

Expert analysis 9: Embedding the right fee culture

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Why talk about culture?

It may seem strange that a report focusing on hard and tangible issues such as profitability, efficiencies, and cash flow should also look at something as intangible and ephemeral as culture. My colleagues at Møller PSF Group Cambridge and I however believe that one of the most important determinants of the long term performance of law firms is their culture. It follows that the culture relating to all aspects of fees, i.e. a firm's 'fee culture' will have an important impact on the financial performance of a firm.

The reasons why culture has such a major part to play in determining the fortunes of a law firm are very much rooted in the fundamental nature of law firms and partnerships. Although the typical modern law firm is a far more 'professionally managed' entity than was the case 20 or 30 years ago, there is a limit to how much influence management can exert on the day to day activities of partners.

Both the general ethos of being a partner at a law firm as well as the practicalities of partnerships (even within LLPs) means that the typical governance and performance management tools generally applied in corporates or financial institutions simply do not work at law firms. One managing partner at a major Scandinavian law firm illustrated this beautifully when he compared his job to that of the local

cemetery director's. When asked to elaborate his explanation was that 'there are lots of people below me, but nobody listens nor does anything I ask them to.'

The power of a strong firm culture is that everyone who identifies with the firm and its culture will seek to live that culture. This becomes self-reinforcing. Under such circumstances strategy is implemented not because of management edict but because partners know what to do on a moment by moment basis, based on broad guidelines built on consensus and clear understanding amongst partners as to what is expected of them. Jan Carlzon, the former CEO of SAS, the airline then famous as the world's best businessman's airline, used to talk about the '1,000 moments of truth' that tested a firm's commitment to customer service on a daily basis.¹ His view was that no management system in the world would ever be able to meet such a challenge and that it was a firm's culture that enabled any employee, anywhere within the organisation, to take the right decisions in a timely manner.

What is fee culture?

Fee culture can be defined as the principles and norms that underlie and guide partner and fee earner behaviours, beliefs, and assumptions in relation to all activities involving fees. These can be grouped into a number of broad categories as follows:

- Find the (right) work;
- Win the work;

- Deliver the work;
- Get paid for it; and
- Review and repeat.

Figure 1 provides an overview of these categories and the key activities associated with each.

Find the right work

There are few things that fee earners and in particular partners in any law firm fear more than an empty desk. Many partners are thus tempted to accept any work that presents itself (as long as they are reasonably well qualified for it) irrespective of whether this work actually makes sense from a financial perspective or whether the work would contribute to the building of a sustainable practice.

This is why most law firms now try to engage their partners in some form of forward looking business planning, encouraging individual partners to identify personal and practice goals. Some do this better than

others. Management should help partners balance short-term versus long-term objectives and determine how they could win better or more business from existing or new clients by being more structured in their approach and by collaborating better with fellow partners. Please note that more attractive or interesting does not necessarily mean more complex or 'headline' work. Some firms may be targeting very specific work that others would label as 'operational' or 'commoditised'. If these firms are structured to execute such work efficiently, winning more of this work will generate economies of scale and makes very good financial sense.

By having a clear view as to why a particular piece of work is of interest, partners will have a better, more balanced perspective on the criteria, including financial terms, for deciding whether or not to accept a new matter and on what terms. This will help counterbalance any temptations to accept work for the sole purpose of having work.

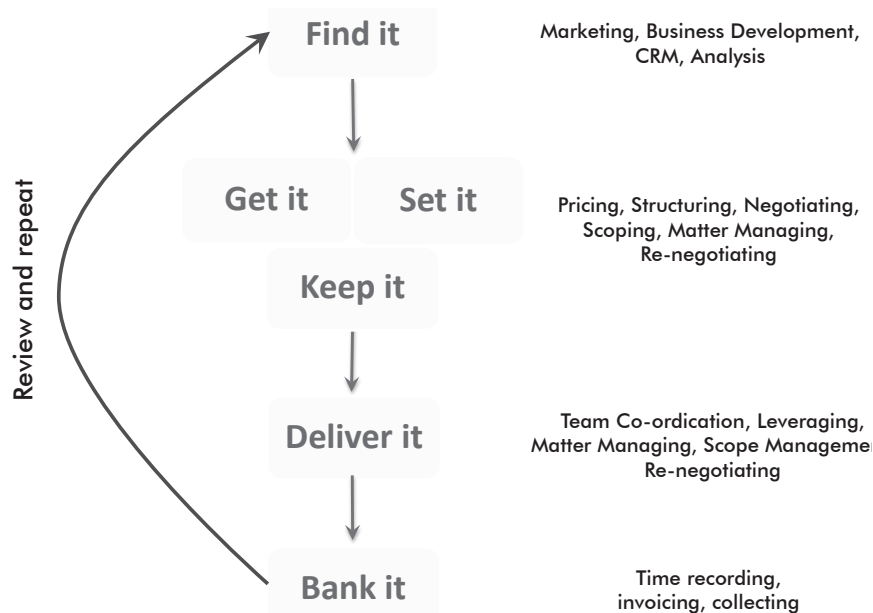


Figure 1: Principle fee activities (© Møller PSF Group Cambridge/Ori Wiener)

Broadly speaking, a piece of work that contributes little to the growth of one's practice should not be discounted (see below about the role of pricing and fee negotiations). On the other hand, a piece of work that has been identified as strategic may well be worth winning on discounted rates. This could for example include accepting work at a significant discount for a major or highly reputable new client, or it could be work that will generate innovative know-how or create a track record in a new area of the law.

It is essential that partners have a clear understanding of all of their alternatives, both in terms of potential work that is likely to be available in the market and in terms of the contribution to their practice and firm from alternative activities such as marketing and business development, generating or updating know-how, team leadership etc. Experience shows that partners will take a broader and more robust perspective on fees if they share views and ideas with fellow partners and if they feel that they have a clear understanding how their management and peers value these alternatives.

Win the work

Having identified the kind of work and clients to go for, partners need to determine what is needed to win the work. This can be broadly broken into two broad activities – business development (including pitching), and negotiating the terms of a potential matter.

Business development and pitching is all about finding topics of interest to the client, getting in front of the right decision makers, understanding what it takes to win the work, and demonstrating to the client that their best option is to use the particular firm and lawyers. Fee negotiation on the other hand is all about:

- Setting the right terms and conditions, including price, fee structure, and scope;
- Getting these agreed with the client; and
- Ensuring that the terms negotiated are the terms charged.

The latter is particularly important as changes to the work or matter are seldom properly reflected in the fees unless partners make the effort. Most lawyers find fee negotiation stressful if not downright terrifying. There are many reasons for this, chief amongst them being the perceived and real conflict between the interests of the client (as much work for as little cost as possible) and the interests of the lawyer (getting paid fairly for the work and the expertise that went into it). Partners worry that if they overplay their interests they risk losing a piece of work and maybe even the client.

They are right to worry but that does not mean that they should not try to 'fight their corner' and resist their clients' efforts to push down rates or otherwise extract additional value from the lawyer. A strong culture of sharing experience and values between partners can help individuals deal better with the inevitable pressures and risks inherent in fee negotiations.

Deliver the work

Most lawyers feel that if there is one thing that they do not need any help in it is in being a lawyer and doing their work. Unfortunately they are often wrong when it comes to running matters profitably. One of our clients conducted a detailed analysis demonstrating that almost twice as much profit was 'lost' from poor matter management as from any discounting to win work. Other CFOs confirmed that their firms' profits leakage followed a similar pattern. Reasons for these leakages include

inefficient staffing, the temptation for many lawyers to do the work themselves rather than delegate and increase leverage, poor team coordination, and poor planning. One of the biggest causes of profit leakage however is the management, or lack thereof, of scope creep. As already alluded to above, it is not unusual for matters to grow above and beyond original expectations. Either the volume of work increases and/or additional areas of work need to be addressed before the matter can be concluded. Many lawyers still react to requests for additional work by doing the additional work first and then deciding if they can invoice for it or not. The problem with this approach is that if they do not invoice they dilute their profitability or, if they do invoice they risk an unhappy client, likely to resist paying for the perceived overrun. In this case there will not only be dilution but also a relationship problem.

The recommended approach to handling changes in scope is to start by monitoring progress of the matter against the scope (this of course assumes that there is a sensible scope to begin with) and to raise the issue of fees as soon as out of scope work is needed or requested. This approach is as relevant where the fee is based on hourly rates as when the fee is fixed or based on an estimate. It is absolutely essential, if dilution is to be avoided, for changes in work to be reflected in changes to the fee promptly, and for client expectations to be well managed.

Partners need to feel comfortable about their approach to scope management and re-negotiations given that clients may well threaten with dire consequences if a lawyer does not comply with their requests. This is most likely to happen when partners support each other in resisting unreasonable client demands. This is a major area for potential improvement as there are major differences between the scope management practices

within the same firm and even the same practice area.

Get paid

An outsider observing partners in a large range of firms could be forgiven for thinking that most partners do not care about being paid. Partners seem grateful for the privilege of doing legal work for clients that submitting an invoice and ensuring that it gets paid on time seems rather like spoiling a great party. Consequently many firms' financials suffer from poor invoicing practices. This includes issues ranging from poor, incomplete or late time recording, to issues relating to late invoicing. The former is a particular problem in the case of hourly based fee structures. The propensity for associates to self-censor hours worked is frequently compounded by many partners' habitual 'hair cutting' of hours billed, irrespective of whether the hours can be justified.

Late billing also impacts adversely on a firm's financial performance. The later a bill is submitted the higher the chances that the bill will either not be paid or that the clients will demand an additional discount in return for agreeing to pay the bill outstanding.

Partners have to become more disciplined in the way they get involved and in the billings processes for their matters. Improvements in this area do not necessarily require significant additional time investments. One particular partner we worked with used to sequester himself and his billing assistant for three to four days every quarter to issue all pending invoices. Not surprisingly that particular partner's WIP used to oscillate wildly, making the firm's cash flow management even more difficult. The simple suggestion of only sequestering himself for one day, but monthly, resulted in a smoother WIP, lower write offs, and a more efficient billings process.

Partners like to reserve for themselves judgement as to when a bill should be submitted to a client. It is essential that they remain responsible for this aspect of their relationships. However, a firm's culture with respect to the 'right' way of going about this can dramatically improve such decision making processes and improve financial performance.

Review and repeat

Peter Senge's famous book, *The Fifth Discipline*,² demonstrated how competitive advantage could be generated by organisations systematically learning from reflective conversations, review, and experience. This practice is slowly spreading to law firms where transaction and relationship reviews are becoming more common. Systematic approaches to pricing or fee negotiation reviews, however, appear to be relatively rare. Partners are therefore left to themselves to judge the effectiveness of their past actions. Not surprisingly they will tend to repeat behaviours which they think were successful and tend to change or avoid certain behaviours where they think they have failed.

The problem with this individualistic approach is that it is extremely difficult to gain an appropriate perspective on success or failure, i.e. individuals are more likely to suffer from judgement errors. Winning a piece of work at a 30 per cent discount may feel good to the individual but may in fact have needlessly given away margin or may cause longer term pricing problems with the client, who may now wish to apply the discount to all other partners of the firm.

Likewise, losing a particular piece of work may feel like a failure to the individual, but, if they have applied 'good negotiation practice' and defended the firm's market position, it may in fact have been the best

thing to do. Just because a client decided to say 'no' does not automatically mean that the partner has been doing the wrong thing or that the partner should not continue as before. The propensity to reach the 'wrong' conclusion is driven by a number of psychological phenomena such as loss aversion, availability bias, and fundamental attribution error. These have to be countered to avoid long-term barriers to good fee management. Daniel Kahneman, the 2002 Nobel Prize Laureate for Economics, describes in fascinating detail how these effects and others can cause poor decision making and how these can be avoided in his book *Thinking Fast and Slow*.³

Kahneman demonstrates that one of the most effective ways to avoid these judgement errors is for reviews to be conducted in a structured and objective manner in which the experience of a number of experienced individuals is brought together and institutionalised. A firm will clearly gain if it can identify 'good practice' and help its partners to apply this, even in the face of individual setbacks.

How to embed fee culture

Having identified the elements of a strong and positive fee culture, the key challenge for a law firm's management is how to generate such a culture and how to bring it to life. There are no easy answers to this challenge. Each firm will have to define its own response to this challenge. It is likely however that the following elements will be involved.

Define goals

It is well worth it for management to define what it is trying to achieve. Where are the biggest problems? Are the issues related to unfocused business generation efforts? Are the problems due to poor partner fee

negotiation skills, or a lack of confidence? Do partners feel pressed to accept any work in order to deliver 'billable hours' rather than profit? Understanding the root causes of poor fee behaviours will help provide focus to any initiatives and will also indicate how progress can be measured.

Raise awareness

Given that most partners became lawyers because they wanted to practice law it is not surprising that many lack sufficient understanding and awareness of a firm's key economic drivers. The CFO of a major international law firm once confided that his partners had a good feel for how much turnover a particular matter would generate but that the vast majority would not have a clue regarding that matter's profit margin.

Partners need to understand the issues and drivers underlying a firm's overall profitability as well as that of each of their matters. However, care has to be taken not to overwhelm partners in this area. Most are interested to know about the value of their profit points but few will take the time and trouble to fully understand the drivers underlying this value. This sort of information is best delivered through a mixture of group presentations as well as issuing partners with selected financial information on their matter. Exception reports in which, for example, partners are provided with data regarding their 10 most profitable and unprofitable matters have proven particularly effective in generating awareness and in prompting corrective action.

Training and tools

The temptation of many management teams is to avoid as much as possible of the above, to throw training at the partners, and hope that some of it will stick – technically referred to as 'sheep dipping'. The likelihood

that training alone will achieve any major change is remote. Training as part of an overall approach to implementing change can however make a massive difference.

The High Impact Fee Negotiation training delivered by the Møller PSF Group is an example of this. The programme has been delivered to over 1,000 partners at a broad range of law firms in the UK and Europe over the last three years. Feedback from all attendees has been uniformly positive. The impact on profitability however has varied. Those firms that accompanied the training programme with a broader agenda, where one or two senior partners took a sponsorship role, and where efforts were made to share experience have generated very significant benefits. On the other hand, those firms that left partners pretty much to their own devices after the programme reported lower benefits.

Another frequently encountered approach is for tools to be made available to partners and to expect that they are used. Such tools include pricing or matter planning tools and databases of past transactions to support pricing decisions. Such tools can be very helpful but most partners will not use such tools unless it has become part of 'the way things are done here'.

Generally speaking partners are most open to changing their behaviours if they see other partners act in the appropriate way. Those firms in which partners actively teach other partners or act as role models so that other partners learn by doing will generate the greatest competitive advantages from improved fee management.

Establish a common language and expectations

One contribution that training can make is to help establish a common language across a partnership with respect to fee behaviours,

especially fee negotiations. Although it is still a matter of scientific controversy how much our thinking is influenced by our language, experience has shown that partners are better able to engage constructively with each other when they have a common language and apply commonly held principles. This is why training that establishes 'good practice' can help, but only if management find ways to bring these standards to life outside the training room.

Training can also help establish common expectations of what is appropriate behaviour or not – this however, requires exchange amongst partners with the aim of generating consensus.

Encourage partner exchange/establish consensus

One of the most important features of a vibrant culture is that all partners feel that it is part of them and that they are part of it. Lawyers, highly trained to spot problems, are a group of professionals that have a particularly high need to get assurance from their peer group. Partners learn best from each other. Allowing partners room for discussion and reflection is essential in any of the group sessions referred to above.

In addition however, partners have to feel comfortable that they can discuss fee issues openly with their peers and that it is safe to do so. Management has to play a leading role in de-risking these topics. Senior partners should engage junior partners in discussions demonstrating that taking risks and sometimes getting it wrong is part of what being a partner is all about. Best are examples where established and successful partners model good behaviours by, for example, consulting other partners ahead of a major negotiation to make sure they have not missed a trick.

Incentives and recognition

Most partners respond well to recognition of effort and do not respond as well to formal performance management or incentives systems. Most important however is a management's commitment to creating dialogue amongst partners around these themes to help partners understand what is expected of them and to provide support in specific areas. Key to this is creating an environment where partners feel that fee management is not risky and that it is well worth the effort and is the responsibility of every individual partner to help each other achieve the right outcome for the firm.

When these conditions are met firms and their partners can confidently look forward to financial success, a stronger sense of partnership, and a bright and profitable future together.

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