revenue

X £250 per hour = £825,000 additional revenue

Worth doing?

Educate your fee earners as to why full time recording is important

Whether a firm prices its work on a fixed fee basis or charges by the hour, recording matter related time by fee earners is an important management tool and as such is a vital element in building profitability -

- Time worked on a matter is only one factor to be taken into account in arriving at the 'right price for the job', but without knowing what will be involved in managing work then controlling costs will be difficult if not impossible;
- If fee earners under-record time on files then they are pre-judging the decision as to what is the right price for the job;
- It will not be possible to safely quote a price for similar work in the future based on files where time has not been fully recorded.

Some practical steps to take to improve the capture of matter related time

- Make it easier for your fee earners to record matter-related time;
 - Review your time recording system – how user friendly is it?
 - Train your fee earners regularly to use your time recording system more effectively;
- Review your 'non-chargeable time' because it is often used by fee earners to just fill up the day when they have insufficient matter related time to record. Ideally remove the ability of fee earners to record 'non – chargeable time' unless they have a real non – fee earning role to perform which needs to be monitored;
- Compare daily time recorded by fee earners with the hours they are in the office. The 'utilisation rate' is an important performance indicator.

The message to fee earners should be that -

'If time relates to a client matter then fully record that time so that the firm

- will have a complete record of what work has been done for the client; and
- can make an informed decision as to price when billing the matter'

3. Maximise the realisation rate / stop writing off the value of time which should be properly billed to the client

Writing off the value of recorded matter related time causes law firms to haemorrhage a great deal of profit.

Check your realisation rate, which is the percentage of the value of recorded work in progress on a matter which is billed to a client.

NB - this is unlikely to be an accurate figure because there will probably not have been full matter related time recorded on the file.

How much work in progress did you write off in your last financial year?

Introduce a write off policy such as the following –

'All WIP to be written off more than [£100] or [5%] of the recorded time, whichever is the higher, must first be approved in writing by the [managing partner]'

How much more profit in your last financial year would you have made if you had reduced by 50% the value of work in progress you wrote off?

Negotiating Prices

As the above examples illustrate, profitability really can be increased substantially if just small improvements can be made to each of the disciplines described above.

However, ultimately profit improvement involves managing the behaviour of people and improving their skills and the area where there is perhaps the greatest potential to do this is in relation to **negotiating prices**

In your firm, how do you approach discussing money with clients? Is it -

- face to face?
- on the telephone?
- by email?

And who discusses pricing with clients? Is it individual partners / other fee earners, or in relation to more important matters, is it the managing partner, finance director or a group head?

There seems to be evidence in many firms that there is a need for **better negotiating skills** on the part of some individual partners. Sometimes this may be

- a matter of helping certain partners to develop useful negotiating techniques with clients to help them achieve desired pricing outcomes;
- more often however, it can be an issue of some partners feeling embarrassed to talk to clients about money.
- Some partners may also consider that to discuss money with clients will damage their relationship with clients, although the opposite is usually the case as clients are likely to have far more respect for a partner's abilities if that partner is able to engage in a robust pricing discussion.

Coaching on a one to one basis can often be highly effective to deal with these hurdles to effective price negotiation.

Preparation for a pricing discussion is also key. A discussion as to price should not be treated as a casual chat. Doing your homework as to the scope of the work required and a budget based around that, and being clear as to how you will deliver 'value for money' are basic to that preparation, to help you to show clients why they should buy from you rather than from one of your competitors. Matters to be emphasised may include for example some of the following –

- the **results** you can show you have achieved for other clients and can achieve for them;
- your high levels of expertise / industry knowledge which put you ahead of your rivals;
- your highly developed and efficient processes you use to deliver 'more for less';
- your innovative and cost effective methods of internal working using for example, your team approach, as a way to deliver more value for money.
- Any alternative billing arrangements you have devised which can benefit both client and law firm and strengthen the relationship.

You will also need to have a clear idea of how far you can / are prepared to go if pushed by the client to reduce your price. This is where scoping work beforehand can be important as it can help you to offer a slimmed down scope of work if faced with a price reduction.

On the other hand sometimes there comes a point where it becomes clear that notwithstanding all your abilities to manage work to a price and even though you would like to work for that client, it is not worth taking on that particular job at the price offered because you will only make a loss. You cannot run a profitable law firm on the basis of loss leaders.