Chapter 1: The business case for project management

The shift in the balance of power from seller to buyer
Much has been written about the changing market for legal services. There is a range of views, from predictions about our profession’s imminent demise,¹ to more moderate assessments of the short-term impact of the economic downturn.

There is no doubt that the legal services market is changing and the important question is why this is happening. If the new demands of the market amount to nothing more than short-term price pressure arising from a challenging economic environment, we can assume that the pendulum will begin swinging back, particularly now that we are seeing signs of economic recovery. However, a close examination of what is really behind these changes suggests that the recession was merely a catalyst for an inevitable shift in the balance of power from seller to buyer that will have a long-term impact on the way lawyers work. The boom experienced by the legal profession in the decade leading up to the recession created an environment in which law firms – and not clients – were dictating the way legal services would be priced and delivered. This is a most unusual dynamic in a service business, and it cannot reasonably be expected to continue.

Embracing business realities
There is a misalignment between the way law firms work and the way clients work, and a failure to address this disparity is a strategic mistake.

Consider the following three characteristics of the legal profession and the extent to which they are misaligned with the business objectives of most buyers of legal services.

Time-based billing
Businesses are constantly looking for ways to improve efficiency in order to reduce costs and increase profits. Law firms, on the other hand, do not need to be efficient in the provision of their services to be profitable. Since law firm revenue depends on generating billable hours, utilisation is a major profitability driver. But efficiency is not.

In most law firms, compensation and promotion are typically linked in one way or another to the number of billable hours that lawyers generate for themselves or others. The incentive to generate billable hours is obvious and the risk that this could lead to cost inefficiencies has historically been borne by our clients.

At the risk of stating the obvious, clients prefer pricing models that encourage, not discourage, efficiency.

Annual rate setting
Generally, hourly rates are the product of a firm’s own costs, plus a profit margin. This is why the legal profession is sometimes referred to as a ‘cost-plus’ business. Individual rates generally increase each calendar year, on the assumption that lawyers become more valuable with each year of experience. While this may be true,
it does not take into account the real value of the work to the client. Although many law firms will conduct market research when setting rates, it is often limited to an investigation of what competing law firms are charging for lawyers with similar year of experience.

In the period leading up to the recession, the cost-plus business model led to an unprecedented period of growth and profitability for large law firms around the world. Legal services were in high demand and growing salary, space and technology costs drove rates up every year. The price of legal services increased substantially and a backlash was inevitable.

**Unpredictable overall costs**

Corporate clients run their businesses according to budgets, with strict accountability for cost overruns. They typically receive pricing from their suppliers that is transparent and predictable.

The law firm practice of setting the meter at the beginning of a mandate and charging whatever amount is displayed at the end is at odds with this fundamental requirement of good financial management. Although fixed-fee pricing is becoming more common in certain areas of legal practice, the legal profession as a whole appears to be lagging behind other professional services in adapting its pricing models.

Accounting and consulting firms have adjusted their compensation systems and pricing policies over the years to bring them more in line with the needs of their clients. In the consulting industry, more attention is given to the expected cost of a project, since there is often a threshold decision to be made as to whether the project is worth undertaking. A cost-benefit business case is a standard requirement. If the project is mandatory or critical to the business, as is frequently the case in legal matters, this dynamic can change. For example, in the late 1990s when the business world was concerned with the impact of ‘Y2K’, IT consulting firms had the ability to simply turn on the meter and begin charging. Shortly after ‘Y2K’, this market reverted back to a very cost-conscious environment, where companies looked long and hard at the cost-benefit analysis before approving a project. The parallels to the post-boom legal profession are clear.

It is not reasonable to assume that the legal profession can continue to be an outlier. Time-based billing, arbitrary annual rate setting and the lack of transparency and predictability in pricing are being questioned by an increasingly sophisticated market. A client’s perspective on this is provided in Case study 5.

One very good reason to consider project management is that it will enable a law firm to align itself more closely with its clients’ interests, and this will result in a service delivery model which is more in line with client expectations and business realities.

**The growth of in-house legal departments**

With the increasing size and sophistication of internal legal departments, law firms are playing a less essential role in the business of their clients and are looking more and more like other professional service providers. In this role, it becomes more difficult to justify a service delivery model that is unique.

Many of the individuals who now lead in-house legal departments would have spent some part of their careers in private practice, and so would have a very good understanding of the cost-plus model and the various ways it can work to a law firm’s advantage. They would also have
a unique perspective on the dramatic increase in profits per partner enjoyed at most firms during the boom years. They might reasonably question their own role in tolerating this trend and believe it to be in the best interests of their organisation that they address this apparent imbalance. And that is precisely what they are doing.

The Association of Corporate Counsel (ACC) is the largest organisation of in-house counsel in the world. It has over 25,000 members, representing over 10,000 organisations in 75 countries. The ACC recently surveyed its members to determine what general counsel valued most in its external legal providers and this is what it found:

- Better management, lean efficiency;
- Certainty/predictability;
- Focus on outcomes and results, not just process and analysis;
- Costs that equate with value received; and
- Outside counsel and firms whose motivations and business model are aligned with the client’s.2

Having identified a gap between what its members expected and what they were in fact experiencing, the ACC issued its ‘Value Challenge’. In essence, this is a challenge to law firms to increase the value and reduce the cost of their services (without impacting their profitability). It is also a challenge to in-house counsel to collectively drive this change.

One of the tools that the ACC developed to assist its members in this effort is the ‘ACC Value Index’. This is an online review of law firm performance on a five-point scale (with one being the lowest score and five being the highest). The firms are rated on the following criteria:

- An understanding of objectives/expectations;
- Legal expertise;
- Efficiency/process management;
- Responsiveness/communications;
- Predictable costs/budgeting skills; and
- Results delivered/execution.

The results are available to all ACC members. The ‘Value Index’ is relatively new and the impact on a law firm’s business remains to be seen. However, given that the ‘ACC Value Index’ scores are available to some of the most influential corporate counsel in the world, it clearly does have the potential to play a significant role. In any event, the introduction of accountability on metrics such as budgeting, cost predictability, efficiency and matter management should increase the pressure on law firms to improve their skills in these areas.

In a market that is demanding predictability, efficiency and cost control, law firms must focus on matter management skills to stay competitive. Project management is typically not taught in law schools and while lawyers are generally adept at managing complex legal work, budgets are something most will avoid if possible. Project management can provide the tools and training necessary for lawyers and other legal professionals to perform well in this new environment.

The fragmentation of the legal services market

Globalisation and advances in technology have allowed new entrants into the legal services industry in the form of legal outsourcing and online resource providers. Clients can now divide a single legal mandate among more than one kind of service provider to help ensure that the work is done as cost effectively as possible. Electronic storage and delivery of documents
have also made the physical location of work irrelevant. The availability of online resources in virtually every area of law provides more or less equal access to the raw material of the legal profession. Legal research and document review can be conducted in any location, at any time of the day or night.

These technological advances have caused the full-service law firm model to find less favour with clients who are looking for lower-cost alternatives for more routine work. There is a willingness to ‘unbundle’ legal mandates and to award portions of work to whatever service provider can do it most cost effectively. The growth of legal outsourcers and other alternative service providers in recent years demonstrates that this is not simply a trend, but it is likely to be a permanent fragmentation of the legal services market. Royal Bank of Canada makes it clear in Case study 5 that outsourcing and technology are two important components of managing legal expenses.

Many law firms cannot, or may not, wish to compete with legal outsourcing companies. However, law firms must learn to collaborate with their clients to find the appropriate resources for their work, taking into account all available options both inside and outside the firm. This is most effectively done in firms with a project management capability, because it requires a breakdown of all components of a matter, as well as an understanding of the cost and availability of firm-wide resources. Project management would also facilitate a realistic assessment of the cost of various components of the work. This will make a discussion with the client of the relative value of the work much easier.

The increasing demand for alternative fee arrangements (AFAs)
The market is shifting away from hourly billing and becoming increasingly interested in AFAs. These almost always involve the transfer of some economic risk from the client to the law firm. This can obviously pose a threat to firm profitability unless these non-standard engagements can be priced and managed using some kind of project management framework. Legal project management can help a firm navigate this new pricing environment. (A detailed discussion of this is provided in Chapter 9).

The business case – Six compelling reasons
Before developing a legal project management programme for your firm or legal department, the business case must be understood by everyone involved in the effort. It helps to have a few quick responses ready for lawyers who may prefer the status quo. We have summarised the business case discussed in this chapter as follows:

- **Addressing disparity** – the misalignment between the way law firms work and the way clients work is not sustainable. Law is a service business that must align itself more closely with the interests of corporate clients. Project management is a structured approach that will bring a law firm’s service delivery model closer to the business requirements of its clients;
- **Making the link** – clients want to see a clearer link between the cost of legal services and the value of those services to their business. This is more easily done within a project management framework, where the client defines what a successful outcome looks like and has a reliable estimate of the costs involved in achieving it;
- **Staying competitive** – the market has placed a premium on predictability, efficiency and cost control. This is not likely to change. Law firms must improve
their planning, estimating and matter management skills in order to stay competitive. Project management can do this;

- Responding to the fragmented market – clients can now divide a single legal mandate among more than one kind of service provider. Project management systems will help law firms adapt to, and perhaps even exploit, this new fragmented market;

- Responding to pricing pressures – alternative fee arrangements pose a threat to firm profitability unless they can be priced and managed using some kind of project management framework; and

- Opportunity for market differentiation – although project management is not new, the legal profession has been slow to recognise its benefits. This presents a rare opportunity for market differentiation. Law firms that are prepared to make project management a priority are in a position to have an early-mover advantage in an increasingly sophisticated and competitive market.

References