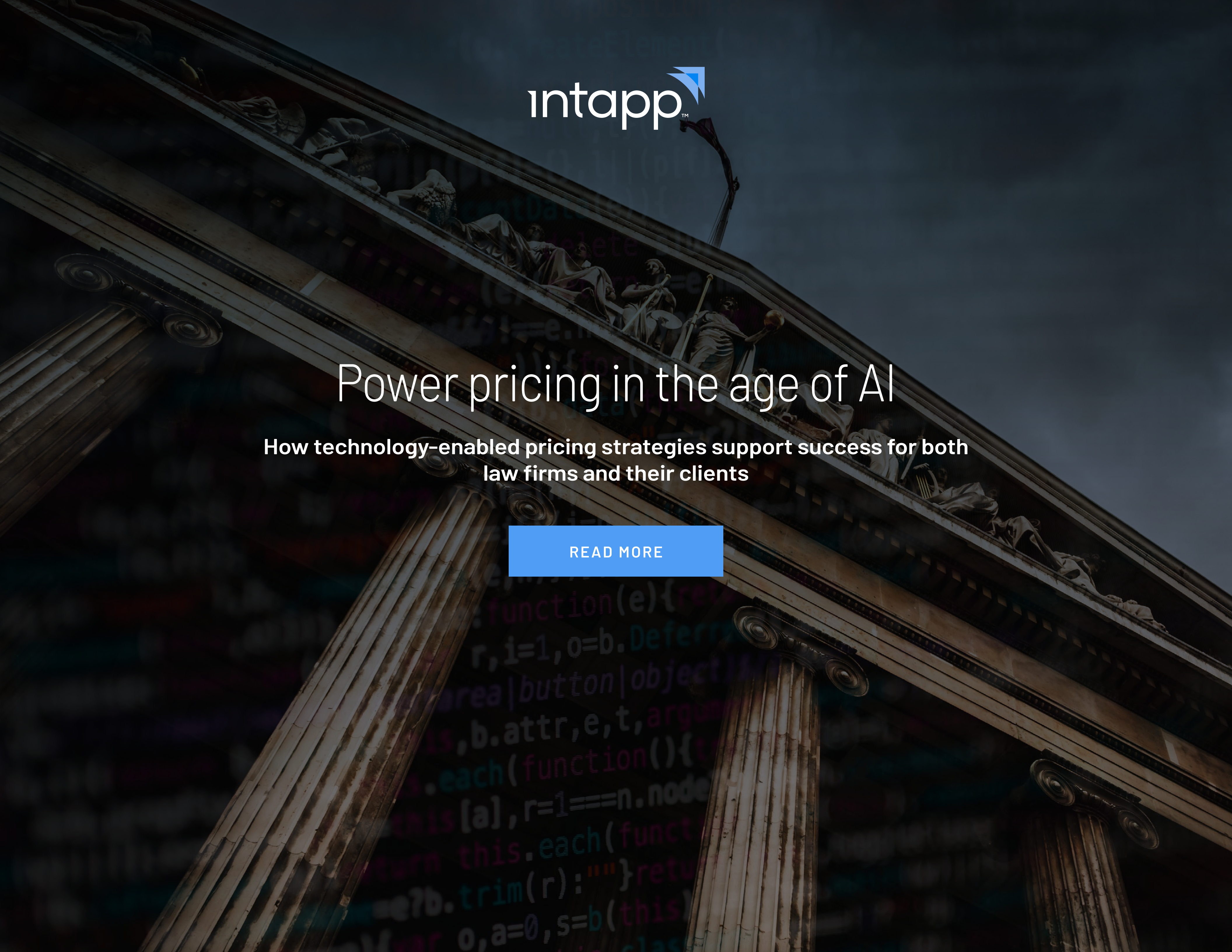

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Power pricing in the age of AI

How technology-enabled pricing strategies support success for both law firms and their clients

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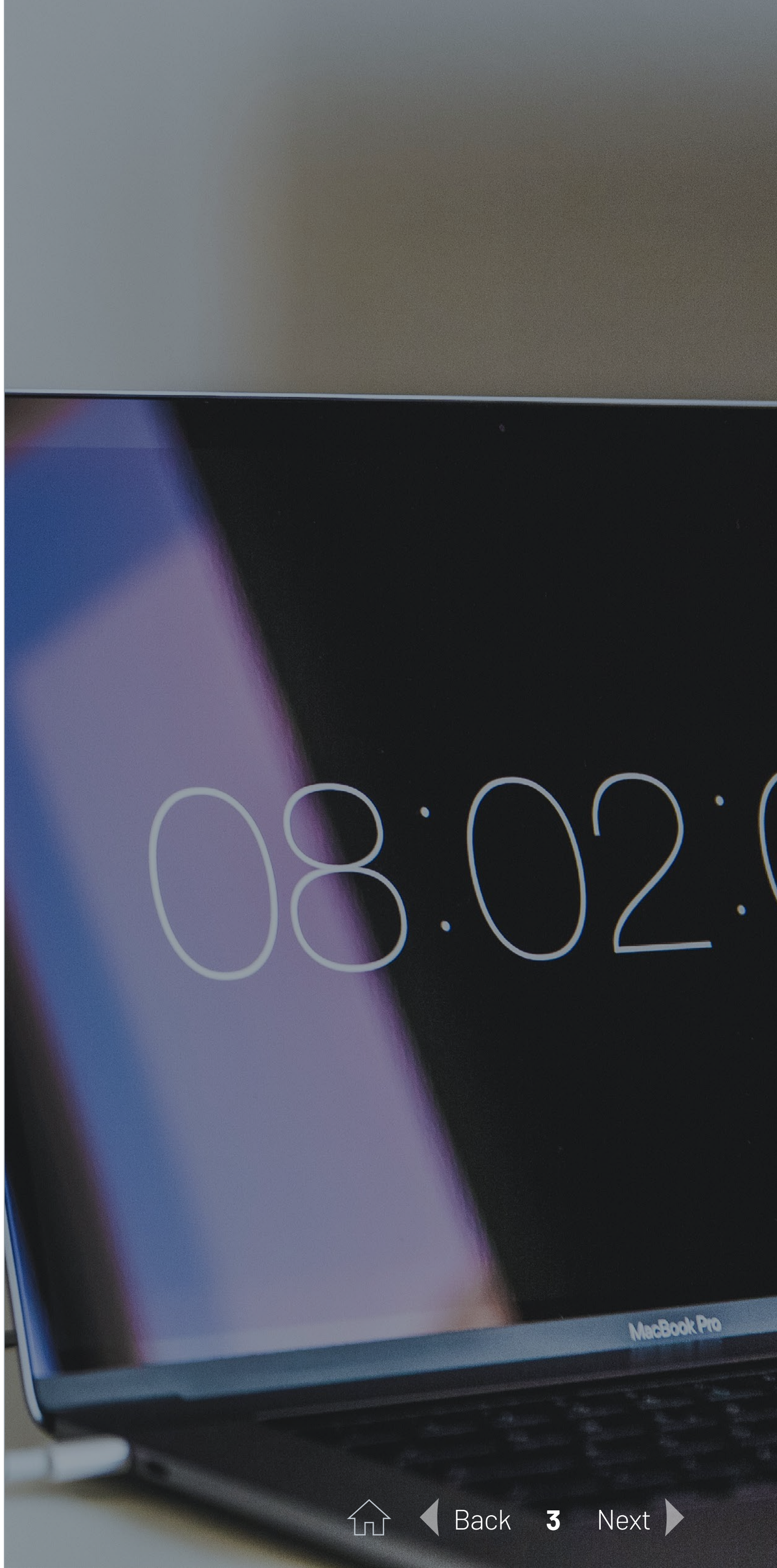
1. Introduction

If there was one tradition that seemed unshakable in the legal world, it was billable hours. Whether a standalone lawyer in a small town or a major firm in New York City, lawyers charged by the hour for their services. That's how it was for decades — but then, times changed.

The Great Recession struck. A new era of competition for legal services arrived and with it a greater client demand for transparency. Today, clients are asking professional services firms — especially in the legal realm — to provide more value and clarity in their engagements. This new, marketplace-driven structure means firms need to create different ways of billing for their services to keep clients happy.

The result? Alternative fee arrangements (AFAs) — pricing and fee agreements that go beyond the traditional hourly billing model. What's more, lawyers are also requesting the change, according to reports including the Altman Weil *Law Firms in Transition Survey*. Savvy lawyers know that AFAs help them remain competitive and grow business.

But while the idea of AFAs appeals to both clients and lawyers, the reality of pricing matters accurately and profitably poses a challenge to many firms. Forward-looking firms are embracing a technology-based approach to meeting that challenge. By leveraging artificial intelligence (AI), firms can mine and analyze their existing data to derive accurate pricing strategies. The outcome is greater value to both clients and the business.



2. The shift in pricing

For decades, the legal field saw sustained growth. Firms enjoyed high demand from large corporations — some employing as many as 200 firms at a time — and lawyers could consistently bill 2,000 hours a year. The result: an overwhelmingly profitable industry.

Then came the 2009 recession. The major economic downturn affected many industries. Hoping to boost their bottom lines in a failing economy, corporate clients reduced their demand for legal work. They increasingly turned to in-house counsel while demanding reductions in the hourly rates outside firms charged for standing projects. Consequently, law firms found themselves competing not just with one another but also with clients' salaried lawyers.

That supply-and-demand shift shows no signs of reversing. According to *Law Firms in Transition*, 95.8% of law firms view price competition as a permanent trend.

If firms are to grow in this environment, they must secure more of a client's portfolio or win work away from competitors. They can only do this by acknowledging the changes in pricing trends and altering traditional billing models.

Realization rates dropping

Just as firms expect price competition to remain, the majority — 60.3%, according to *Law Firms in Transition* — also believe realization rates will continue to decrease. Of those surveyed, only 37.5% saw their firms' realization rates increase against the standard rates from 2016. Looking further back, the average firm's billing realization rate fell over the last decade from 94%to 87%, according to the *2016 Report on the State of the Legal Market*. Unfortunately, a realization rate drop often means a profitability dip, too.

To combat the problem, firms must work to increase their realization rates, a goal directly correlated to pricing. The ability to understand the true effort required — what it actually takes to deliver the work — helps firms understand how to optimize their resourcing. Cue AFAs: A properly constructed alternative fee structure allows firms to set a more realistic price for a matter, ultimately boosting realization.

Pushback from clients demanding more transparency and value

Since the recession, clients have increasingly turned to in-house counsel for legal services, creating an obvious problem for outside firms looking to grow business. With so much internal legal expertise, companies are holding their outside legal firms more accountable and scrutinizing the firms' bills and work effort with an expert eye.

As a result, pricing is now an ever-growing, two-way conversation. Per *Law Firms in Transition*, 85% of law firms report having proactive discussions with their clients around pricing and budgets, while 67% are collaborating with clients on creative alternative pricing options.

The economy, competition, and traditional ways of calculating profitability all play into the push for pricing changes. Ultimately, though, client demand is the driving force behind it all. If it weren't for the shift in needs and wants on the client side, firms may have preferred to stick to the old hourly billing model.

The recent economic shifts have created a trend for vigilance. Clients are now better equipped to be more discerning. They have the tools and knowledge to understand how much time and effort it takes to do the work.

While the long-term ramifications of AFAs on law firms' overall profitability remain an open question, *Law Firms in Transition* found that most lawyers believe the changes will not harm their bottom lines. Unfortunately, 69% of law firms also say that partners are hesitant to change, and only 38%of firms are actively engaged in experiments to test innovative pricing methods.

The resistance is futile, though. The pre-recession demand level for legal services seems unlikely to return. The only way to stay competitive is to adapt.

Types of AFAs

Alternative fee arrangements for legal work have existed for years but certainly were not the norm. However, today's clients seek new service models, prompting law firms to explore different ways to engage commercially. AFAs encompass a wide range of options, including the following:

- **Blended hourly rate:** A firm offers a single hourly rate regardless of which lawyers work on the project. The client benefits from dealing with one pricing structure, while the firm can control how it should allocate its resources.
- **Capped fees:** The firm still employs an hourly rate model but with a maximum amount the client will spend. Both the firm and the client agree the total bill will not exceed that amount, often agreeing upon a minimum as well.
- **Fee collars:** This arrangement rewards efficiency. Lawyers benefit if they complete the work under the budgeted time, while the client receives a discount if the firm goes over.
- **Fixed fees:** Fixed-fee arrangements come in many different flavors: fixed fee plus success fee, fixed fees for single engagements, portfolio fixed fees, and so forth. These combinations keep pricing simple for clients and can help avoid back-and-forth negotiations.
- **Holdbacks:** This contingency arrangement ensures firms receive a large percentage of their usual hourly rate no matter the outcome. They receive the full rate if they are successful. Clients are happy because there is an incentive for the firm to do well.
- **Hourly rate plus contingency:** Both the client and the firm share the risk with this arrangement. The firm is guaranteed a minimum amount with the hourly structure and can only stand to make more if it is successful in winning a case.
- **Portfolio fixed fees:** Firms can provide a fixed fee for a portfolio of many services, creating another avenue for gaining more business.
- **Subscriptions:** A subscription service may enable a firm to capture more business from a client, as it is more malleable in its application than a retainer.
- **Success fees:** Together, the firm and client determine what success looks like for a particular project (for example, an early resolution or lower settlement) and determine a fee for that achievement.
- **Task billing:** A firm can work with the client to create a list of tasks or components, then price out what each piece will cost. The expectations are clear and can help a client with a budget.

3. The rise of the pricing team

Forward-looking firms recognize the growing urgency of transparency, visibility, and responsiveness when it comes to pricing. Many — especially the larger ones — have responded to the pressure by creating roles for a pricing director and team.

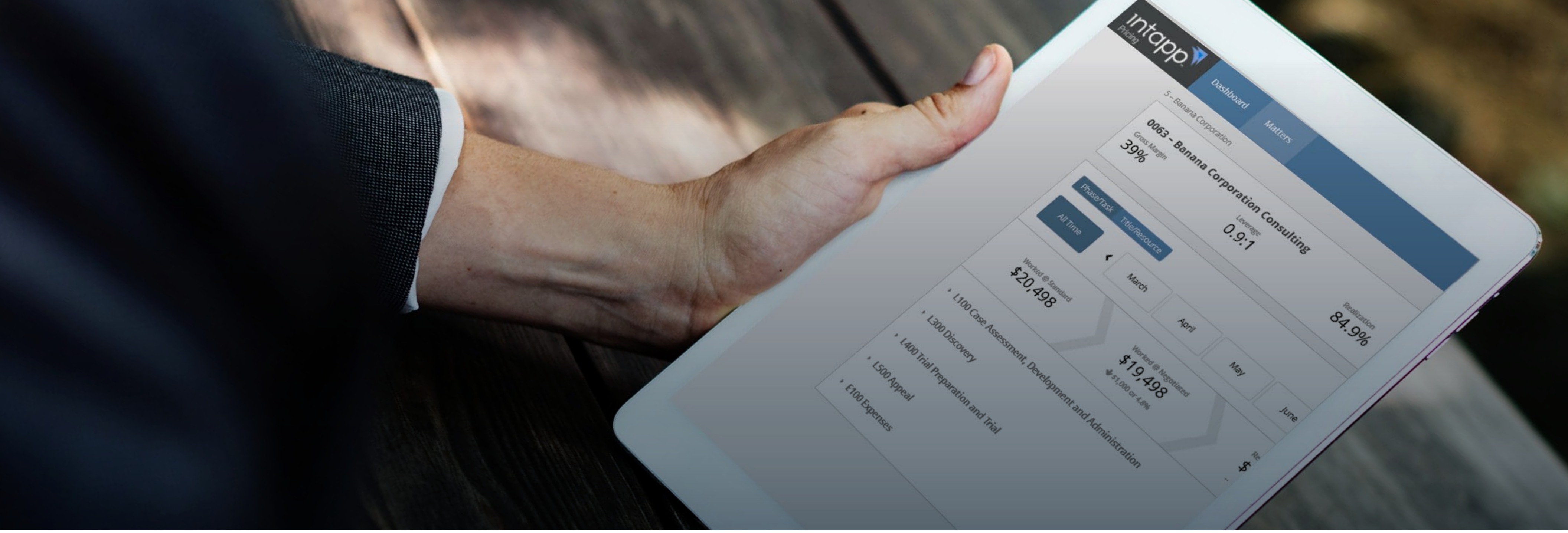
Per *Law Firms in Transition*, nearly a third (31%) of firms have established a formal pricing role. These team members are becoming critical in at least two ways: helping win new business and ensuring the business the firm takes on is profitable.

Pricing teams help firms become more effective in addressing client needs while ensuring the practice's strength and profitability. How do the teams accomplish this? By focusing on several areas:

Analyzing past matters to help create pricing strategies for new engagements

When a firm assesses a potential engagement, it's important to look at similar past work to understand the quantitative resources (time, distribution of personnel) and qualitative resources (resolution of the matter, whether the outcome was favorable) necessary to complete the work. Having this knowledge helps the firm accurately price out the matter. It sounds simple, until one considers the time and effort involved.

That's why firms see value in pricing professionals. Working in conjunction with lawyers, pricing teams can evaluate data from past engagements and use this information to determine how the firm should accurately price future engagements with clients. The more evaluation, the better a firm gets at ensuring it prices its services to generate both the highest value for the client and the most profitable outcome for the firm.



Helping scope and price engagements accurately

To support growth, firms are driven to seek new business, whether with an existing client or in taking on a new one. Determining pricing for new engagements is a challenge and several factors must be considered. The most important of these is scoping the matter or answering the question "What will it take to deliver this work?" Determining the work effort, distribution of personnel, and time required to complete the project successfully — on both the firm's and the client's terms — is key to figuring out the price tag on such an engagement.

How long will the engagement take? What resources does the firm need to leverage? Will the work require more senior associate hours? Pricing professionals help answer these questions, determine the staffing and resources necessary, and then work with lawyers and legal project management (LPM) teams to monitor the work as it progresses. On the firm's end, accurately scoping the work means achieving efficiency and profitability while meeting client expectations. For the client, it means feeling confident they'll receive work at a fair price that represents the value of the outcome. Scoping a project accurately protects profitability, serves the client, and guards the firm's reputation. This thoughtful approach also enables course correction if the parameters of the engagement shift; accurate scoping at the outset helps lawyers frame conversations with the client and changes in approach if circumstances change.

Modeling various options to assess profitability

Once a firm understands the client's needs and can price an engagement accurately, the pricing team can workshop various pricing models to determine the best option for both profitability and client service. Which alternative fee arrangements should the firm consider? What resources can it allocate differently? What happens to the bottom line with adjustments to the support staff? The ability to move levers quickly helps a firm determine what pricing option is the most profitable and also satisfies the client's needs. This is critical to remaining competitive.

Altman Weil snapshot on pricing data

As the American legal industry continues to change and evolve following the Great Recession, Altman Weil has tracked those transformations and developments. Its latest survey, which polled over 800 managing partners and chairs at law firms, plus 50 additional lawyers, found many interesting insights:

- Almost all respondents agreed that firms need to make more of an effort to realign pricing, staffing, and efficiency and that price competition is a permanent trend. But only 19% of firms were systematically re-engineering their work processes. Those that had implemented new strategies reported "significant performance improvements."
- According to 43.5% of firms, adding a pricing director has resulted in significant improvement in firm performance.
- Only 42% of firms reported a link between AFAs and changes in how work is staffed and delivered. But those that did said they were more likely to have profit-per-equity-partner gains.
- More than 84% of those surveyed think more-commoditized legal work is a permanent trend.
- Nearly 62% of firms have included innovation initiatives in their strategic plans and more than 67% are collaborating with clients on creative alternative fee options.
- Almost 60% of firms are developing data based on the cost of past services to support their future pricing strategies.
- The majority of firms report only 1% to 10% of their legal fees come from non-hourly-based pricing even though nearly 80% believe non-hourly billing will be a permanent trend.

4. Technology-enabled pricing strategies

Mining the data necessary to create the best possible pricing strategies or approaches can be difficult. The data is often siloed or stored without consideration for how it can be used strategically. That's where technology-enabled approaches to pricing provide a welcome assist. Technology solutions can find ways to draw insight from current data repositories in ways that human analysis can't. Pricing teams can use emerging technology in several ways.

Automatically sift, sort, and categorize past engagements

A significant aspect of determining profitable pricing strategies for new engagements is to research past data. Yes, a pricing team can try to take on such work. But having technology that reviews the relevant information with algorithmic analysis and deep inspection makes the process more efficient and accurate. Artificial intelligence (AI) can sort through like matters to find only the engagements that provide relevant insight into current pricing requirements. The pricing team can then spend more time developing accurate pricing strategies and optimal resourcing to further relationships with clients.

Model in real time

One of the biggest values of a pricing team is the expertise to model several different fee arrangements and resourcing assumptions for any given engagement. This arms firms with thoroughly researched knowledge of pricing options that will turn a profit. But again, completing such tasks takes time.

AI technology can support pricing teams by quickly delivering real-time information on how resourcing and staffing may impact profitability. The pricing team can adjust the different elements necessary to any given engagement to see how altering one — or many — will affect the margin. Such technology also helps pricing teams compare various models on the fly to determine the most profitable options and can provide insight into how adjusting leverage — changing the ratio of senior partner hours to associate hours — can impact margins. Having these capabilities helps firms maintain efficiency while also swiftly delivering flexible responses to clients.

Provide degree-of-confidence assessments

Having a dedicated pricing team gives a firm an edge when it comes to accurately determining a price range that can win specific business. Adding technology-enabled analysis provides an additional confidence boost through the knowledge that the models were created using appropriate past data. With the aid of intelligent technology, a firm can propose a fee structure, knowing it will meet the client's needs and expectations while enabling profitable execution. Presenting alternatives that are clearly client aware also helps strengthen the partnership between the firm and the client and further the firm's status as a trusted adviser.

Moving beyond a point solution

The benefits of AI are clear. For the best outcome, though, technology is most effective when implemented as part of an interoperable platform, to provide optimal functionality. It's vital that pricing teams look for software that integrates seamlessly with other solutions governing timekeeping, compliance with outside counsel guidelines, and other mission-critical steps in the client lifecycle.

This allows firms to gain insight into how they're functioning as a business, determine what changes need to be made to stay efficient and competitive, and ultimately track real-time matters to make decisions that benefit the firm and the client.

Types of AI used to leverage data

Data can be analyzed in many ways using AI. While beneficial on its own, combining several processes creates a more thorough understanding of past engagements and aids in decision-making for the future.

Natural language processing (NLP)

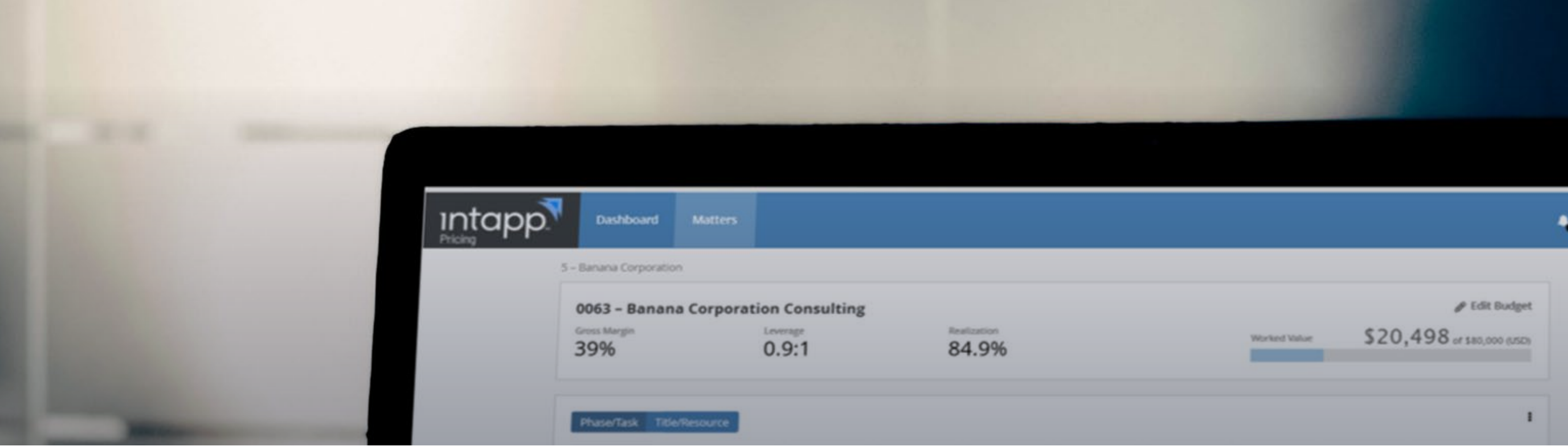
NLP can help firms understand the tasks involved in a matter based on the notes the lawyer writes. It's important to understand the nature of the matter (not just what has been billed) so that a firm can predict price as well as capture nuances that make engagements different and cause changes to pricing and staffing.

Machine learning (ML)

Machine learning works two ways in the context of pricing: data cleansing and feedback. The former, similar to NLP, helps get at the nature of the matter; to be useful, data must be prepared via structuring, organizing, categorizing, and tagging efforts. The latter is used as pricing decisions and changes are made. The model can learn and start to take those nuances into account.

Predictive analytics (PA)

This is where the magic happens. Once the data is collected (NLP) and cleaned (ML), technology can develop a robust set of attributes to predict the scope and price of a matter. By using clustering algorithms, PA can pool together a relevant sample of similar matters, understand their similarities, and pick up subtle differences. Firms can then understand how similar matters were staffed, what tasks were involved, and anything else needed to scope the matter and provide a price.



5. Pricing as a process

While a successful technology-based pricing strategy supports the bottom line for a firm, it can also do much more. Firms can leverage technology to make pricing more of a process, rather than a one-time effort, and also gain visibility into an engagement as it progresses from pricing and scoping to execution and delivery, with proactive management and alerting. Good pricing technology creates a seamless, closed-loop system that allows firms to stay on top of engagements throughout their lifecycles in several ways.

Monitor budget to actuals

Often, a firm would set a budget for a matter but might only realize there was a problem later in the billing or reporting cycles. Technology that integrates across various platforms, including timekeeping and budgeting software, makes it easy for lawyers and pricing teams to track the work in progress: Has the scope changed? Are more (or different) lawyers working on the matter than originally scoped? Are certain tasks or phases taking more time? How is the work progressing overall based on the original plan? All of those questions can be monitored and answered in real time.

Avoid unexpected overages

Even if pricing professionals have access to some analytics, many lack the technology to track real-time changes. A major benefit of consistent technology-backed visibility into engagements is having threshold-based alerting. For instance, an alert might warn a firm that a matter has reached 70% of the budget. When that happens and the number seems "off," a point person can be notified to address the matter in minutes rather than days, weeks, or even months down the line. The technology acts as an early-warning system, mitigates unexpected overages, and gives the firm a chance to correct course, if need be.

Proactively communicate with your client

A system with interconnectivity, visibility, monitoring, and alerting provides insight into the engagement as it proceeds and allows lawyers to communicate proactively. How? Armed with information about scope changes or off-target budgets, a lawyer can communicate with clients and collaborate with them on a solution.

A perspective on pricing

By Stuart Dodds and Colin Jasper, Positive Pricing

When looking back over the past decade, there have been a number of key shifts in law firm behavior when it comes to the pricing of their services.

Prior to 2008, most legal services were billed rather than priced — in other words, rates were agreed to upfront and, upon completion of work, invoices were sent based on hours worked at the agreed rates. However, as clients actively sought greater certainty of their legal spend, they started requesting estimates. For many, these were quickly treated as being either fixed fees or capped fees.

This became a catalyst for a number of progressive law firms, leading to our second behavioral shift. These firms began to make a considerable investment in better understanding the costs of different matters, thus enabling them to create more accurate estimates, avoid losing work (by quoting too high), or having to absorb major write-offs (by quoting too low).

The third behavioral shift came when firms realized they needed to optimize their pricing, determining it was the most profitable way to deliver their legal services using the respective firm's various resources while simultaneously addressing more explicit client demands for greater efficiency. This led to the development of various matter-profitability modeling technologies, often developed in house. Although these solutions contributed to developing better pricing outcomes, they were often impeded by limited functionality and integration, as well as by limited user adoption, especially for those tools that resembled complex spreadsheets or had "too many pricing options."

Which brings us to the major challenges that remain today and leads us to our fourth — though still embryonic — behavioral shift. The question now is how to best use the combination of the vast amounts of available matter data and imperfect information within law firms to guide more insightful pricing decisions. The creation of accurate estimates and the use of matter-profitability modeling works well where matters are reasonably homogenous. But for many firms, this only addresses a small proportion of matters, especially where (as in most legal environments) no two matters are exactly the same.

This is where the use of AI and machine learning can greatly assist those responsible for pricing. It enables them to harness imperfect information and then use it to more accurately predict costs in an uncertain world. Given no lever has a greater impact on the profitability of a law firm than price, the investment in such technology is likely to become essential to leading law firms.

With many AI solutions still in their functional infancy, those solutions with already strong AI and machine-learning capabilities are standing out from the crowded marketplace. For those firms that are ahead of the chasing pack and embrace these new tools, the opportunity to capture more value through a combination of happier clients (through more accurate estimates) and better financial returns (through stronger profitability) awaits.

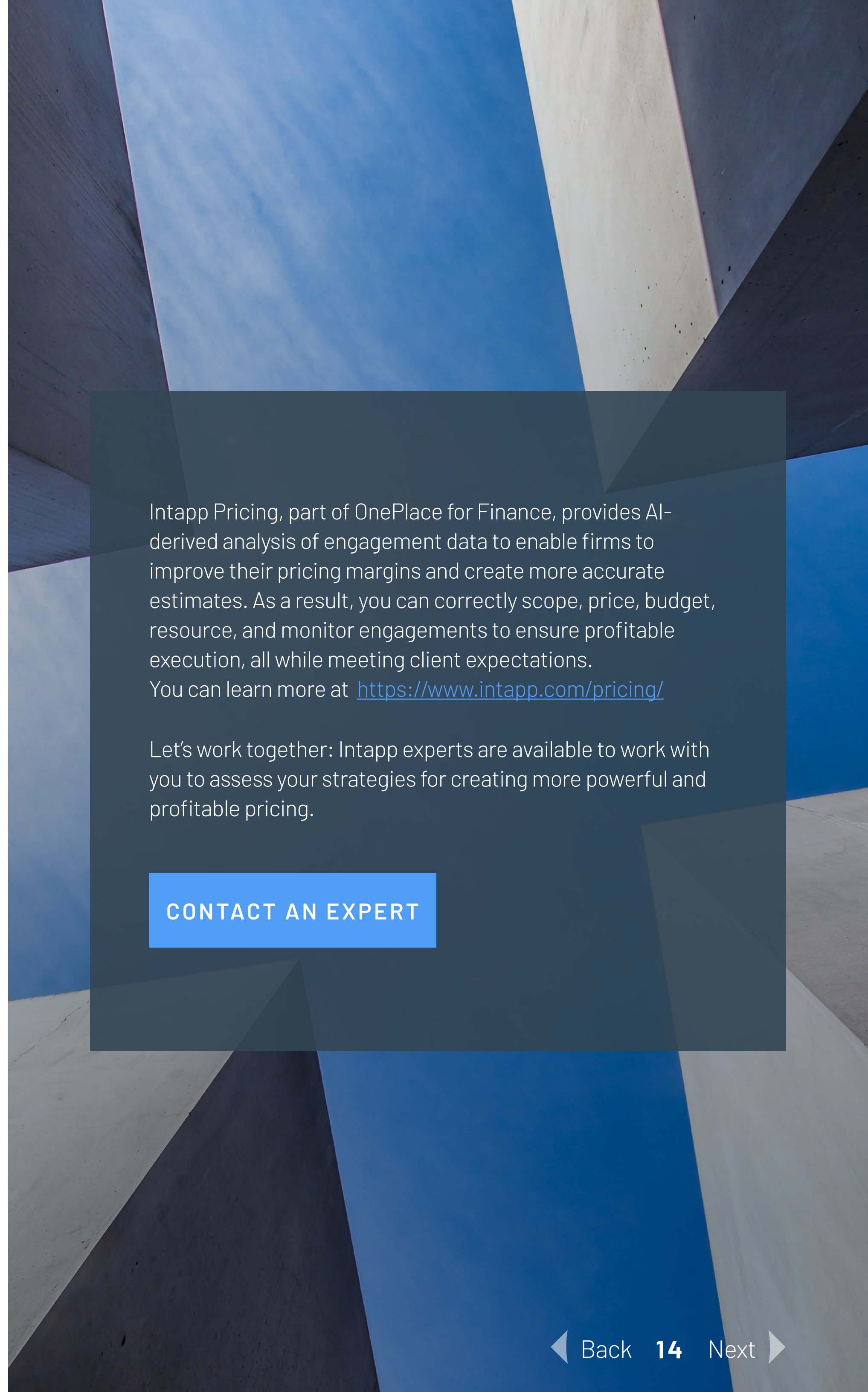
Stuart Dodds and Colin Jasper are the principals behind Positive Pricing, a consultancy that advises professional services firms. Together, they have amassed 45 years of industry experience and are considered global leaders in the field of professional services pricing and delivery.

6. Winning more business

Growth-minded firms are seeking ways to broaden their footprints. Perhaps they handle the litigation work for a client but hope to manage its IP instead. Implementing more successful pricing strategies enables firms to go after — and win — profitable new business more effectively. Having a sophisticated, technology-based, integrated pricing solution allows a firm to look at how to price both current engagements and adjacent work quickly and accurately. It also helps the firm deliver its services more strategically. Additional benefits include:

- Ensuring the proposed pricing meets both the client's needs and the firm's profitability goals
- Providing firms with visibility into a proposed engagement's profitability
- Deriving learnings from past matters

With the powerful combination of pricing teams and a technology-supported pricing protocol, the question for firms changes from "What's the discount going to be?" to "What commercial options and resourcing can we explore that both satisfy the client and turn a profit for the firm?" Having that capability in the current client-driven economy puts power back in the hands of the firm. Firms can now go beyond winning the work with a strong pricing scheme to building and resourcing the strategy in a way that ensures profitability.



Intapp Pricing, part of OnePlace for Finance, provides AI-derived analysis of engagement data to enable firms to improve their pricing margins and create more accurate estimates. As a result, you can correctly scope, price, budget, resource, and monitor engagements to ensure profitable execution, all while meeting client expectations.
You can learn more at https://www.intapp.com/pricing/

Let's work together: Intapp experts are available to work with you to assess your strategies for creating more powerful and profitable pricing.

CONTACT AN EXPERT

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