Billable hours - why it's time for firms to slaughter this sacred cow

Every organisation has sacred cows – policies, procedures, customs, traditions or even individuals that are untouchable and incontestable.

Organisational sacred cows can be fine if they drive positive behaviours, beneficial client relationships and a thriving culture. However, when these sacred cows drive negative, out-dated and unsustainable behaviours, publicly slaughtering one can strongly signal positive change.

One such sacred cow for many professional services firms (particularly law firms - on whom this article focuses) is the 'billable hour'.

What's wrong with the billable hour?

The top performing firms believe in putting the client first, doing things the right way and having a deeply rooted value set which drives all successful behaviours.

Accordingly, the top firms measure and reward the successful behaviours which underpin these beliefs with at least as much diligence as they measure short-term, 'activity-driven' metrics (utilisation and billable hours). The type of behaviours the top firms measure and reward might include: client loyalty, business development, people development, responsiveness, collaboration, new relationships, trust, service innovation and successful projects.

The main problem with the billable hour performance metric is that it specifically rewards and underpins behaviours that can be both to the detriment of the firm and, more importantly, its clients.

Clients do not like the billable hour. There is little correlation between quality of service and cost as the client still gets charged the same amount whether the litigator wins or loses.

Rather than engendering a positive relationship with clients, billable hours often create an unnecessary debate between parties with both sides analysing, evaluating and auditing the fees. The lack of transparency and perceived secrecy around pricing means that clients never really know how much and for what they will be charged at the end of a project.

Clients know that billable hours are inflationary because they will be charged for a block of unit time whether or not they use the whole block. This inevitably leads to a negative perception.

What's more, the fear of being charged a significant amount for simply contacting your lawyer means there is little incentive for regular communication. The clients can be reluctant to call the lawyer and equally they can become cynical or suspicious every time the lawyer contacts them.

Within the firm, billable hours drive inefficiency. To generate more revenue for the firm, somewhat counter-intuitively, individuals seem to be rewarded for prolonging litigation, 'churning the bill' and creating unnecessary work.

As one law firm partner said: "The billable hour makes no sense even for lawyers. If you are successful and win a case early on, you put yourself out of work. If you get bogged down in a land war in Asia, you make more money. That is frankly nuts."[i]

There are not many other industries where taking longer over a task would be rewarded. Similarly, there are not many sectors where the quantity of output (hours) is rewarded over the quality of output. Without doubt, law firms want to be seen as providing a high-class, quality service but rewarding time spent surely pushes the firm's image towards the negatively perceived, low value, commodity end of the spectrum?

So what is the alternative?

One strategy that is regularly discussed but rarely implemented[ii] is value-based fixed pricing, whereby prices are primarily (but not exclusively) built on a perceived understanding of the estimated value for clients, prices are set as a function of this value and the ability to design and deliver a service that directly meets these clients' needs, rather than on the cost of production (hours billed).

In contrast to hourly billing (or cost-based pricing), value-based pricing directly rewards the positive behaviours firms want to see:

i. Client communication and relationships are strengthened as clients have to be involved in any discussion of value
ii. Listening is key, as firms have to take on the customer's perspective in order to make a value assessment
iii. Quality (not quantity) is rewarded as only exceptional service and results will see the firm generate the value expected by the client

Why value-based pricing struggles to work in practice

Unfortunately, there are problems with using value-based pricing in practice. According to Hinterhuber (2008), the key barriers are:

1. **Difficulties in making value assessments:** Can firms, particularly consulting firms, or their clients really know what value will be created before a project starts? What if the job is (or becomes) particularly complicated? Value-based pricing assumes that a client knows what benefits they want or will receive as a result of the engagement. This is not always the case.

   The risk then lies with the advisor – both in convincing the client of the value before any engagement and then in assuming that value is delivered.

2. **Difficulties in communicating value:** Many firms struggle to communicate the value that they will bring in accordance with perceived client needs. If you cannot communicate value to a client, it is hard to justify a price.

3. **Difficulties with market segmentation:** Firms need to have an in-depth understanding of their clients to know on which aspect of the service each segment of the market will place value.

4. **Employee management:** Encouraging behaviour change is hard and performance metrics have to reward the adoption of new behaviours. If firms continue to reward on output (billable hours worked) rather than performance metrics (behaviours concurrent with the new pricing policy such as client satisfaction, client loyalty, referrals) then new client-centric strategies are doomed. To successfully adopt a new way of working, firms will have to train, model, coach and reward new behaviours that correspond with such an approach.

5. **Difficulties with senior management support:** The only way new behaviours can be applied and then embedded is if partners and senior managers are aligned to the new metrics and embody the required new behaviours themselves. There is no point introducing a new value-based pricing structure if senior management simply revert back to old metrics of performance.

How law firms are adopting alternative pricing models in practice

For those who believe that slaughtering the sacred cow of billable hours is unrealistic, there are firms who have already begun adopting alternative models that encourage and reward behaviours much more aligned to their clients' needs.

One law firm for example, Jackson Lewis, last year decided to move away from billable hours as a metric for compensation. At the time, Vincent Cino, the firm's Chairman said:

"Associates at the firm will be assessed on efficiency, client service, responsiveness, team-orientation and pro-bono commitment in an effort to align the way Jackson Lewis delivers legal services with clients' needs.

The billable hour is directly opposed to the best interest of the client and to the provider of service because, by its very nature, it adds an artificial barrier to the accomplishment of the only real objective which is a quality legal product for a set and expected price."[iii]

Alternative fee arrangements that are now offered to clients by some law firms include: Fixed fees/flat fees; Capped fees (hours not to exceed a set amount); Collar fees (sharing of "savings" or "overages" should actual fees deviate from estimate); Contingent fees, Success or performance bonuses; and Broken deal fees.

Reed Smith is another top law firm that illustrates this new way of measuring performance by putting clients at the forefront of all behaviours:

"At the beginning of each engagement we sit down with our clients to have frank and detailed pricing discussions where we ask questions such as:

- What would the client consider a successful outcome of the matter?
- What are the client's priorities, both overall and for the matter?
- What are the key risks and opportunities? Does the client have specific pricing parameters/concerns?

The answers to these questions help ensure that each client's goals and business objectives are captured by the most appropriate alternative fee or value-based pricing arrangement."[iv]

Why professional services firms need to start slaughtering some of their sacred cows

The top performing firms believe in putting the client first, doing things the right way and having a deeply rooted value set which drives all behaviours. Any sacred cow that rewards behaviours directly against these values, such as the billable hour, should be slaughtered.

Unfortunately, within some professional services firms the sacred cow of billable hours is just a small part of a much larger herd.

There are still some firms who believe that their brand and reputation are impregnable and are unwilling to remove out-dated policies, procedures, customs or traditions even if they reward behaviours and encourage a culture that's to the detriment of their clients.

Lou Gerstner, former CEO of IBM found exactly this situation when he joined the technology giant in the midst of a serious downward spiral in the early 1990s. He later wrote: "this rigor mortis that sets in around values and behaviours is often devastating for successful companies"[v] Gerstner became well known for very quickly slaughtering many of the sacred cows at IBM which rewarded negative behaviours.

Professional services firms can no longer rely on an assumption that their clients do not have the sophistication or inclination to change providers. Operating in a competitive marketplace, ripe for disruption, with clients more knowledgeable than ever before ensures that the way a firm's employees behave will make or break the firm's success.

Firms whose metrics ensure a behavioural set with the client at the heart of everything they do will be best placed to thrive.

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[i] "Kill the Billable Hour": http://www.forbes.com/forbes/2009/0112/026.html

[ii] Hinterhuber, A (2008) "Customer value-based pricing strategies: Why companies resist" Journal of Business Strategy p.41-50 http://www.hinterhuber.com/media/publications/articles/pricing/Customer_value_based_pricing_strategies_obstacles_JoBS_2008.pdf

[iii] "Which Biglaw Firm Just Got Rid Of Billable Hours?" http://abovethelaw.com/2014/11/which-biglaw-firm-just-got-rid-of-billable-hours/?rf=1

[iv] "Reed Smith - Client Value Initiative" http://www.reedsmith.com/clientvalue/

[v] Gerstner, L. (2002) "Who Says Elephants Can't Dance" HarperCollins p.185