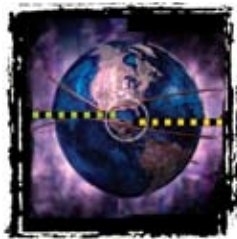


Taming the Corporate Legal Spend

What's needed is a total cost view that targets equal improvements in both the rates (prices) and quantity (number of hours) of the legal services provided.

By Daniel Mahler



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Are we living in a litigation-crazy world?

Executives at most firms would likely answer “yes,” based on their familiarity with corporate expenditures for legal services, which have continued to rise unabated in recent years. Even those corporations that have established a flat demand for this noncore yet highly important service are feeling the pinch via rising rates—a development that is drawing the attention of the CFO and other budgetary gatekeepers.

This increase in legal spend has come in conjunction with the rapid consolidation of law firms. Most of these newly consolidated firms have been leveraging their newfound economies of scale to improve their own profitability and create one-stop megashops while maintaining or raising their traditional billing rates.

Where does this money go? A quick glance at the typical corporation’s legal-spend breakdown is telling. The internal legal function usually accounts for something like a quarter of the corporate legal budget, while settlements, judgments, and other fines generally represent another 25 percent or so of this spend. The remaining half of the legal-spend pie, then, goes to pay the fees of outside counsel.

At a minimum, it would seem possible to reduce the costs surrounding litigation, contracts, merger-and-acquisition activity, and other actions that frequently require the use of external legal service providers. In fact, those companies that have begun to address legal costs typically achieve results ranging from 10 to 25 percent in savings—an impressive figure on its own, and even more astounding in light of the sheer size of

the legal expenditure in some industries.

So why is it that so few companies have attempted to rein in their legal spending? For starters, at most corporations the legal spend base is highly fragmented, with few negotiated contracts in place with law firms. The chief legal officer and the internal legal staff often have deeply entrenched relationships with outside counsel, which typically include a combination of specialty service providers and long-term associations with trusted firms.

Seemingly limitless budgets combined with a certain amount of territorial protectiveness on the part of the corporate legal function has long served to inflate the legal spend. But as successes in other indirect areas such as temporary services and human resources attest, the legal spend can be addressed in a strategic cost-reduction effort. Such an effort would focus on using established business techniques to preserve the value obtained from this spend. The legal function’s subject expertise, procurement’s process expertise, and the watchful eye of the finance group can collectively bring a smarter approach to legal spending while keeping final decision-making powers in the chief counsel’s hands.

Total Cost View

A total cost view will target equal improvement in both the rates (price) and the quantity of services (number of hours) required for each type of legal service. This approach will maximize the value of a legal services cost-reduction effort. A range of techniques—including strategic sourcing, relationship restructuring, demand management, insource/outsource mix optimization, and legal risk management—can be used to address one or both components of the total cost equation.

Strategic sourcing can directly address the price side by leveraging the corporate-wide legal-services spend volume to reduce the number of providers. In doing so, it is crucial to look deeply into costs to unbundle services and examine weighted average rates.

While rates for individual legal services can be successfully negotiated downward, this practice alone does not guarantee success on the price side of the equation. Legal firms have learned to make concessions on the rate side without actually reducing their fees by changing the mix of staff that works on a legal matter (for example, by applying a partner where an associate who bills at a lower rate would suffice). Therefore, it is equally important to negotiate, measure, and track the “net blended rate”—the weighted average rate charged across all levels on a case—for services.

Relationship restructuring also factors into the price side through legal-service provider tiering and preferred-partner programs. Better rates are obtained by consolidating this spend into fewer, larger partnerships. Consolidation also allows for stronger and deeper relationships with these providers and reduces the amount of time that internal legal resources need to dedicate to managing these relationships. The goal ultimately is not simply to reduce the number of legal-service providers but to define the ideal or “right” number of firms to work with. That number will vary by company according to how many firms they are already employing and how many relationships they want to manage.

Law firms tend to be more receptive to blended rates in less strategic or routine areas, such as employment law and patent filing. Offshoring these commodity-type legal services in order to lower costs is another trend, with savings from 30 to 70 percent being achieved.

While rate reduction is key, companies can also take actions to reduce the quantity of their legal services. Formal case-management processes, for example, can be implemented to apply new rigor to early case assessment in order to determine which matters should be settled out of court and which should go to trial. Policy guidelines can clarify which circumstances mandate the engagement of outside counsel and which parties can make these decisions at which levels — essentially, taking a make-versus-buy approach to services. Each of these techniques helps to reduce the quantity of legal hours that need to be applied.

Technology, information, and knowledge transfer collectively allow the business to work smarter and faster at lower cost through automated case management, e-billing, online information sharing, and centralized knowledge-management systems. Each of these techniques frees up time for internal legal resources, which can be reapplied to other matters to reduce external spend. In working through its retail litigation spend, a major investment bank reduced costs by some 20 percent by emphasizing demand management and internal process improvements.

Both rate and quantity can be addressed through an insource/

outsource mix optimization program that drives improved decision making around which legal services should be handled by internal legal resources and which require outside services in order to generate savings without reducing quality. Typically, an hour of external legal service is billed at nearly triple the cost of a comparable internal legal resource. While this expense can be justified for highly strategic matters, nonrecurring work, or specific subject matter expertise, most work can be handled in a more cost-effective manner by internal staff.

Both internal and external costs need to be mapped out before these strategic choices can be made. However, the insourcing of legal hours should not simply lead to the equivalent addition of full-time resources. Instead, an examination of the legal function’s productivity should be undertaken before this additional work is taken on; oftentimes, internal legal staff is found to be performing a significant amount of low-value work that could conceivably be outsourced or offshored. Where necessary, taking on additional headcount is a sensible option when the threefold cost of employing external firms is factored in.

Finally, risk management can also help lower the quantity of legal services required. This data-intensive approach seeks to

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eliminate the drivers of legal costs through an analysis of previous litigation cases in order to identify commonalities. Risk management examines liability exposure to drive out root causes wherever possible in order to avoid legal expenses altogether.

No Silver Bullets

Bear in mind that no one technique can be applied across all outside counsel; instead, a blended strategy that considers the unique qualities of each type of legal service is called for. For instance, routine litigation may be addressed through traditional sourcing techniques, while mergers and acquisitions or complex litigation may require a formal restructuring of existing relationships. Significant cost reductions can be achieved when entrenched relationship with outside legal firms are challenged face to face. Many firms become much more aggressive with their pricing and delivery models when they are presented with a credible threat to consolidate legal suppliers.

Maximizing the value of the legal spend is a challenge that offers significant rewards. Companies experience their greatest successes with such endeavors by tackling the issue from all angles through a holistic program. Success relies on cross-functional teams that leverage the subject matter expertise of the legal function and the process knowledge of supply management.