

# The price is not right

**John Chisholm** predicts the demise of law firms charging by the hour for their services – and looks at more efficient and innovative ways for firms to price their work.

**“I** have been saying for some time that hourly rates are becoming a thing of the past ... some of our younger lawyers, in particular, solely in order to write their daily billable hours, are ... being less than efficient ... the principle of payment by the hour is against the basic philosophy of total quality management and any other reasonable objective quality assessment ... we have to look at better ways to price our services ... both from our business's perspective and from our clients'.”

The above is an extract from a memo I sent as managing partner to my (then) fellow partners in 1994. While I agree I may have been slightly optimistic in my prediction that hourly rates were becoming “a thing of the past” (I prefer to think that I was simply light years ahead of my time!), I'm now much more confident in predicting the demise of time as the main, if not sole, basis on which law firms price their services.

Time costing (as distinct from time recording) took hold in Australian law firms by the early 1980s. Many management consultants/practice management vendors and accounting firms were touting it as the panacea to professional service firms at last capturing real and justified financial gain. But many legal commentators were not convinced this method of valuing our services was a smart business move. Some suggested that, as a profession, we might rue the day we introduced time costing for reputedly (short-term) financial betterment – possibly at the cost of losing longer-term real sustainable financial gain, not to mention loss of credibility with the public and our clients.

Over the past two decades we, as a profession, have come a long way in regard to pricing our services. Or have we? Despite widespread criticism from the most legal

commentators, the judiciary, governments, professional bodies, lawyers, clients and even law firm partners themselves, anecdotal evidence indicates that 70 to 80 per cent of legal services in Australia in private law firms are charged solely or predominantly by time – and that in most of the remaining 20 to 30 per cent where law firms use other methods to charge, these have been introduced at the instigation of clients, not the law firms themselves.

So why do we still largely persist with ‘the almighty hourly rate’?

In my view, the reasons are:

1. Hourly rates are easy and efficient. You can not find a simpler method. Give me an hour, record it on a timesheet, feed that to a PC, produce a read-out at the end of any month, send a bill and away we go.
2. Hourly rates are acceptable to most clients. Of course they are – we convinced most of our clients over the past 30 years that this was the way to go.
3. “All our competitors are doing it ...” and the last thing we want to do is something different.
4. Most practice management systems are built around time. And law firms have invested millions into their PMS and need to get some return on that investment. Try inserting something other than time into your firm's PMS and see what happens.
5. Hourly rates document effort. No-one can argue with that. Sometimes, you might have to give clients a list of the effort you put in (your timesheets) and occasionally a client might dispute the value attributed to the effort – or the effort itself – but that is a small price to pay for the ease of the system.
6. Most firms' budgets, measurement and rewards structures are built around



hours. Most firms still operate on an adaptive capacity model which cascades down to ‘fee earners’ who are budgeted for and expected to write x billable hours per annum, per month, per day.

7. We have not had any real training and experience in pricing or in alternative pricing models. Therefore naturally we feel uncomfortable and lack confidence in talking to our clients about anything other than the time it is going to take to do a job.
8. Over the past few years, business has been good for most law firms. Generally, most law firms have experienced increased demand for their services, with resultant increased profits. For most, there has been no real incentive to fundamentally change their basic business model.
9. It transfers all risk to the client. “As long as I do the time, I'll get paid for the crime.” We do not share any risk nor the upsides or downsides with a client. To agree on a fixed price in advance with a client requires an element of risk most lawyers are not prepared to take.

So why have/are some law firms moved/ moving towards alternative pricing models – especially fixing prices in advance – if things are so good using time as the determinant of

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charging? Principally, because (in my view):

1. Some clients insist on other pricing methods. And if we want that client's work, we have to accept their method of charging – and then perhaps change our work practices to accommodate or make the most of the client's pricing regime. Why might some clients insist on other pricing methods?
  - Even if the hourly rate is certain, often the total fees are unpredictable and uncertain and some (most) clients would prefer certainty
  - Clients sometimes feel hourly billing can lead to overservicing by the law firm
  - Some clients feel they are only paying for input and not output and that, with hourly rates, law firms do not take or share any risk
  - They know or perceive that traditionally there has been plenty of 'fat' in hourly rates and that firms will move on hourly rates if pushed
  - They know they are much better pricers than their law firms.
2. Some law firms have realised some clients do not always have their law firm's interest at heart. Some clients who are better skilled at pricing than we are (especially

those who engage procurement specialists) have successfully negotiated lower prices (hourly rates), resulting in a lower than expected financial return to the law firm and/or a retreat from those clients.

3. Some firms acknowledge that not every lawyer enjoys filling out daily timesheets. Yep, the best and brightest do not always like having to account for every six minutes of their day.
4. Some firms have worked out that, unlike many other industries, where efficiency gains are often rewarded in additional profit margins, there's little incentive to improve internal efficiencies if charging by time. In fact, hourly billing can reward inefficiencies, whereas if I could improve my internal efficiencies and yet hold or increase my prices, I could make better profits.
5. Some firms have realised that some clients prefer certainty of fees and will often pay a premium to have this certainty. These firms have gathered specialist expertise in being able to scope the work they are going to do for their clients before they undertake it and put a price on it, enabling them to fix their prices in advance.
6. Some law firms realise there's a limit to their profitability if they use hourly rates. The capacity to increase profits is limited by the number of hours a fee earner works and by the hourly rate the client/market will bear.
7. Smart firms know that if you have to estimate your fees anyway, you may as well fix your price from the outset. Marketing 101 teaches us that once you mention a price, this will 'anchor' a client to that price and often mean that significant explanation or negotiation is required if we want clients to happily accept a higher price.
8. Some firms have not only fixed their prices in advance, but also fixed their terms of payment in advance. That eliminates cash flow issues, both for firms and their clients, who often like the 'evenness' of paying regular legal fees as against the 'irregular' large chunks when work is actually performed.

The smarter, more innovative and successful firms that rely on enduring relationships with

their clients also understand that while the client is the final arbiter of value, they only want clients who appreciate the value they provide. They are not only good at properly explaining to clients the value they provide, but also good (and disciplined) at saying no to clients who do not appreciate the value they provide to them.

Such firms, when fixing their prices in advance, realise too that prior to communicating a price, the work to be undertaken has to be properly and thoroughly scoped, with both the client and the law firm understanding what is and isn't included in the price. If additional work needs to be done that's outside the scope of work priced, then the law firm re-prices that work prior to the work being undertaken.

In my work in this area with law firms, I'm continually told it is impossible to fix prices in advance, mainly due to a range of contingencies, most of which are outside the control of the firm and that, if they did fix their price on a matter, especially litigation, they may 'lose' money on it because they would invariably underprice it. I'm sure the same argument was used before market forces insisted that conveyancing, wills, retail mortgages etc. would, in the main, have their prices fixed.

Pricing is a skill we're not taught, because we haven't had to price our services as the rest of the business world has, because we've relied on 'rates' (usually set by reverse competition, I might add). However, it is a skill we could learn – if only we had the time and the incentive.

An increasing number of good law firms in the US, the UK, New Zealand and now Australia have assembled such pricing skills and are reaping the benefits associated with being early movers to any new, innovative model. One day, however, value pricing will no longer be seen as new and innovative, but simply the norm.

It is a shame that most law firms will do nothing until their clients insist on fixed prices, thereby ensuring those firms will have lost many of the financial and other benefits they might have rightfully gained had they moved more quickly. Meanwhile, such firms will continue to have arguments with clients over fees and rates, have cash-flow issues and accept a client's continued push to negotiate lower and lower hourly rates. ●

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