

# A CFO's Perspective



By Anthony Licata

If the economic uncertainty of the past few years has taught us anything, it is that human behavior is hard to change. Tasked with rapidly responding to a shocking drop in the demand for goods and services, CFOs were faced with decisions aimed at preserving short-term profits or stemming losses, while at the same time setting strategy to deal with real-time changes or challenges to our conventional business models.

What did we do? We attacked expenses with unprecedented vigor. Even the most diligent expense-slashing mavens found new energy and a keener eye for cost containment. Despite the turbulence of the past few years, we spent 80 percent of our time addressing the 50 percent of costs that were the easiest to affect. In many ways it reminded me of business school Management 101 classes and executive self-help books urging professionals to tackle the most difficult items on your to-do list first. Easier said than done. It is not the way we are programmed.

If we are going to be honest about real cost savings, we have to admit (at least to ourselves) that there is substantial spend ingrained in every organization that is begging for a fresh look. That spending is protected by politics, red tape or the daunting recognition that the fix will require a lot of hard work to identify and reorganize. In the recent business climate, short-term expense actions were the call of the day, but we always knew there were items that would actually produce substantial benefits in the long term that needed to be addressed. When the recession began to materialize, we had an immediate need to show results, and this was our time to shine, so we went after the low-hanging fruit.

The consequences of this exercise easily can lead to an unbalanced organization. Certain business lines or critical infrastructure departments can become too lean in key areas, while others might remain bloated and too top heavy. This asymmetric approach might not meet the needs of the new business model or competitive challenges.

Run through the list of the top vendors at your company — how many of you find professional service organizations at or near the top? Sure, the auditors and consultants on the financial side were addressed in many respects because we control the workflow. But what about other service providers? Have you ever wished you could rip the cover off your legal spend? Any reason you haven't gotten there yet? Do you think you have?

Let me let you in on a secret: You are not as far along as you think. Legal spend is getting a lot of attention these days. As the CFO of an international law firm, I can't help but be struck in some respects by the way organizations have decided to address the issue of legal cost containment. Let's go through a few.

## Legal Spend and the Procurement Process

A natural reaction to get an immediate handle on legal spend is to involve procurement. Traditionally, legal spend was not part of the procurement world in nearly the same proportion as it is currently. Procurement professionals deal primarily in price and volume and spend their professional lives analyzing both. Potential volume (hours required) when hiring outside counsel for a pending litigation or a transaction is hard to measure or predict and often falls outside of the procurement professional's expertise. As such, the focus quickly narrows to rates or unit cost. This is a problem, and more so, for the organizations buying legal services than for the firms that are selling their legal expertise.

What frustrates organizations most about legal spend? Is it their lawyers' hourly rate, the perception that their lawyers aren't paying attention to the collective amount of hours spent on a project, the fact that legal matters always take more time or cost more than originally forecast, or that the hourly model seems at odds with your company's interests? From my experience, it is the volume of the hours and the staffing model that upset most buyers of legal services. Given these different concerns, I am surprised to see many organizations' procurement departments focus solely on hourly rates during a pricing negotiation. On one hand, this sole focus on rates makes perfect sense — it is a metric that is easily measured and understood. For instance, standard firm rack rate is X and the negotiated rate is Y, which allows me to show a discount of Z. Bingo. The procurement professional can show value and has a metric to measure "savings" to the company.

But are those savings real? Have you done a post-matter, post-mortem financial analysis to assess the legal services provided? Did the law firm meet your company's objectives? How was the quality of the end product? Was the matter efficiently and appropriately managed? Did the firm perform at a level that you would reward them by retaining them for future matters?

True, not all legal work is novel. There are hundreds of great lawyers doing high-quality work at firms of all sizes throughout the country. In recent years, work deemed “commodity work” has shifted to what are labeled lower-cost providers. The key question is whether by going downstream and funneling work to firms that have a lower rate structure, are you, as a business, actually saving money? If lower-rate attorneys are less effective or have less experience efficiently managing matters, what is the likelihood that your rate savings are lost through the volume of unnecessary work being performed?

It may sound like I am making a case for large, pricey law firms, but I am not. As a keen observer on the other side of these price discussions, I think that these factors (not just hourly rates) should be considered when buying legal services, and, in reality, they are not. It is amazing how many executives do not ask these fundamental questions or assume that someone else in their organization is addressing them. You would never discuss the unit cost of the door handle during a discussion about a car that you are purchasing, why do it here without a discussion on the relative value of the service to the work performed?

## Alternative Fee Structures and the Definition of Value

When you buy that car, you drive it for a period of time and then make an internal assessment of whether you received real value for the price you paid. It's not about the sticker price; rather, it's your perceived value in relation to cost. General counsel and other executives in board rooms across the country treat legal spend in a similar fashion. There is an expectation of the cost of legal services in relation to the value of the service or the result their law firm obtains. Most law firms are bad at getting this information from their clients. Disputes over fees happen because there is an expectation gap between the client's perception of the value of legal services and their lawyer's desire to get the best result for their client without paying attention to costs. More basic than that principle is lawyers' collective unwillingness to manage their team of professionals. Unfortunately, corporations need to spend more time than they should have to worrying about the structure of their legal arrangements.

In an effort to show alignment with their clients' cost concerns, firms have started discussing their willingness to engage in alternative fee arrangements (something other than a billable hour arrangement). A fixed fee for a legal matter or a portion of a legal matter is now the most common of these alternatives. Most of these arrangements are still rate-driven and are built off a discount to a standard leverage model (i.e., X percentage of partner time, Y percentage of associate time, etc.). This is not a real evolution in legal pricing. Instead, parties should be talking about the value of the work for the price, a novel concept in the legal market but one commonly accepted in other businesses. People like me, financial executives at law firms, are responsible for whipping our collective cost structures in line to deal with the new pricing models (to the extent you get there) and, in turn, must find ways for our business to stay profitable. Stable firms and stable clients are a good thing. There is a value to having lasting relationships with firms that know the clients' business. The quicker we

can both evolve on a pricing model that works for both, the faster we start to get a return on this benefit.

We have been inundated throughout the last 18 months with RFPs (request for proposals) from organizations that we'd be honored to represent. The first page of many requests contains the following request: “Please provide the amount your firm is willing to discount rates.” Many RFPs then go on to state that 20 percent off standard firm rates is a “suggested” starting point for discussion. We consistently respond to such questions with a proposal to do an alternative fee after a discussion with the client on the scope and value of the work. More often than not, this invitation is declined because the sole focus is on rate discounts. This is a wasted opportunity to solicit true competitive bids and assess value for price when compared to skill set of the individual attorneys and firms. How about this for a suggested RFP question of law firms: “Explain your methodology for ensuring the best and most efficient lawyers are working on our engagement and that projects will be managed to minimize the costs to the organization. Please give detail on what reporting the organization will be able to obtain from your firm to ensure our projects are being managed appropriately.” This certainly seems like the basis for a better discussion on value.

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## Law Firm Evolution

Law firms have a long way to go to evolve with the changing landscape of how legal services are delivered. Some will respond with a real sense of urgency and, in some cases, radically change processes, invest in technology and take a long hard look at their infrastructure model to adjust to a different level of demand from clients. The ones that do this will survive. Others that hang onto a dated model will suffer or even fail.

More importantly, law firms have to understand that there is a new service that comes with doing business with clients these days. The service is transparency, the ability for firms to deliver information to clients (on a daily basis, in some instances) about how cases are being project managed and where in relation to budget the work stands. If a new pricing model is going to work and, most importantly, you — the clients — are going to trust it, we — the law firm — must be willing to prove to you that we have the tools to price and manage projects effectively. That said, you should really start asking better questions of your law firms. If those questions focus on value, not just rate discounts, you will be well on your way to achieving real cost reductions in your legal spend. ■

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*Anthony Licata is the CFO of Dechert LLP. He can be reached at [anthony.licata@dechert.com](mailto:anthony.licata@dechert.com).*