

Power of the Purse How Corporate Procurement is Influencing Law Firm

By Dr. Silvia Hodges

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Corporate purchasing departments are increasingly driving the decisions on hiring and managing outside law firms. Silvia Hodges discusses the role of procurement departments and offers tips on how law firms can change their approach to improve their chances of winning corporate business.

You don't have them on your speed-dial, you don't have their mobile number, you are not connected to them on LinkedIn, Google+ or Facebook. And that is your problem. Or, at least, it will be soon.

Unless you sit across from corporate purchasing, procurement or sourcing managers in a pitch, they are the faceless people accused of everything from interfering with the lawyer-client relationship; of having no knowledge and ability to judge the quality of legal services; of unreasonably squeezing firm's margins; to playing firms against each other and cherry-picking in order to get the lowest price. (Recently, after losing a pitch, one outraged lawyer complained that "they [the procurement managers] probably got their brains for a discount".)

It is unlikely that procurement or supply management, as it is often referred to in corporations, will go away when the economy finally picks up again. A growing number of companies bring in procurement or sourcing professionals to help evaluate providers of legal services and negotiate a good deal for their employers. After buying raw materials, goods and services for their employers, corporate purchasing departments started sourcing engineering and architectural services in the late 1980s, marketing, public relations and advertising services in the mid-late 1990s, accounting and tax services in the mid 2000s, and now it is the legal industry's turn.

In a study we conducted on the influence of procurement on the purchasing of corporate legal services, more than half of the respondents were from Fortune 1000 companies, about a third from Fortune 100 firms. 58 percent of the respondents in the study¹ said that the procurement or supply management departments have been involved in the purchasing of legal services for three or more years.

The involvement of procurement typically starts with the negotiation of master agreements, management of the panel selection or legal commodities such as e-discovery. This is often done through so-called "reverse auctions."² Some corporations today are much further along in the process:

¹ The research was conducted in collaboration with the Institute for Supply Management and the American Purchasing Society and Prof. Sven Tuzovic. Preliminary of the study were presented at Harvard Law School on December 6, 2011.

² In a reverse auction, a client puts work out for bid, using specialized software or online. Multiple firms offer bids on the work and compete with each other to offer the lowest price that meets all of the specifications of the bid.

procurement is no longer involved in the sourcing of commoditized legal services only, but also in the selection of firms for high-stakes work. Our study found that procurement buys a wide variety of legal services, from general and specialist law firm panels to ad hoc and routine legal services, litigation, transactional, and advisory services.

Procurement's involvement is typically triggered by a senior management decision to save costs. In-house counsel, many of whom had free reign when hiring outside lawyers, have greater accountability for legal spending: they are increasingly in the spotlight as companies expect them to budget legal expenses on a basis similar to other departments. Until recently, the legal department was excluded from company-wide cost cuttings. This is no longer the case.

Procurement's tactical potential as a cost killer is no secret. That is their corporate mandate. Spending less on suppliers can directly improve the bottom line. *The McKinsey Quarterly* wrote in a 2007 article titled "Inventing the 21st-century purchasing organization", that a "decade of globalization-fuelled competition has opened the eyes of executives everywhere to the strategic benefits that can be achieved through the intelligent use of purchasing and supply management."³ The role of procurement has always been based on the idea of cost control, getting external suppliers to reduce their prices and preventing departments from unnecessary spending through managing what is purchased. Procurement sees its job to make the buying of legal services more transparent and aims to help the legal department to make the best-informed decision. Procurement professionals say they source more objectively and strategically, compared to in-house lawyer who they see as subjective and unstructured buyers.

Few people like to share decision-making power or want to involve other departments into decisions that concern and affect their area. Since cost cutting and the involvement of procurement are typically mandated by top management, GC typically don't have a choice, however. To make it work, procurement and legal department have to collaborate. I have not seen any companies where GC and CPO (Chief Procurement Officer) were at war with each other or just tolerated each other and achieved good results. Nobody wins in such a situation. We found, however, that procurement and in-house legal department often work very well together. Procurement experts typically take the role of the buyer: they are responsible for the engagement letter/retainer or framework agreement and negotiations (64 percent in our study); 42 percent in the study were influencers in the buying decision, affecting the outcome decision with their opinion; 39 percent were gatekeepers, i.e. they control the flow of the information; 18 percent were initiators, recommending the purchase of legal services, and 17 percent were the deciders, in that they make or have the ability to veto the final decision. Some GC and CPO assume "good cop" and "bad cop" roles that work very well: as in-house counsel, if you have to deal with your counterparts every day, it is much better to have procurement people be the tough negotiators/bad cops. It doesn't destroy your working relationship with your outside counsel.

Ideally, procurement brings skills, processes, discipline and focus to complement the service-specific knowledge and experience of the internal users, the in-house legal department. It assists in-house

³ Chip W. Hardt, Nicolas Reinecke & Peter Spiller, *Inventing the 21st-century purchasing organization*, *The McKinsey Quarterly*, 2007, Number 4, page 115.

lawyers with defining the scope of the project, selecting the right supplier, negotiating, and structuring compensation, evaluating supplier performance, and leveraging business with preferred suppliers. Says McKinsey: “[...] the intelligent use of purchasing helped [a company] rein in rising legal costs by separating legal services into commoditized segments (including paralegal and research needs) and creating sourcing strategies for each individual segment. Meanwhile, the company introduced systematic performance metrics—such as indemnity averages—and created an independent general-counsel office staffed with lawyers trained in purchasing basics.” Indeed, companies with a sophisticated approach to procurement pay attention to talent by upgrading their procurement skills and exploring ways to connect employees across the organization in a common purpose. They set high aspirations and establish goals that balance their vision of the future with a clear focus on how to achieve it. Top procurement professionals place a special emphasis on aligning their sourcing efforts with strategic corporate goals.

We found that despite the widely held belief among lawyers that procurement officers normally buy widgets and have no idea about the law, a good number of procurement people have a legal background. In fact, in our studies between 10 and 30 percent had a JD, the remaining majority held MBA degrees. Some worked in law firms, some in in-house legal position prior to joining the procurement department. One example I found particularly interesting was the Assistant General Counsel of a *Fortune 500* company who switched from legal to the company’s procurement department in the 1990s and was responsible for sourcing legal services for a number of years. Definitely a pioneer!

The involvement of procurement and their way of comparing law firms requires a different approach from law firms, a different way than just thinking in terms of hourly rates and billing. Procurement professionals demand predictability, project and budget management even more than most GCs. The Chief Procurement Officer (CPO) of a large company told me that “if you know your business, you should know how long something takes and how much something should cost.” He used to work in the nuclear energy sector, that in his opinion had many more unpredictable factors and was much more complex than your average litigation. Yet, people were able to come up with a price. He thought that lawyers being unable –or unwilling– to put a price tag on a piece of work told him that they didn’t really know their business. He assumed that lawyers never bothered to analyze their business, because they did not have to. However, more and more law firms have recently started to conduct detailed cost analysis and plan and manage their firms with sophisticated metrics and benchmarks.

Procurement and sourcing managers aim to work with functional leaders –including the general counsel– to improve performance and focus on business value as well as cost. As McKinsey puts it: “Top performers view purchasing not only as the commercial conscience of the organization but also as its competitive eyes and ears.” There is little doubt that the involvement of procurement is an important factor behind a power shift in the legal industry to the client. Procurement today has its seat at the table when it comes to sourcing professional services. Our colleagues in advertising, architecture, accounting, and engineering among others, have had to learn to deal with this. It seems

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that it is our turn now. If you have not already, I suggest putting “Reach out and get to know the Chief Procurement Officer of top clients” in your New Year’s Resolution list for 2012.

Dr. Silvia Hodges recently lectured at Harvard Law School on “Power of the Purse: How Corporate Procurement is Influencing Law Firm Selection”. She teaches marketing and management at Fordham Law School in New York. As a speaker, researcher, and consultant she focuses on how clients buy legal services, in particular procurement, and cross-cultural/international challenges of law firms. Hodges can be reached at hodges@silviahodges.com.