Practical Innovations in Legal Pricing

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Chapter 7:
Pricing legal work is a two-way street

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The legal marketplace has unquestionably shifted, notwithstanding the law firm partners and in-house counsel who lament the good old days. Gone are the days when a general counsel would identify a short list of lawyers from the elite tranche of law firms in a particular market segment, demand a 15 percent discount from the best rates offered to anyone else, and then publish an approved counsel list so anyone in the legal department could assign work to that firm and lawyer without a second thought. At least until a new general counsel arrived, or in five years when good sense dictated that the law department review its approved counsel and rates, whichever came first. The new world means law departments employ procurement and operations analysts to identify quality metrics and then routinely push all legal work through a competitive bidding process to find the most suitable provider. And law firms increasingly employ pricing professionals to adapt the traditional hourly rate pricing to fixed fee and value pricing and contingent arrangements. So why are so many law firms retained on a basis that, call it what you may, essentially boils down to brand strength plus hourly rate discount schedule? No one's surprised to hear that many law firms continue to lag in adopting these proactive measures. But it shouldn't come as a surprise to learn that many law department buyers are just as laggard in their behavior. It's time for both parties to step up their game.

Market disruptions drive change… sometimes

In a market disruption, there are predictable patterns of behaviors exhibited by the incumbent participants. I and many others have written extensively about law firms, playing the role of taxi drivers and licensing commissions, pursuing legal and regulatory assistance to prevent law departments from turning to alternative legal providers, playing the role

of Uber and Lyft in our disrupted ecosystem. When the incumbent sellers fail to impede the progress of disruptors, they then take to characterizing the disruptors and their various approaches as harmful to quality, incorrectly conflating the notion of "What I'm comfortable doing" with "What's good for the buyer." Finally, the incumbent sellers acquiesce, slowly but surely adapting, in large part by adopting innovations first introduced by the disruptors. Those who don't adapt eventually and inevitably disappear.

But there's also a repeatable pattern of buyer behavior. Returning to our ride sharing metaphor, a fast-growing number of former taxi passengers in major cities have used Uber or Lyft, but a far greater number have *not yet* used a ride sharing service. When new disruptions emerge in a market, a small number of early adopters will quickly embrace these disruptions. However, most buyers will resist, some against all reason, for quite some time until serendipity or "strong encouragement" from internal stakeholders force them from their comfort zone. According to Forbes, in 2016 Uber had 8 million users and operated in well over 300 cities, while Lyft had 0.7 million users in 61 cities. But there are numerous news reports of reluctant buyers eschewing ride sharing services due to, among other reasons, disproportionate concerns about safety. Similarly, there is a large number of law departments, both big and small, and operating in a variety of industries, who resolutely ignore disruptive approaches, choosing instead to select outside counsel in large part on their chosen law firm's willingness offer fee discounts. However, the market disruptions eventually enter the mainstream, giving air cover to even the most reluctant and change-resistant buyers.

Lower cost inefficiency is still inefficiency

Market disruptors generally drive down prices for services delivered the "old" way. This poses both an opportunity and a challenge for a buyer looking to rein in costs. There's plenty of opportunity to embrace new ideas and generate greater productivity at a lower cost without compromising quality. However, it's generally far more comfortable to use this downward price pressure to squeeze existing suppliers into lowering rates, into doing more for less, thereby avoiding significant upheaval in the procurement of critical services while simultaneously reducing expenses.

Consider the law department relying on four primary law firms for critical legal work in the primary jurisdictions in which its business

operates. Each of the four law firms has significant experience in the industry and type of matter. However, each relies on the hourly billing model, an approach in which hourly rates must increase every year to reflect the increasing seniority of the lawyers, irrespective of the value of the services to the client. In an efficient market, a longtime supplier will rely on accumulated experience to reduce the cost of goods sold, and share these savings with its clients in order to reduce the likelihood of defection. In the law firm market, however, while lawyers may discover potential efficiencies via this learning curve, they have no economic incentive to charge less, because doing so leads to lower revenues and profits.

Enter the disruptor, who offers alternative approaches to the law department buyer at a lower cost than the current law firms. This quickly ripples through the market, and the value of the services are reset and "anchored" to this new price level. Even if the law department doesn't end up adopting the disruptive new approach, its representatives are now emboldened to seek discounts from its four current law firm suppliers. They may also seek different law firms offering the same services but at a lower price point. Alternatively, the law department leaders may compare the law firm prices to the cost of internal staff and conclude that it's more economic to add headcount to the law department, thereby converting the episodic and external law firm cost to a permanent internal carrying cost.

In both scenarios, the law department avoids the costly and distracting burden of adopting disruptive new technology, but may also forgo the offsetting virtue of increased productivity. Simply lowering the cost of acquiring inefficient services, services that over time always *increase* rather than *decrease* in cost, is a short-term and lazy solution. In some cases it may make sense to increase internal staff, but the recent trend of significant increases in law department sizes is unsustainable. Few CEOs will agree to permanently divert limited working capital to internal, non-strategic, episodic resources. Even if the current CEO has agreed to this "build vs buy" outcome, the next one is unlikely to.

What we really need is continuous improvement

While one immediate benefit of market disruptions for buyers is increased pricing leverage, this is a red herring. Squeezing law firm suppliers or shifting to lower-cost versions of the incumbent law firms is a temporary and fleeting fix. The real opportunity lies in embracing a continuous improvement mindset and culture.