

Next Generation Technology

*Is your law firm
ready?*

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There is no question nowadays that technology is present in all aspects of our daily lives.

Without realizing it, as part of countless daily activities, we interact with components based on, or supported by information technologies.

We drive a car out of the garage, using a card or remote control which opens the door by means of a microprocessor. We use automatic devices to raise toll booth bars. We buy gas with a credit card which checks a data base to determine whether we can charge the purchase, at the same time that it updates a register of our purchasing history and patterns. We arrive at meetings with hand-held or laptop computers; and we connect them to wireless devices which allow us to exchange electronic documents. We read and answer emails, or even conduct international conference calls with our clients, before we even get to our office, using our personal computer or cellular phone.

This brief description of an everyday early morning routine was unimaginable twenty years ago for most people.

If the daily use of technology has had this kind of impact on our personal lives, what can we say about its impact on the business world?

It is impossible even to consider starting a business without taking into account the necessary technological components which we will need, not only to obtain competitive or strategic advantages, but just to run daily operations effectively and competitively.

Only a starting point

Nicholas G. Carr recently wrote in his *Harvard Business Review* article "IT Doesn't Matter: "

"By now the core functions of IT, have become available and affordable to all. Their very power and presence have begun to transform them from potentially strategic resources into commodity factors of production " (note 1)

Years ago the mere use of information technology systems could deliver strategic competitive advantages. Today it is only the starting point. If technology itself is not part of a law firm's basic business model, the firm cannot expect to generate sustained profitability.



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What are the implications for law firms?

Figure 1, below, shows how, through the latter half of the 1990's, most interactions of law firms with their clients were done by phone, fax, and physical exchange of documents. Phone networks and data networks were not interconnected, and there was no electronic interaction between clients and law firms. The technology infrastructure was based on a simple local area network (LAN), which provided administrative support to the firm's professional practice. IT services were generally only used to distribute internal mail, and prepare documents, effectively turning this small infrastructure into a sophisticated typewriter.

Technology has become the backbone of the business world, thanks to the standardization, commoditization, and democratization of its access, and as a result of significant decreases in its associated costs. However, technology is only a powerful tool, or set of tools, which allow the creation of value-adding solutions for the business, its organization and its people, and ultimately for its clients.

Law firms, supported by their human capital, provide high value-added services to their clients. Their capacity to execute, deliver, and control is as critical to their success as their capacity to leverage and optimize their human and intellectual capital.

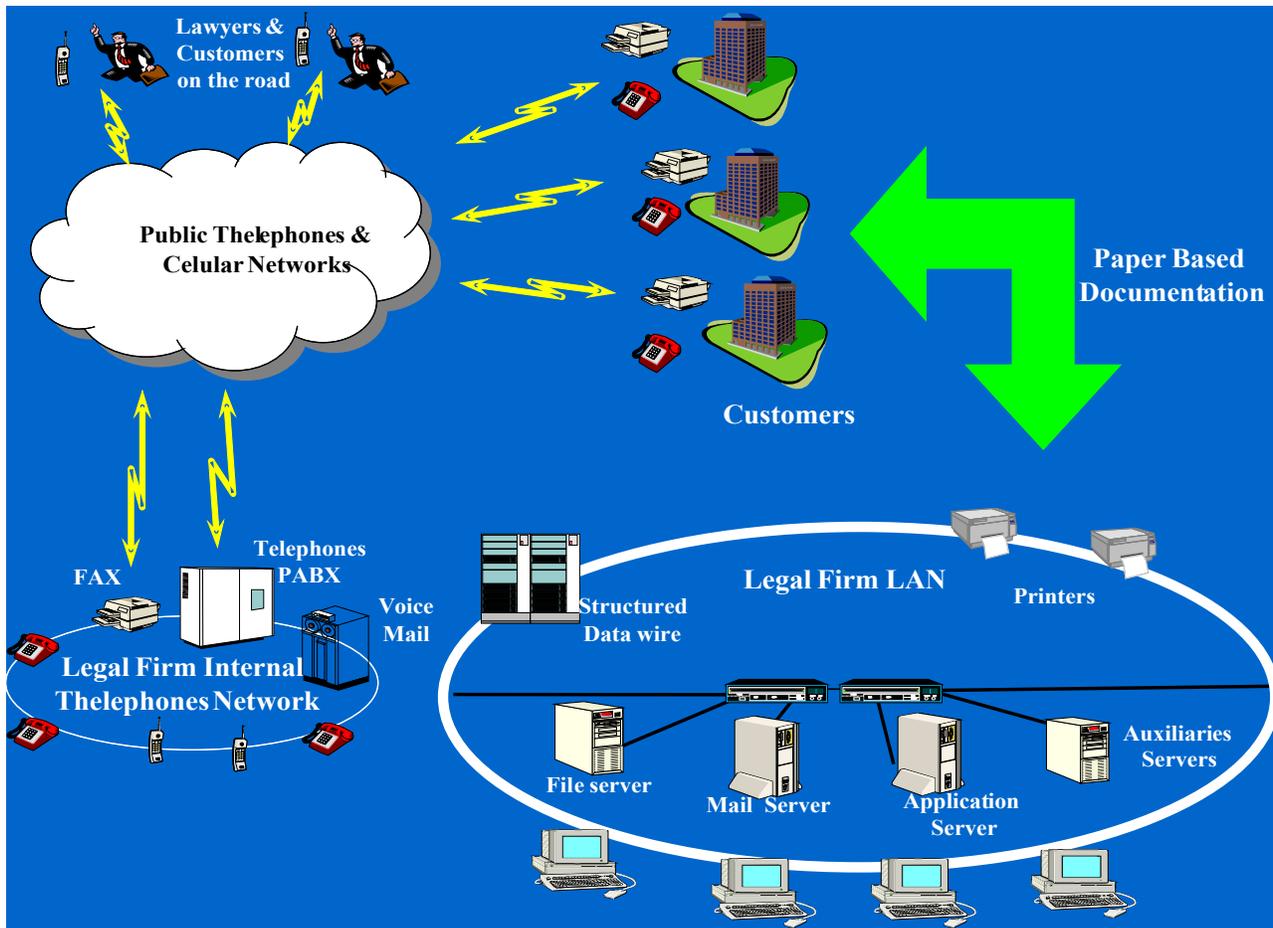


Figure 1 Technology infrastructure and interactions through the second half of the 1990s

Today, both clients and the professionals who advise them require greater service delivery capabilities, a better quality of end products, and greater access to administrative information which allows them to manage their budgets, among other things. Currently, clients have significantly greater access to information, to services, and to other law firms, literally at their fingertips, through a click on the Internet. Former geographic barriers and boundaries no longer apply. Decisions are made based on added value, quality, immediacy, efficiency, mobility, virtualization and lower costs.

The new business reality

Figure 2 illustrates in a simplified manner how interaction between clients and law firms has evolved over the last seven years and how this has required an evolution in business models, including processes and technology infrastructures that support this new business reality and associated new processes.

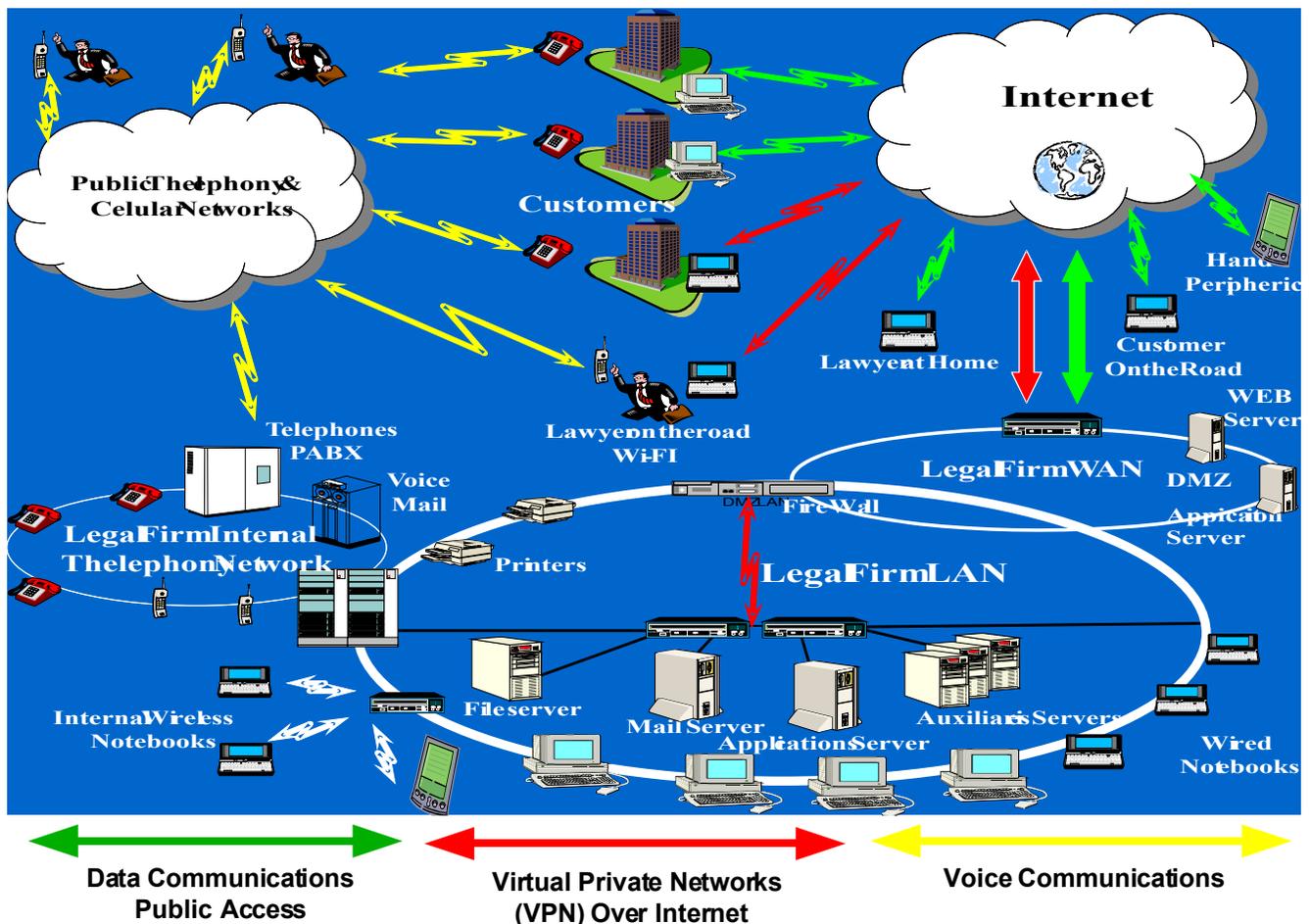


Figure 2 21st century technology infrastructure and client interaction

In only ten years...

Comparing law firm technology in the 1990s (Figure 1) with law firm technology only ten years later (Figure 2), there are several striking observations:

- ✓ The telephone-paper model (Figure 1) has been replaced by a model that relies strongly on communication systems that deliver voice and data, usually in the form of electronic documents.
- ✓ The Internet is now a primary means of data transmission.
- ✓ The Internet also allows for a virtual work environment for the firm's associates, through the use of virtual private networks over Internet and over the phone, which improves customer service and increases revenues for the law firm.
- ✓ The firms' websites provide clients and associates access with new services, such as newsletters, access to private data, billing information, and reference articles, among other things. To achieve this, it has been necessary to create new business processes and to improve, strengthen and automate other processes, such as billing and timekeeping.
- ✓ Much information is exchanged through transmission of electronic documents by email, which has become a critical mission resource and has improved associate productivity significantly.
- ✓ Telephone and data networks start to converge.
- ✓ Law firms' local area networks (LANs) are no longer stand-alone, and are now integrated with other LANs by Internet, forming a wide area network (WAN).
- ✓ The Internet and WAN networks interconnections has begun to require security measures to protect the firms' LANs from intruders.

Technology is not enough

Law firms, as part of the business world, are not exempt from the impact of the technology revolution of the last few years. Their challenge, today, is to develop a culture that is focused on the client, to be competitive, profitable, and to have the capacity to innovate and to respond rapidly to change. This cannot be achieved through the use of technology alone. It also requires correct usage of the technology and intelligent investment,

Law firms are meant to deliver high value-added legal services to their clients, not to develop and deliver information technology systems. It is not necessary that law firms become high-tech boutiques. What is required is that their technology infrastructure be able to sustain their strategy and business model consistently, allowing them to deliver the excellence of services that the current business world expects.

A law firm must evaluate carefully which technologies to incorporate, and especially when to do it. Forefront technologies remain expensive, and their deployment and maintenance are costly, until they have been totally proven. This is why it is usually wise to be part of the second or third wave of adopters of these applications. However, any investment must also consider the new technological trends, to ensure that it can be protected in the longer term.

IT infrastructure has become the foundation of the organization's operations; and solutions which support organizational culture, business intelligence and delivery of services are built upon it. It is integrated by a set of physical, logical, methodological and administrative components, both in-house and outsourced, which allow for the continuity of operations and require an adequate cost-effectiveness.

Professional service automation

As an example to illustrate this discussion, we can mention PSA (Professional Service Automation) solutions, which automate several law firm business processes. This concept is defined by the Aberdeen Group as follows:

“PSA is a suite of integrated applications designed for services-centric organizations that enables personnel across the services value chain to become more productive and profitable; those goals are attained by increasing efficiency through improved planning, increased collaboration and personnel utilization, enhanced financial management, and integrated knowledge management.” (note 2)

Studies by the Aberdeen Group (and our own experience) indicate that these solutions bring about an estimated 10% increase in profitability, by avoiding losses due to “revenue leakage”, and an increase of about 8.1% in productivity of professional staff.

When the Aberdeen Group figure is applied to the economics of a typical midsize law firm, the increase in revenue can be dramatic. Consider this conservative model.

Example

Assume that a 70-lawyer law firm has an average hourly rate of \$200.

Lawyers in this firm each have an average of 200 hours per month for work. On average, they use 50 hours per month for vacations, professional development, illness, marketing, and administrative matters. This produces an average utilization rate of 75%. An average of 150 hours per month per lawyer is billable to clients.

Assume that the billing realization rate for the firm is 90%. In other words, 10% of the billable hours are written off before they are billed. This is not a financially desirable rate. The firm, in effect, is “giving away” 10% of its services. Unfortunately, it is a very optimistic realization rate for many law firms.

Here is a model of the firm's usual billing productivity:

Hours worked per month:

$$200 \text{ hours per lawyer per month} \times 70 \text{ lawyers} = 14,000 \text{ hours}$$

Billable hours per month

$$14,000 \text{ hours} \times 75\% \text{ utilization rate} = 10,500 \text{ hours}$$

Value of billable hours:

$$10,500 \text{ hours} \times \$200 \text{ fee per hour} = \$2,100,000$$

Hours billed per month

$$10,500 \text{ total billable hours worked} \times 90\% \text{ billing realization rate} = 9,450 \text{ hours}$$

Value of hours billed per month:

$$9,450 \text{ hours billed per month} \times \$200 \text{ per hour} = \$1,890,000$$

The “leakage” for the firm is \$210,000 per month, and \$2,520,000 per year.

No firm is perfect, but suppose that a PSA system could improve the lawyer utilization, not by the 8.1% measured by the Aberdeen Group, but only by 5%. The improved productivity would affect two critical economic measurements. In our experience, PSA systems, when properly deployed in a law firm, can improve productivity throughout the service delivery system, not just at one point. The improvement is not a total of 5%, for example, but can be 5% at more than one point in the process.

Therefore, it would be reasonable to expect a PSA system to improve both the utilization rate – the percentage of available working hours that are devoted to billable work – and also the percentage of billable hours that actually get billed.

Here is what would happen to the law firm in our example, even if the Aberdeen Group's 8.1% improvement in productivity is not achieved. Assume, instead, only a 5% improvement in utilization and billing realization.

- ✓ Billable hours per month increase from 10,500 hours to 11,025 hours.
- ✓ Value of billable hours per month increases from \$2,100,000 to \$2,205,000.
- ✓ Hours actually billed per month increase from 9,450 hours to 9,839 hours.
- ✓ Value of hours billed per month increases from \$1,890,000 per month to \$1,984,500.
- ✓ Additional revenue increases by \$94,500 per month and \$1,134,000 per year.

It is important to notice that this increase in revenue happens without anyone actually working even one more hour. The PSA system improves the ability of the firm to capture and bill the hours

that have already been worked and the fees that have already been earned.

Most of this additional revenue goes directly to profit; because, after deducting the costs of the PSA system, this increase in productivity requires virtually no additional resources. Moreover, at this level of improved revenue performance, the firm can probably totally recover the costs of the system in approximately 90-120 days.

What is required to get these results?

To obtain this type of results, it is necessary to base business processes on an IT infrastructure designed and managed through a structure of processes and relations. This structure of processes and relations must ensure that technology is directed and controlled within the organization, balancing risks against return on investment. It is common to find models, such as the one illustrated above, in which the possible benefits available have been lost due to incorrect implementation, or simply because the firm made bad incorrect decisions about the mix of technological components used by the firm. As in other areas of law firm management, bad results usually in result in higher costs.

Thus we begin to see the importance of IT services management, in terms of aligning business processes support with the firm's strategy, improving the quality of professional services, shortening delivery times and reducing IT risks. They can produce real financial results, not only short-term but sustainable over the years.

The IT investment

Currently, information systems, IT infrastructure and communications account for over half of the capital budget for most business sectors. IT management practices integrate IT evaluation, planning, organization, acquisition, implementation, delivery, support and performance management, to ensure that the capital budget is used correctly.

Each investment must take into account current realities, but must also be analyzed and executed observing the medium and long term trends. This protects today's investment tomorrow. This process requires important decisions which should be made professionally by IT

specialists.

This is why midsize law firms, and even small ones, need to include in their structures an IT function that provides solutions to information and technology infrastructure needs of their businesses. Given the strategic impact of IT on the organization, the IT function should report to the firm's managing partner or the executive committee. Unless that direct reporting relationship is present, there is a danger that the critical link between IT services and business objectives will be weak or broken.

The coming structure of law firm technology

What is the near-term future of law firm technology? Figure 3, on the next page, shows the next evolutionary step, which is already emerging. Several points are especially important:

- ✓ Firms which have done a good job of implementing the model in Figure 2 will be able to migrate to the new model with low investment.
- ✓ Collaborative work is deeper, supported by voice, data and video communications, and by the possibility of remote work from different locations on the same document, among other applications.
- ✓ Data, voice and video networks are unified, resulting in important savings and service improvements.
- ✓ Further penetration of the internet allows for virtual work environments for associates, through the use of VPNs over the Internet and video telephony, improving client service, increasing revenue for the firm, and reducing its costs significantly.
- ✓ Clients continue to receive more and better services by means of the law firm's website, as new applications become available to them and to the firm's professionals.
- ✓ Convergence of telephony and data networks is completed. Usage of 3G-type

cellular phones and IP telephony reduce “on the road” costs significantly.

- ✓ Integration of LANs and WANs continues.
- ✓ The need for network security increases.
- ✓ The model requires better systems for information management, knowledge management, knowledge sharing, human resources and financial management, in order to maintain profitability and offer more and better services.

We can appreciate how, in less than ten years, amazing transformations have taken place in the way in which the business world operates. Law firms that have adapted their business models to the new market rules have been able to keep up with their clients. Some have strengthened their business, increased the quantity and quality of services to their clients, and achieved higher profits.

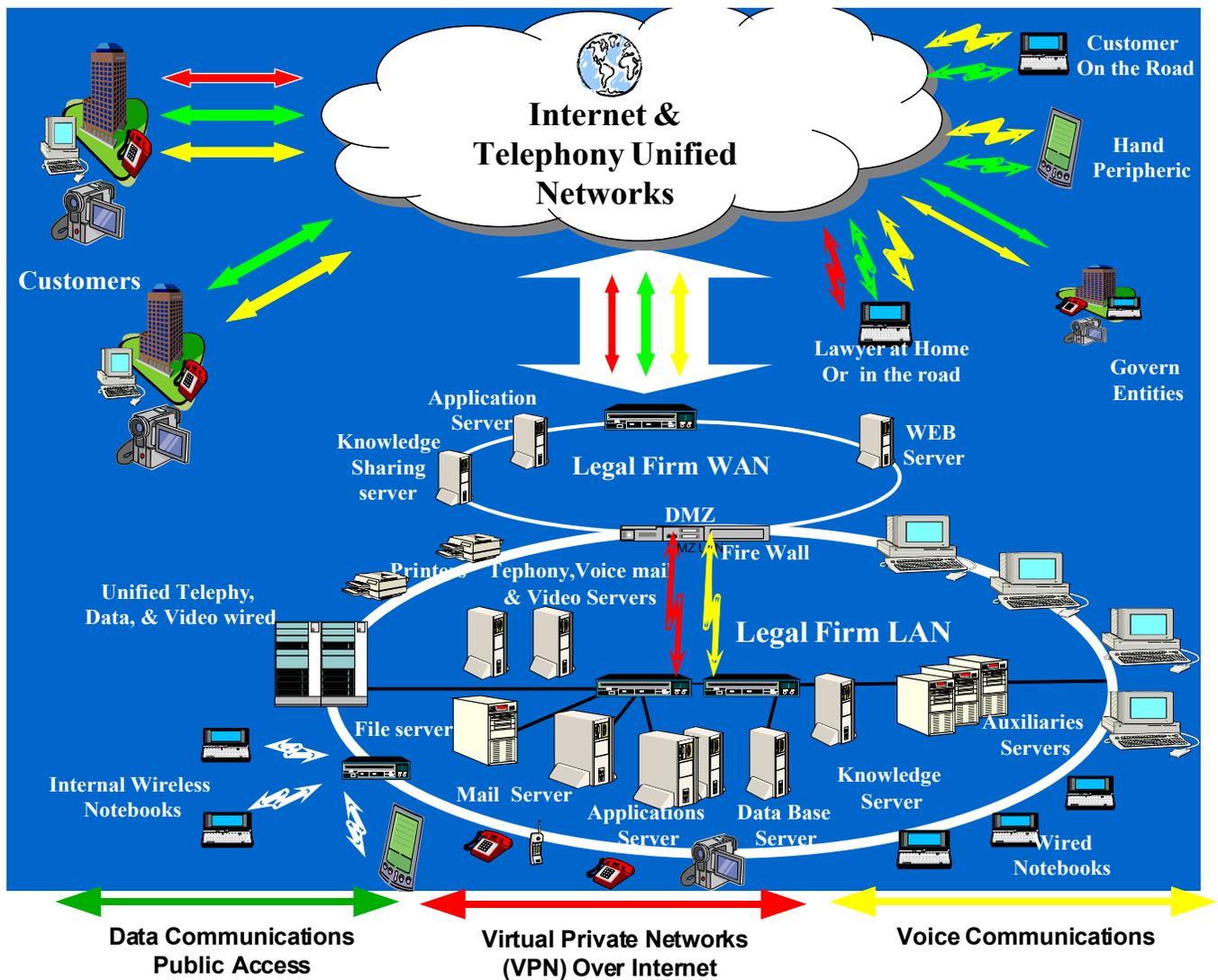


Figure 3 Technology infrastructure and interaction currently in transition in law firms

Is your firm ready?

The environment pictured in Figure 3 is coming quickly. Most law firms are not prepared for these changes. Many have not even completed the transition to the environment in Figure 2. If a law firm wants to continue to meet client demands and service expectations at a reasonable level of investment, it needs to get ready now.

To be ready for tomorrow, each law firm needs to answer some important strategic questions now:

- ✓ Does your firm have the right business processes, information systems and services that your business requires?
- ✓ Is your firm prepared to operate under the model illustrated in Figure 2, and to transition into the model illustrated in Figure 5, protecting its investments?
- ✓ Has your firm reaped the benefits you expected from the investments made to date?
- ✓ Does your firm have a professional IT department? Is your department able to support and participate in the development, management and implementation of your business strategy?
- ✓ Does your senior management team include a Chief Information Officer (CIO) with the ability to interpret the needs and strategies of your business?
- ✓ Does your CIO have the experience, knowledge and vision to manage the full spectrum of information systems, IT infrastructure and communications?
- ✓ Is your CIO qualified to conduct the required processes of selection, implementation and integration?
- ✓ Does your CIO have the experience in strategic planning and implementation, in negotiation and change management that is required to meet the goals and objectives of the firm?.

Law firms that answer these questions now will be better prepared for the profound changes that will continue to evolve rapidly in law firm technology over

the next five years. Law firms that ignore these questions, or make unwise and short-sighted decisions about them, will find it increasingly difficult to keep up with their competitors.

Notes

1. Nicholas G. Carr, "IT Doesn't Matter" *Harvard Business Review*, May 2003. Nicholas G. Carr is an editor-at-large at *Harvard Business Review*. He edited the *Digital Enterprise*, a collection of HBR articles published by Harvard Business School Press in 2001, and has written for *Financial Times*.
2. Aberdeen Group, *What Works in Professional Services Automation: Ten Case Studies That Show How to Successfully Select, Deploy, and Optimize Organizational Performance through PSA*, February 2003.