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FM Feature

FINANCIAL MANAGEMENT

Raise Your Firm's Billing Structure ROI

How you charge clients can help, or hurt, firm profitability. Are you making the most from every matter?

The demand for legal services hasn't been exactly robust since the Great Recession hit. In 2009, demand declined at a rate of 5.1 percent. In the years between then and now, it has varied from flat to slightly negative, according a 2015 *report* from the Georgetown Law Center for the Study of the Legal Profession and Thomson Reuters' Peer Monitor.

ERIN BRERETON
Owner, Chicago Journalist Media

"The billable hour is still out there, and one thing we're seeing is that many law firms are receiving requests from clients to provide accrual information."

CHRISTINE INDIANO
Manger, HBR Consulting

Facing increased competition for a reduced amount of available work, many law firms have encountered greater pressure to woo clients with attractive pricing. For some, that has meant offering a greater number of alternative fee arrangements (AFAs), which provide clients with additional cost predictability.

Other firms have held on to the traditional billable hours system for at least a portion of the matters they handle.

When determining what AFA/rate-times-total-hours mix a billing structure should include, firms need to take several factors into account. If your firm's current fee system isn't proving as profitable as you'd like, consider using the following information to make adjustments.

BILLABLE HOUR BEST PRACTICES

It's fairly rare for a firm to solely charge clients by the hour; only about 7 percent of firms avoid using any type of non-hourly billing, according to Altman Weil's 2015 Law Firms in Transition *survey*.

Still, billable hours remain a popular option. In 2014, partners worked an average of 1,686 reported billable hours; their non-billable hours were, on average, about 526, according to Major, Lindsey & Africa's *2014 Partner Compensation Survey*.

In an AFA, firms can lose money if they end up spending more time and resources than they'd planned.

Hourly billing provides compensation for all the time spent on a matter. However, to maximize profitability, firms need to ensure attorneys’ hours are being accurately tracked — which can be a challenge for small firm attorneys, who are likely handling additional administrative and other tasks. A 2012 LexisNexis *survey* found 39 percent of time wasn't being billed at firms consisting of one to two lawyers.

“We’ve been seeing AFAs gradually creep into the marketplace for the last seven years. Before that, they were kind of a novelty.”

MICHAEL RYNOWECER
President & Founder, BTI Consulting Group

“The billable hour is still out there, and one thing we’re seeing is that many law firms are receiving requests from clients to provide accrual information,” says Christine Indiano, a manager at legal adviser HBR Consulting. “Clients are getting a little fed up with waiting until the end. They want to know two weeks in what you have done.”

Firms whose attorneys only log their time once a month have found early-in-the-matter client requests difficult to fulfill, according to Indiano.

To offer clients additional clarity, Foley & Lardner LLP, which employs nearly 900 attorneys and has offices in North America, Europe and Asia, launched a budget management tool in 2009. Clients can use the tool to track fees and expenses throughout the billing cycle and compare them to budget estimates, providing additional matter cost predictability.

“It was a pioneering approach to legal project management,” says the firm’s Pricing and Analysis Manager, Jon Lindrus. “Back then, we had anticipated that the way law firms needed to interact and serve their clients would change. It is clear today that clients have universally come to value and expect more transparent, predictable pricing from their law firm.”

RISING AFA REVENUE

AFAs, of course, existed before the recession. Firms like Fox Rothschild LLP, which predominately charges by the hour, has used them for a long time. According to Firmwide Managing Partner Mark Siloh, the 750-attorney firm, which has 22 offices in the United States, has explored alternate arrangements throughout its 109 years in business.

However, fueled by client demand — the reason 68 percent of firms *say they offer AFAs* — alternative fees grew from roughly 5 percent of total revenue at the world’s largest law firms in 2008–2009 to around 22 percent in 2015, according to the *ABA Journal*.

“We’ve been seeing AFAs gradually creep into the marketplace for the last seven years,” says Michael Rynowecer, President and Founder of BTI Consulting Group. “Before that, they were kind of a novelty.”

In 2015, 88 percent of firms with 50 to 99 attorneys and 100 percent of firms with more than 500 attorneys used AFAs, according to Altman Weil's annual law firm survey.

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MARK SILOH
Firmwide Managing Partner, Fox Rothschild LLP

"Clients want lawyers to have some skin in the game," Siloh says. "Most lawyers would be very happy to continue billing by the hour and going merrily along. [But] clients have leverage — that's why AFAs are gaining acceptance."

Smaller firms, according to Rynowecer, can often be a bit more aggressive in AFA use.

"Large law firms often say they need approval to enter into an alternate fee arrangement," he says. "Smaller firm partners typically don't, so they can be more flexible."

Yet to ensure AFA work is profitable, firms need to handle the work efficiently. Indiano recommends reviewing the firm's current matters to examine which types have provided the best return on investment (ROI), and why.

"[Identify] a set of matters that have been the most profitable because they were set up in a certain way — for example, 75 percent of the time involved came from associates," she says. "Then look at what would be best going forward."

SUCCESSFULLY BLENDING AFAS AND BILLABLE HOURS

A portion of most firms' work — anywhere from 10 to 40 percent — is alternative fee arrangements, according to Rynowecer.

Some firms tie specific alternative billing methods to certain types of cases, such as labor and employment litigation matters. However, implementing one-size-fits-all pricing can be complicated, says Lindrus, whose firm routinely offers fixed project fees, stop-loss arrangements and other types of AFAs.

"Just because one arrangement works for a particular client does not necessarily mean it will work for another client — or even the same client on a different matter," he says. "It is critical to understand the client's priorities and needs first — their assumptions and the scope of the work — to determine the best pricing arrangement for any given client or matter."

"It is clear today that clients have universally come to value and expect more transparent,

To help analyze previous work and determine which AFAs will work best, HBR has seen an increased number of larger firms hire a dedicated pricing professional in recent years. As of 2015, 76 percent of U.S. firms have added some type of pricing officer, according to Altman Weil's Law Firms in Transition survey.

"It's really a newer role," Indiano says. "It allows firms to have someone to lead and say, 'These are *predictable pricing from their law firm.”*

JON LINDRUS
Pricing and Analysis Manager, Foley & Lardner LLP

our policy and procedures going forward for bringing in new clients. These are the standard AFA options we’re allowing.’”

Determining how many AFA cases to accept, in addition to a firm’s billable hour matters, can be somewhat of a science.

Fox Rothschild asks clients who request an AFA to submit a memorandum outlining the reasons they want it and why they think they’d be a good candidate for one. Siloh says the firm tries not to vary from its basic AFA format — which typically involves a client paying a significant percent of its standard fees, plus a success fee ranging from 10 to 30 percent of the case’s resolution, at the backend to compensate the firm for working with a reduced fee during the matter.

In recent years, Fox Rothschild has also begun requiring another practice-area partner to review the memorandum to confirm the initial analysis of the case’s worth. If the firm determines the work involved will render an AFA unprofitable, it declines the client’s proposal.

If the firm agrees to the AFA, its success fee isn’t guaranteed. However, when the firm periodically assesses its work, if the sum profits from all AFA matters equate to the amount clients would’ve paid under its full billing rate, Fox Rothschild considers the system a success.

“We understand that when we do alternative fee arrangements, some will be winners, and some won’t,” Siloh says. “But if it gets us back to neutral, we think that’s a good result.”

ABOUT THE AUTHOR

Erin Brereton is a legal industry marketing consultant and freelance journalist who has written about the legal industry, finance, business and other topics for more than 50 legal associations, magazines, websites and other publications.

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