

Alternative Billing . . .

The Revenue Impact on Law Firms

Last month, Jim Hassett, founder of LegalBizDev, a business development and marketing consulting firm, published The LegalBizDev Survey of Alternative Fees. It is the most lucid and comprehensive study that we have seen on this topic.

Dr. Hassett interviewed chairmen, senior partners, and C-level executives at 37 AmLaw 100 firms during June-September 2009. His book provides revenue analysis, practice area-specific guidance, and best practices to effectively design and implement non-hourly billing.

For a copy of the complete 144 page survey, contact Elisabeth Westner at 617-217-2578 or survey@legalbizdev.com.

In this issue, Dr. Hassett, a frequent past contributor to Of Counsel, discusses the ongoing impact of alternative billing on law firm revenues.

—Editors

Estimating AmLaw 100 Alternative Fee Revenue

In the first few interviews conducted for our study, *The LegalBizDev Survey of Alternative Fees*, I asked participants to tell me the percent of revenue that their firms derived from alternative fees last year. Several declined to answer, and I concluded that many participants would be unwilling to disclose this number.

Later, I came to believe that there was a second reason for their reticence: Many simply did not know the percent of revenue in their own firms, a point that we will further discuss below.

So I switched to a less threatening approach, and asked: “Last year, approximately what

percent of revenue at AmLaw 100 firms do you think came from alternative billing; that is, fixed or contingent, excluding blended and other approaches that are strictly hourly?”

It can be hard to pin down lawyers, and when they were asked to provide an estimate for all AmLaw 100 firms, many initially said that no one could possibly know this number. When they were prompted to provide their best estimate anyway, many said things like, “I’ve seen lots of different numbers that are kind of speculative,” and, “It is a complete guess.”

When they finally did offer a number, it was often hedged with statements like:

It depends on the experience people have with managing alternative fee arrangements once they strike the deal. If that does not go well, then firms and clients will somehow figure out how to get back to hourly fees. If it does go well, the percentage will increase

If the economy comes back to full steam and the supply and demand change so that supply is short or at least more in line with demand, it will not change much. If, however, the downturn continues for some time and clients and firms are forced to learn new ways of working, that percentage could go up.

When we got past the hedging, people often offered a range rather than a single number, such as when one interviewee said, “My sense would be it might be around 20 percent to 30 percent, something like that.”

In order to be able to compute an average, I pushed each respondent to come up with a single number. For example, for those who responded with “20 percent to 30 percent,” I suggested that I use 25 percent as their

number, and the individual agreed. When two or three people participated in the same interview, I averaged their responses to come up with a single estimate.

Once I had an estimate for last year, I asked the same question for five years in the future. Ultimately, 30 of the 37 firms in this survey provided estimates for both last year and five years from now. Their answers appear in Table 1. Firms are arranged by the size of their estimate of last year's revenue, from the smallest to the largest.

For the seven firms that refused to estimate one or both of these numbers, I asked the direct question: "Do you think alternative fees will become more common in the next five years?" All seven said yes. Thus, every single participant said that the use of alternative fees would increase over the next five years, either by answering the direct question or by providing percentages.

In his book *The Wisdom of Crowds*, James Surowiecki argues that the best way to gather reliable information in complex and uncertain situations is to ask many knowledgeable people, and then average their estimates. If that is correct, the averages in Table 1—11 percent of revenue for last year and 26 percent for five years in the future—are clearly the best available information about how widely these billing arrangements are used and will be used at large US firms.

The total revenue for AmLaw 100 firms last year was \$67 billion, according to *American Lawyer*. If one simply multiplies this number by 11 percent, it gives a rough estimate of \$7 billion for last year's alternative fee revenue in this group.

Similarly, multiplying \$67 billion by 26 percent would put the figure at \$17 billion five years from now. Of course, both figures exclude the alternative fee revenue from many thousands of smaller US firms. (Some would argue that the \$67 billion base should also be adjusted for future changes in five years, but

Table 1: Percent of AmLaw 100 Revenue from Alternative Fees

	Last year	Five years in the future	Five-year growth rate
<i>Estimate 1</i>	1%	5%	400%
<i>Estimate 2</i>	4%	25%	525%
<i>Estimate 3</i>	5%	9%	80%
<i>Estimate 4</i>	5%	15%	200%
<i>Estimate 5</i>	5%	33%	560%
<i>Estimate 6</i>	5%	50%	900%
<i>Estimate 7</i>	7%	15%	114%
<i>Estimate 8</i>	7%	20%	186%
<i>Estimate 9</i>	8%	15%	88%
<i>Estimate 10</i>	8%	20%	150%
<i>Estimate 11</i>	8%	23%	188%
<i>Estimate 12</i>	8%	25%	213%
<i>Estimate 13</i>	8%	30%	275%
<i>Estimate 14</i>	9%	18%	100%
<i>Estimate 15</i>	9%	28%	212%
<i>Estimate 16</i>	10%	12%	20%
<i>Estimate 17</i>	10%	23%	130%
<i>Estimate 18</i>	10%	25%	150%
<i>Estimate 19</i>	10%	25%	150%
<i>Estimate 20</i>	10%	35%	250%
<i>Estimate 21</i>	10%	40%	300%
<i>Estimate 22</i>	13%	25%	92%
<i>Estimate 23</i>	13%	30%	131%
<i>Estimate 24</i>	14%	21%	50%
<i>Estimate 25</i>	14%	25%	79%
<i>Estimate 26</i>	20%	33%	65%
<i>Estimate 27</i>	20%	43%	115%
<i>Estimate 28</i>	23%	40%	74%
<i>Estimate 29</i>	25%	35%	40%
<i>Estimate 30</i>	25%	50%	100%
Average	11%	26%	198%

The five year growth rate in the Table 1 was calculated with the simple formula:

$$\frac{\text{Percent five years in future} - 1}{\text{Percent last year}}$$

we decided to stick with the simplest possible projection.)

However, it is important to remember how wide the range of estimates was:

- From one percent to 25 percent for last year's AmLaw 100 revenue;
- From 5 percent to 50 percent for revenue five years from now; and
- From 20 percent to 900 percent for the growth rate.

Given these differences of opinion about revenue, it is not surprising that AmLaw 100 firms have radically different strategies and tactics for the types of alternative fees that they offer clients. Several participants noted that these differences may become increasingly important in future marketing. As one put it:

Eventually there will be some sort of an equilibrium reached where, for many firms, 25 percent or 30 percent of the work will be alternative fee or fixed fee work, [but] other firms will become much more radical. They will change their business model completely, and 50, 60, or 70 percent of the work that they do will be based on alternative-fee arrangements.

Different firms will handle it different ways. And I actually think that there will be room for this differentiation; that clients will want to use different firms that approach this differently for different work."

[The marketing implications of this increased differentiation are among the themes expanded on in *The LegalBizDev Survey of Alternative Fees*.]

Measuring the Percent of Each Firm's Alternative Fee Revenue

Several participants in the first few interviews for our study were reluctant to talk about the percent of revenue that their own firms derived from alternative fees. As noted

already, I assumed that it was confidential information, but as I probed deeper, I began to think that some of them might not know the percent in their own firms.

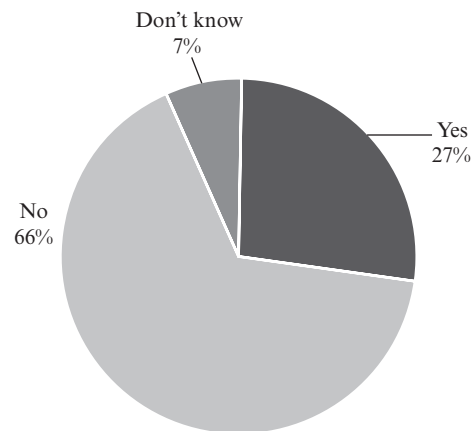
So I added a direct question to the remaining firms about how easy it was to determine alternative fee revenue in their own firms. The results are shown in the Figure 1.

People who answered no—that their accounting system does not code alternative fees separately—talked about how difficult this figure was to track, as in these comments:

We don't have it. I don't know if we will be able to add that in the future. There are so many different varieties [that] you would probably have ten different ways to code them and an eleventh coming next month.

I think the most complicated part of that process is [defining] what an alternative fee is. Once everybody is in agreement about what that definition is, we have wonderful people in our finance

Figure 1: Can you easily look up alternative fee revenue in your firm?



Does your accounting system code alternative fee projects separately, so that you can easily look up the exact percent of last year's revenue from alternative fees at your firm? (n = 30)

department who are able to do some real gymnastics and come up with numbers.

It's not as simple as one would think to capture all of this accurately, [because] arrangements change over time, definitions can be fuzzy and many arrangements are actually hybrids.

As an example of arrangements changing over time, one firm described what can happen to hourly estimates when clients perceive them as fee caps:

[Lawyers] are supposed to clear their side agreements, so in theory [the firm] knows them all. But what happens in real life is [that] a client says, "What's it going to cost?" and the lawyer replies, "Oh, I can't tell you [because] we don't have enough facts yet, but normally a deal of this size would run \$120-150K." The client hears, "You've promised me \$120K." And then that's it; that's the fixed fee. And [the firm] doesn't know that because [the lawyer] thought what he said was, "This is what it costs on average."

Today [our firm] has learned that [lesson], but two years ago we'd happily keep saying, "This is what you should be planning on," thinking it was a planning tool. At the end the client would say, "Gee, this cost \$200K, how is that possible?" And we tell them, "Well, you know, your CEO got fired in the middle of the deal. The deal dragged on for three years. It turned out you got sued, so, yeah, it cost \$200K." But the client only pays \$120K and the lawyer comes back and says, "Oops, gotta take a big write-off."

When I do the write-off, I might or might not classify this as an alternative fee. First of all, I would be writing this off as a submitted bill, because I wouldn't even hear until the client balked. And then I might or might not think to attribute it to the client thinking my estimate was a cap. We put a little sentence in [the bill]

that explains why we're taking a write-off, but there wouldn't even be a way to capture that as an alternative fee.

Several firms reported that they were currently working on tracking alternative fees better:

We cannot just run a report, but we certainly can look at our top 200 to 300 clients and figure out really fast which ones are alternative fee arrangements. There are codes, but I'm not sure how reliable they are. People on a straight contingency will usually put the contingency code in. But you typically don't see that as much for these alternative fee arrangements where you're doing a fixed fee for all of the client's litigation . . .

We're trying to assemble that sort of stuff in a more reliable fashion, but it's not something that falls directly out of the system.

Another firm reported that, "The system is being modified to track that information. When I started the alternative billing committee and asked that question, no one had a clue. But since we're moving more in this direction, we're beginning to configure our accounting system to do that."

A few also talked about how important it is to improve measurement within their firm:

This is really going to be an issue, not just for the law firms but also for the systems providers to law firms, those who sell accounting systems. Many of these accounting systems presume that the only source of revenue is hourly fees.

A project we are working on right now with various lawyers and our technology people is to track which of our matters are within our definition of alternative fee, and how we and the clients did on those. In the past we would take the occasional contingent case or fixed fee, but we did not worry about separately accounting for such matters.

As the percentage of alternative arrangements is growing, we want to track it more and learn from our experience. ■

—Jim Hassett

Jim Hassett founded LegalBizDev to help lawyers develop new business. He offers coaching, webinars, workshops, retreats, “train the trainer” programs, books, and CDs as well as high-level consulting. Reach him at jhassett@legalbizdev.com.

Client Interview Programs . . .

Ten Common Mistakes That Law Firms Make

For decades, consultants have been exhorting law firms to talk to their clients to find out what they're doing wrong, what they're doing right, and what next steps will provide specific service benefits. The law firms that have done so find that such “audits” not only protect existing relationships but also open up additional new business vistas.

That said, doing these interviews incorrectly can be as harmful as, or even more harmful than, not doing them at all. Today, as in the past, there are only a few law firms that approach this client relationship initiative systematically. Others typically make persistent strategic as well as tactical mistakes, planning and staffing their outreach ill-advisedly. As a result, they send the wrong messages at the very moment when it is imperative to send the right ones.

Years of advising on and conducting such client interviews have alerted us to 10 particularly fundamental mistakes.

1. The net is too wide. Plan to focus your outreach program on the top 10 to 30 clients, choosing those clients either because there are potentially serious problems or significant opportunities to expand the relationship or, as is often the case, both at the same time. By targeting 100 or more clients, you'll likely dilute the overall impact at every turn.

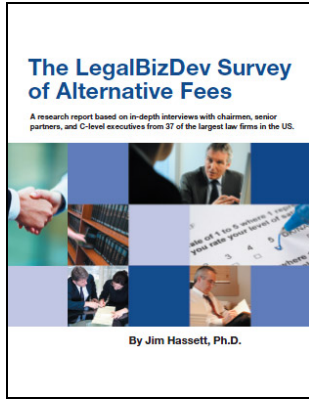
2. The audience is too small. With client relationships of real significance to your firm, there is seldom just one person whose input is critical. A general counsel will not usually have a sufficient grasp of

what everyone thinks, even within the narrower context of the law department, not to mention the non-lawyer business persons with whom your firm also deals on a frequent basis. There may even be as many as 10 individuals per client whose feedback is invaluable; seldom will there be fewer than four to six.

3. You don't meet in person. You'll never get the gritty, necessary details over the phone from clients who really need to look you in the eye before sharing politically sensitive information or candid, personal feelings. Nor will you capture the nuances of what they're saying unless you can observe their facial expressions and body language. It's a particularly good example of how doing client audits wrong is worse than not doing them at all, since clients expect in-person interviews and will feel they're being given short shrift if they're asked to fill out cut-and-dry written or Web-based surveys or to respond to a perfunctory, neutral “researcher.”

4. The competition questions never get asked. Of what value is a positive comment from a client if there's no benchmarking? Let's say that the client says you're doing “terrific” and means it. But what if he or she simultaneously thinks that your nearest competitor is the best law firm that the company has ever retained? In my own work, I am always asking my clients' clients to share their perceptions of other firms and specific lawyers from those firms. Ask the client to make a point-blank comparison. From there it's a short jump to a better understanding of how the company distributes its legal work

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“Momentum is building in the marketplace for new ways of charging for legal services. Jim Hassett's new survey summarizes valuable insights from AmLaw 100 decision makers about how the market is changing and what will and will not work in the future.”

– Harry Trueheart, Chairman, Nixon Peabody