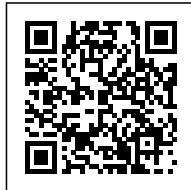


SUICIDE PRICING – HOW LOW CAN YOU GO?

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Desperate times call for desperate measures – or so we are led to believe. In the short-term, tactical solutions may seem attractive. But in the long-term, they can harm not only law firms that are using them but also the overall market for legal services.

Hay una llamada urgente para tomar medidas extraordinarias- o al menos eso es lo que se dice. A corto plazo, soluciones tácticas suelen parecer atractivas, aunque a menudo drásticas. Sin embargo, a largo plazo, pueden dañar no solo a los despachos que las usen sino además a todo el mercado jurídico en su generalidad. A medida que los mandatos de los clientes decrecen, la competencia es feroz, lo cual crea presión en los precios. Por lo que para mantener a los abogados ocupados, los despachos están recortando brutalmente honorarios - intentando competir con los demás en un mercado cada vez con menos demanda. La cuestión para los despachos es, ¿hasta dónde puede llegar el recorte?

The current economic climate demands efficiency and cost effectiveness, and businesses worldwide are reducing their costs and have become much more price sensitive. Some are centralising work on fewer law firms in return for discounts, while others are using a wider range

dependent on their needs.

And, across both Spain and Portugal, this shift in the market is causing issues for law firms that are having to deal with a real drop in demand.

The low down

Law firms have their own fixed costs to cover, and as the number of client mandates are decreasing, competition is fierce, which in turn is creating enormous pricing pressures. "It is very much a buyer's market," says Mark Smith, Director of In-house Legal Markets at LexisNexis. This is intensifying the pressure, while also serving to highlight the fact that the legal industry is suffering from a crippling case of excess capacity and an unwillingness to perform the necessary cuts.

So, in a bid to keep their lawyers busy, law firms are cuttings prices – as they try to compete with each other for the smaller amount of legal work that exists in the market.

The issue for law firms is how far to cut prices. It is one thing to win a piece of work at a slightly lower price – but are these prices sustainable in the long run or do they threaten to damage the business model that law firms have built up in the past?

Doing work that is unprofitable, or slightly off strategy, as a way of keeping their people until the upsurge is one thing. But to cut prices so low and assume that clients will happily agree to price rises once the market rebounds is quite another. And one that In-House Counsel say is never going to happen.

Price determination

"The big driver behind this is the basic issue of supply and demand," says Kevin Doolan, Partner and Head of Client Relations at Eversheds LLP. "Wherever supply and demand get out of sync there will be an effect on price. Law firms may be hoping for an upturn in demand and living with lower prices until that happens."

In the short term, it is logical that any work, at any price to keep your lawyers busy goes straight to the profit line. So at the end of the year, even if the work was done below its true value, at least you have got some revenue in.

In the long-term, however, if everyone is working at much lower prices, what happens is that they are replacing work at proper prices with work at unsustainable ones

"There is also a basic economic law in play whereby if you have an excess of supply over demand, the price keeps dropping until balance is restored, but the smart firms are now looking at how they can add more value to the services they provide, rather than just looking at price. For example we have seen clients willing to pay a premium for certainty of cost, or to reward a particularly good outcome." adds Doolan.

Overcapacity

When dealing with an excess of supply, the Anglo-American approach has been much tougher, while Iberian firms abide by a different set of cultural rules.

In the UK and US, when faced with similar issues, law firms went primarily for the sudden and deep cut, because they felt it was better to take one big bad hit rather than people seeing somebody leave every month, as discussed in this issue's [Panorama](#).

But as one Iberian Managing Partner commented to Iberian Lawyer: "Being that much smaller than our UK/US counterparts, we function in a much more familial and collegiate rather than 'business' environment, which makes it very difficult for us to let people go."

While there is no denying that deep cuts in numbers are happening across Iberia, they are happening very quietly and very slowly, which is only prolonging the issue of pricing to feed the structure. And there's a cost to being slow to restructure – you may depress the market price.

Differentiation

Part of the problem, suggests a Madrid Managing Partner, off the record, comes from the fact that the majority of law firms are still offering very similar services, and the only way they can

differentiate themselves is on price. And in the current economic environment, that means going lower than the competition.

But as one In-House Counsel told Iberian Lawyer: "Currently, when you ask for a fee quote you get huge differences that cannot be explained as the services being offered are exactly the same." They are seeing competing law firms coming in at very different sides of the price scale, and this raises a number of questions. "If someone is offering something at half price, there are clearly huge risks for us as the client. Will the work be done by associates rather than partners? Will it be done as well as the law firm that is charging double? Is it too good to be true?"

In-House Counsel also commented that when they see law firms cut their prices to the bone, they naturally assume that the lawyers won't be so keen on doing their work and the best team aren't going to be dedicated to the work that brings in the lowest revenue. "Lower prices are very synonymous with lower quality," one commented.

"I think the key element to suicide pricing is the hourly rate," says Smith. "In-house Counsel don't want it but they haven't been able to work out what they want instead." So you're then left with a situation where the market is saying 'we don't want what we have at the moment' but there are no real obvious alternatives being offered by the law firms.

In-House Counsel also don't have the experience and deep pricing capability to solve the problem as they've never had to do it. "Time and time again I hear In-House Counsel are really frustrated because they'll go out and ask for innovative pricing and the law firm offers something up, trying to be innovative, but what comes back doesn't work or isn't good enough," explains Smith.

Conversely, law firms are therefore doing their best to offer some forms of innovative pricing, capped fees, fixed fees, project based pricing, etc, but just see In-House Counsel asking for cheaper hourly rates. So if 'cheaper' is the only way they can sell their services to their clients, and the default position is the hourly rates, then the only way to win is for your price to be lower than your competitors' – which only serves to add fuel to the already burning fire of low pricing.

Collaboration

Something needs to be done to break the vicious cycle of spiralling prices. And many agree that the only way to do this is for In-House Counsel and their external law firms to put their heads together in a collaborative, rather than competitive way.

In-House Counsel need to save money, but it's not all about dropping rates. "If you want a sustainable reduction in price, you have to talk about scope with a client," explains Doolan. "You have to lay out a more efficient working model and not just attack the hourly rates."

He quotes a General Counsel who, like many, demanded a one time percentage discount off the hourly rate – in this case 15 percent – from all of his external lawyers. But at year-end, he saw that his bills had not fallen, in fact some had even risen. "Where a client is asking for a simple reduction on the hourly fee, which is not the right conversation to be having. They may end up with more junior lawyers on the case and don't drive real efficiency. You need a collaborative approach to drive better working practices."

Law firms and In-House Counsel therefore need to start making commercial, not competitive decisions. But doing so while sat at the same table, working together to see where they can both make savings without compromising on quality, reputation or potential future working relationships. "I think there's a real disconnect in communication where both sides need to say we know what we're doing is not working so let's jointly invest time and effort to make something that works better because in the long run," says Smith, "because that's an investment worth making for both of them."

Stop the madness

Lawyers will always find a strategic reason to lower prices, and with the economy as it is, this shows no signs of stopping anytime soon. "Lawyers like to be busy, and worry when they are not. We struggle, therefore, to prevent our partners lowering their fees without thinking this through first," one Iberian Managing Partner told Iberian Lawyer, "as they are trying to feed an unsustainable

structure and ensure there are no idle members of the team – the incentive to price dump is huge". The market is going to earn less; there is no doubt about that. "But it's now a question of saying 'we have to adjust, we have to be sustainable, but like any business we also have to make a profit'," says Doolan. "And clients understand that as it makes complete commercial sense, they work under the same pressures."

Internal and external lawyers have to work together to make sure not to destroy the value of the market. And there is now an opportunity for a collaborative dialogue between them to work out new pricing models going forward in line with the times we are living in. Those who get it right will be leaders in defining the market.

"Those law firms that offer services that are wrapped up in very clear value propositions for individual service lines have the flexibility to do some things with pricing," explains Smith. "And those are the firms that are better placed to avoid the pain about pricing in the market." Differentiation is currently the big challenge for law firms.

2013 is expected to see the first radical efforts at change, but whether they will go far enough remains to be seen. Once the first does, however, it is expected that others will follow.