How Law Firms Can Stay Profitable While Clients Cut Costs

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In any business situation, many forces are at work at the same time. The crosscurrents of economic influencers are ever present to drive results that are sometimes at odds, though sometimes in harmony, with each other. Fortunately, economic pressures on lawyers and clients alike are really not at odds with each other, but are aligned.

On the one hand, businesses are actively taking steps to control legal expenses. This effort has the joint goal for the client of continuing to receive high-quality legal services at a lower overall cost.

There are many ways that businesses do this. Indeed, some clients are bringing the work back in-house to cut costs, while others are appropriately identifying commodity legal work and making bulk-pricing arrangements with their law firms.

Seeking out lower-cost, high-quality law firms is another way to reduce cost. Progressive clients make sure that their law firms are efficiently handling matters, engaging in good process management, staffing matters with the right talent that is also appropriately priced, using technology to increase efficiency and reduce cost, and recommending to the client cost-effective directions to take with matters. These are but a few of the ways in which law firms can deliver “the value proposition” to their clients.

By the same token, law firms are focusing more and more on the profitability of their operations. Indeed, the law business is just that, a business. For a business to be successful and to provide a living for its staff and a return for its owners, it must be profitable. While we read much of “BigLaw” and its drive for $1 million-plus profits per partner, there is plenty to be said for “midlaw” and the simple proposition of providing a win for both the clients in the form of reasonable cost for quality legal services and for the law firm in the form of profitable operations.

We all know that profit is the excess of revenue over expenses. It has been well documented that the recent economic downturn has caused many businesses to function more profitably by reducing the cost of providing their goods and services to their customers and clients. Law firms are no different.

Law firm managers have spent a lot of time and energy over the recent years doing just that — being more intelligent about expenses. For example, as work habits have changed, the legal assistant-to-lawyer ratio has changed markedly, thereby helping to contain staff costs. Many of the staff reductions are countered, however, by the addition of staff members with different skill sets than the traditional legal assistant. Law firms have added staff in areas of litigation support, IT, marketing, project management and pricing.

Similarly, law firms are learning to be more efficient about the use of their space and, as a result, have reduced or eliminated law libraries, reduced or replaced paper files with electronic files, and changed to a more uniform and reasonable office size.

Firms have worked on the cost of the insurance that they purchase, the electronic legal research that is conducted, and the other miscellaneous costs that are incurred throughout the year. Through these efforts, law firms have addressed most of the gains that can be achieved by reducing and controlling expenses.

The other side of the profit equation, the addition of fee revenue, is where the continuing and ongoing focus needs to be. All law firms seek additional business through organic growth, lateral acquisitions, mergers and entering into new geographic, practice or industry markets. All of this is going on concurrently with clients’ growing sensitivity to the cost of legal services, increased competition amongst law firms, and the growing commoditization of legal work.
Lawyers and law firms feel the pinch of these crosscurrents that affect fee revenue. More appropriately, however, lawyers and law firms should be ahead of the game, seeking ways to deliver legal services in a more cost-effective manner while at the same time ensuring that the quality of the work remains high and clients are increasingly satisfied in this ever-changing legal environment. In short, this is the time for both the clients and the law firms to succeed on a much higher plane of cooperation and uniformity of goals.

Law firms should look at today’s reality as an opportunity to better serve their clients. Clients rightfully demand value — value in the terms of wise counsel, the efficient delivery of legal services at a reasonable cost, effective budgeting, and predictability of results and costs. A curious fact, one that is sometimes rejected by or lost on lawyers, is that by properly responding to those demands and delivering the value that is sought by their clients, they can do so competently and profitably. These client demands are not to be resisted. They are to be embraced.

Recognize that in today’s articles and programs on this subject, clients rarely talk about the quality of the legal services. That is a given. It is demanded and expected that lawyers serve their clients well. That goes without saying.

The definition of quality has evolved. Of course, the full knowledge and analysis of the law is assumed. But there is much more. Clients want a frank and open discussion of the cost-effectiveness of handling their matters, and the steps that could be taken on their behalf to value engineer the process and to achieve a cost-effective result at a price that is fair for the client and the firm.

The law firm, on the other hand, needs to make sure that it is able to deliver those services by assigning the work to people who are properly trained and properly priced and who use appropriate technology, and carefully budget the overall cost of the delivery of those legal services in a way that achieves the client’s goals and then delivers the legal services as planned and budgeted, unless circumstances change.

Whether the client requests it or not, the firm and the partner in charge of the matter should develop a budget. The steps that need to be taken to handle the matter must be carefully foreseen and parsed. The cost of each of those steps must be carefully identified.

By breaking those steps down into their component parts, the time and cost involved in each component level of the process can be determined. In calculating that cost, the law firm can identify the individuals who will be involved in delivering each component part of the service, and the cost to the firm of those individuals.

Once completed, the budget prepared for the client also becomes the firm’s cost analysis for the work. With that budget and cost analysis in hand, both the client and the law firm can determine whether the result can be obtained cost-effectively and whether the law firm can profit from the work. Both client and law firm win.

If lawyers are not looking at concepts like gross and net margins, they are only kidding themselves that they can continue to deliver legal services effectively for years to come. They cannot continue to take in matters that add to the top line without knowing how much it will cost to do the work.

The old adage is true, “you cannot make it up on volume” if the work is not profitable. This exercise must be engaged in by law firms, by practice groups, and by individual lawyers as they determine how to continue to deliver quality legal services at a reasonable price so as to provide the profits necessary for the law firm venture to continue and to keep client satisfaction high. —By Raymond J. Werner, Arnstein & Lehr LLP

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