The Benefits of LPM

Excerpted from:

Legal Project Management, Pricing and Alternative Fee Arrangements

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LegalBizDev, 2013

The reason Legal Project Management (LPM) is growing so rapidly is that it helps law firms meet client needs and their own needs.

When ALM Legal Intelligence surveyed LPM users, they provided a list of 13 benefits and asked, "Which of the following benefits has your firm realized from its project management effort?" Every item on their list was realized by at least 20% of the group. Their most common benefit—"More productive relationships with clients"—was achieved by 62%.

The survey concluded that, "LPM can help bring increased effectiveness, reduce wasted time, and manage client expectations… Those that can successfully implement LPM will find over time that they gain a competitive advantage."[i]

The benefits of LPM include:

- Protect business with current clients
- Increase new business
- Increase the predictability of fees and costs
- Minimize or eliminate surprises
- Improve communication with clients
- Manage risk
- Increase profitability
- Improve realization
- Deliver greater value to clients

Which benefit is the most important? It depends on whom you ask.

Mike Roster, the co-chair of the ACC Value Challenge committee, has a unique perspective on the current changes in the profession. In his work as a practicing lawyer, he managed large legal teams from both sides of the table, as former General Counsel at Stanford University and Stanford Medical Center, and as the managing partner of Morrison & Foerster's Los Angeles office.

Roster often gives a talk entitled “Facing Realities,” and his key slide lists three targets that law firms must meet to stay competitive in today’s increasingly challenging environment:

1. Reduce clients’ total legal costs (either compared to recent experience or to an industry benchmark)

2. Provide high predictability

3. Improve outcomes (for example, reduce the average cost of verdicts and settlements for specific types of cases or reduce the number of workplace disputes that arise in the first place by some target percentage)

“You’ve got to provide at least one to stay in the game,” Roster says. “You will need to provide all three to win.” In his view, LPM is most effective when both sides agree on at least one of these goals in advance so that LPM is being used to achieve something specific.

Others emphasize the role of LPM in risk management.

Professional liability insurance is one of the top operating costs for most firms, and its cost keeps going up.

When underwriters set the rates for a particular firm, one factor they take into account is how well the firm manages risk. LPM can reduce professional liability risk many ways, including helping lawyers to control quality, to meet critical deadlines, to avoid or quickly resolve fee disputes with clients, and to maintain active, open and timely communications with clients on all aspects of every engagement.

For example, *Risk Management* magazine quoted Stuart Pattison, a vice president at CNA (one of the largest commercial insurers in the US), about the insurance implications of properly defining legal scope:

> A well-drafted engagement letter can spare future turmoil by spelling out the precise nature of professional services including the attorney handling the matter, specific duties that are not covered, a time-frame and a definition of who the firm will—and will not—be representing… Professional liability insurers now consider a well-established risk management program as a pre-requisite for insuring a legal practice.[ii]

According to Bob Feagin, formerly managing partner at Holland & Knight and now special counsel at Paragon Risk Management Services Ltd., “Project management is the key to improving client service, and client service is the key to managing risk. When law firms succeed in managing risk and reducing losses, that has an undeniable impact on lower rates.”

While some say that achieving a client/firm joint goal is the most important benefit of LPM, and others stress risk management, a third group focuses on its impact on AFAs and realization.

Lawyers need a reason to be interested in LPM, and the simplest and most common reason we've seen is that a firm has committed to a fixed fee. Nothing gets a lawyer's attention better than knowing that if they go over budget, they will have to pay for it themselves.

As compelling as AFA pressures are, it is important to note that AFAs represent as little as 15% of law firm revenue (see Chapter 8), so the revenue impact of LPM is likely to be far larger for hourly work than for AFAs.

In hourly work, the most direct link between LPM and profitability is in its impact on improved realization.

Anyone who has been involved with law firm finances knows that the *realization rate* is critical to every firm's success. There are three main types: billing realization, collections realization, and total realization.

Billing realization compares what is actually billed to a client to what could have been billed. More formally, billing realization is equal to the amount billed to a client divided by the value of the time recorded on the matter. There are two main ways to calculate the value of the time, one based on the actual rates negotiated with a particular client, the other based on standard hourly rates. Collections realization is more straightforward and compares what clients were billed to what they actually paid. Total realization combines the effects of billing and collections realization in a single figure. (A brief example of the calculations behind these rates can be found in the appendix.)[iii]

In many firms an individual lawyer's realization rate will affect her compensation, and the firm's overall rate has a significant impact on the bottom line.[iv]

The best available public data on law firm realization is published by Thomson Reuters. Its Peer Monitor Index is based on reported results from 116 large law firms including 45 from the AmLaw 100, 41 from the AmLaw second hundred, and 30 others. Their key measure is called "collected realization rate against standard" and refers to the "percentage of work performed at a firm's standard rates that is actually billed to and collected from clients."[v] According to a recent report, "Realization has now been falling fairly steadily for more than three years… Realization reached another new all-time low, with net collected realizations falling just below 84%."[vi]

This figure represents a serious financial issue and a danger sign. Legal project management (LPM) can help solve the underlying problems.

Many lawyers think of LPM as a way to improve performance on fixed price matters, and it is. But the vast majority of legal work is performed on an hourly basis, so at the end of the day its impact on improved hourly realization could be more significant.

Consider, for example, this common scenario: A client asks her lawyer how much it will cost to handle a particular matter. The lawyer replies that she really can't say because so many different variables are involved. The client says, "Yeah, yeah, I know. But my board keeps asking me for

the number. What should I tell them?" After additional hemming and hawing, the lawyer finally says, "Well, in the past, in situations like this we've seen costs ranging from $80K to $110K."

The client hears, "I will do this work for $80K," and passes that number along to the board.

The lawyer begins the work, and for the next few months everything seems fine. Until the matter ends and the client receives a bill for $135K. "I can't pay this bill," she says. "You told me it would cost $80K, and that's what I told my board. If it was going to cost more, why didn't you say something sooner?"

An awkward negotiation drags on for months, and the client ultimately pays $90K. The firm has to write off the other $45K. The billing realization rate on this matter is 66.7% ($90,000 divided by $135,000). No one is particularly happy with the result, and the relationship and the chances of future business have been damaged.

This situation might have been avoided by applying LPM. Our approach is based on eight key issues we first published in 2009 (see Chapter 3), and which have since become widely accepted:

Eight Key Issues in Legal Project Management

1. Set objectives and define scope
2. Identify and schedule activities
3. Assign tasks and manage the team
4. Plan and manage the budget
5. Assess risks
6. Manage quality
7. Manage client communication
8. Negotiate changes of scope

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If the relationship partner had taken some time at the start to clearly define scope, both the client and the law firm would have had a better idea of what was and was not included in the cost estimate. If she had planned the budget and managed it closely as things went along, at the very least she and the client would have had some warning about the rising cost. If there had been room to negotiate changes in scope, perhaps the client would have paid more. If there had been a hard cap, perhaps there would have been a chance to limit the work to stay closer to budget.

Constant management of client communication and expectations would have been a big help, not just for the realization rate, but also to maintain the relationship. If the lawyer in this scenario had discussed the issues with the client early in the process, she might have gotten a larger payment, or perhaps she could have met the client's true needs with fewer billable hours, and greatly increased client satisfaction.

No one would argue that LPM will end all disputes over legal costs. But it has already started to end some of them.

So what should we conclude is the most important benefit of LPM to law firms? Is it improved realization? Increased new business? Reduced risk? Something else?

You tell me. The answer depends on what you are trying to achieve.

About the Author

Jim Hassett is the founder of LegalBizDev, a consultancy that helps law firms enhance client service and increase profitability by improving project management and business development. The firm offers coaching, webinars, workshops, retreats, train-the-trainer programs, publications, and more. Contact him at jhassett@legalbizdev.com.

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[i] http://www.almlegalintel.com/SurveyDescription.aspx?id=x Sm7KzduNUc=&type=fEFgIaD+grg=, 17.

[ii] http://adverselling.typepad.com/how_law_firms_sell/2012/ 02/index.html

[iii] For an example of realization calculations, consider a small matter that required 10 hours of partner time at $400 ($4,000) and 40 hours of associate time at $200 ($8,000) for a total of $12,000. But the relationship partner feels that the associate could have been much more efficient and decides to bill only 20 of the 40 associate hours and write off the rest. He sends out a bill for $8,000 ($4,000 for 10 partner hours at $400 plus another $4,000 for 20 associate hours at $200). When billing realization is calculated based on the actual rates charged to this client, the rate is 66.7% (the $8,000 actually billed divided by the $12,000 value of the time cost at discounted rates). However, some firms calculate billing realization based not on actual hourly rates for a particular client, but rather on the standard rates for each lawyer before discounts. Assume that this particular client had negotiated a 20% discount, and that the partner's standard rate is $500 and the associate's standard rate is $250. In that case, the value of the original time is $15,000 ($5,000 for 10 partner hours at $500 plus $10,000 for 40 associate hours at $250), and the billing realization rate is just 53.3% (the $8,000 actually billed divided by the $15,000 value of the time at standard rates). This rate reflects both the discount and the write-off. Now suppose the client feels that the $8,000 bill was too high, argues his case, and ends up paying only $7,000. This yields a collection realization rate of 87.5% (the $7,000 paid divided by the $8,000 billed). In this example, if it were based on actual discounted rates, total realization would be 58.3% ($7,000 paid divided by the $12,000 value of the time at discounted rates.) If it were based on standard rates, it would go down to 46.7% ($7,000 paid divided by the $15,000 value of the time at standard rates).

[iv] According to the 2007 Law Firm Economic Survey by Lexis Nexis, "Billing realization has a relationship to increased partner income while collection realization doesn't." (To our knowledge, this is the latest available data.) In other words, lawyers are paid for billing more hours, whether clients pay for them or not. From a straight business point of view, this is a bad idea. You get what you pay for. So when firms pay lawyers for billing more hours, whether clients actually pay those bills or not, they create a culture that values billing more than getting paid. The results of this can be seen in the data on realization rates at large firms, which are not pretty.

[v] Hildebrandt Institute and Citi Private Bank, *2012 Client Advisory,* 2.

[vi] http://newsandinsight.thomsonreuters.com/uploadedFiles/Reuters_Content/ 2012/07_-_July/PMI_Q2_2012_v1.0-2.pdf