The Value of Everything: How to Measure and Deliver Legal Value?

Jan Geert Meents and Stephen Allen

Abstract

Oscar Wilde famously described a cynic as someone who knows *"...the price of everything and the value of nothing"*. Legal departments have allowed themselves to become the focus of such cynicism, seen as a (high) cost, rarely able to articulate the value of what they do.

Measuring cost is important, legal functions need to be more efficient and their failure to do so has only increased the level of scrutiny they face.

Almost all commentary on legal departments, to date, has focused on the cost of legal and its failure to leverage technology and alternative ways of working.

However, if everything is viewed only through the "cost lens" then effectiveness is often overlooked—and 'value' not understood.

What, therefore, is "legal value" and *how do we measure and deliver it?* In answering these questions, we will also consider *Why do companies "buy law"* and *What should their return on investment be*?

1 Costs Are, Currently, Everything

As our industry stands today, there remains an unblinking focus on the cost of legal services. There are many reasons for this:

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1.1 Perception (Versus Reality)

The "cost" of lawyers has been, in equal part, a source of humor and frustration for many business people. However, if we take a step back and look at legal cost compared to other areas of business expenditure, we will see that it does not represent a major area of cost, for most organizations. A survey by PwC in 2013 revealed that, on average, cost of legal (both the cost of the in-house legal team and the fees paid to external legal advisors) was just less than 1 % of revenue. This figure rises to almost 2 % for highly regulated businesses but drops to around 0.3 % of revenue for simpler business models, such as retailers.

By comparison, as a percentage of revenue (Table 1).

So why is the cost of legal seemingly such an issue?

1.2 Historical Prejudice

Although not the case today, historically in-house legal teams have been seen as "the department that likes to say no". Many avoid going to legal for this reason. We all know this view was unfair then and is wildly out of line with the reality of what most in-house lawyers offer today. However, the perception does remain amongst many in business, unjustly.

Those who do go to legal, and then engage external lawyers, have found the lack of precision when agreeing on the potential fee a reason for unease. Further frustration is created through the wide spectrum of fees charged for work of a similar type.

If someone's livelihood is based on the number of hours they spend and the pages they fill—then are they not going to have more meetings and write more letters? Again, this is a case of *perception versus reality*. Lawyers work incredibly hard for their clients and in most cases, will self-regulate the amount of time spent that is added to the final bill—generally applying further discounts before issuing it.

1.3 Modernizing the Production Process But...

The issue of cost is continually cited by many market commentators as a need for lawyers to modernize (most strikingly by Professor Susskind in a number of books, including *"The End of Lawyers?"*). Industry *"gurus"* claim that applying new

Table 1 LexFuturus Research—Support Department Costs—v—Revenue, 2015

Area	% of revenue
Information technology	3.4
Marketing	2.8
Finance function	2.7
Legal	*0.9*

business concepts—such as *“lean six sigma”*, technology, project management or even artificial intelligence—would drive down the cost of production.

However, here again the “dictate of the hourly rate” holds the industry back. New ways of working will require investment, some of which will be significant. If, however, “hours worked” remains the sole metric of choice—such investment is difficult to justify.

In order to encourage the investment needed to ultimately reduce the cost of production, legal services must be bought and sold differently. But how?

1.4 The Great Procurement Experiment

In recent years we have seen a growing number of procurement departments getting involved in buying legal services. For want of a universal metric, procurement professionals have resorted to comparing hourly rates and discounting as a means to drive down cost. Most law firms have trimmed or, in some cases, even eradicated margins to meet the criteria necessary to continuing working for some clients. The suppliers have, by and large, met the challenge thus far but little margin remains for this to continue.

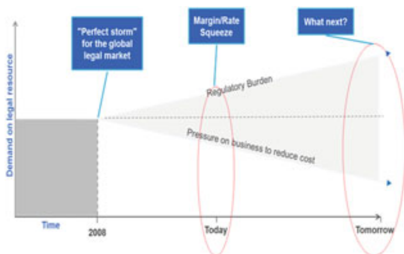
1.5 Now Adding the Global Financial Crisis to the Mix

Post the Global Financial Crisis (GFC), we have seen further pressure on “legal cost”. Whilst, comparatively, legal remains a small area of business expenditure for most organizations, it has come under much greater scrutiny post the GFC.

There are two main drivers for this: regulatory burden, and pressure on business to reduce cost (Fig. 1).

Post the GFC, all businesses have focused even more keenly on cost, and the target for potential further areas of cost reduction has fallen on *legal*. Having already looked at applying process, technology or outsourcing efficiencies to other support functions—such as finance, marketing, IT and HR—legal had been largely left alone, not only because it was a comparatively small area of business expenditure, but also due to the fact that legal cost (unlike HR, Finance and IT) is only partly spent internally, while an equal percentage spent on external lawyers.

Fig. 1 LexFuturus 2015



Savings gained by putting finance or HR teams into shared service centers were not available when looking at the legal team, and therefore those teams were left largely untouched.

The second reason why legal has risen up the agenda is that the burden of regulation has burgeoned since the GFC. Companies just have more law and regulation to deal with than before and this trend is set to continue. Examples would be the great volume of financial market regulation on banks, anti-bribery and anti-corruption laws or additional and renewed data protection regulation. The impact of the increase in regulation is further compounded by the requirements it places on organizations in complying with it.

Further, it is no longer sufficient to have policies in place to set out how the business is to comply with the regulations. Adopting the model established by Sarbanes-Oxley, organizations now need to be able to demonstrative "active compliance"—tracking policy, documentation, adherence and deviation. The expense and effort of compliance is far greater than it was previously, adding cost and even further scrutiny.

However, as every in house lawyer knows, the penalties for non-compliance are far greater than before the GFC. The fines are no longer symbolic and are ever more punitive. The maximum fine in the UK for a data protection breach used to be £5000—it can be up to 4 % of annual global revenue under the new General Data Protection Regulation (GDPR). The penalties for directors now include the threat of custodial sentences. Being non-compliant is not an option. The burden of risk escalates at the very same time when the need to reduce legal cost increases.

So what is next? What should in-house lawyers be focusing on?

2 Value of Everything

All this focus on cost is, ultimately, limiting for in-house legal teams. If in-house lawyers are to "run legal as a business" they need to change the perception of what they do as being a cost and instead look at it as an investment, which is driving value for the business. In order to achieve that, they have to be able to articulate, target and measure legal value. To assess the investment in legal, we have to better understand the value of legal. How can it be measured? Where should investment be made?

To understand this better, we first have to ask why do businesses buy legal.

Businesses buy legal for two reasons:

1. to help ensure that money doesn't go out of the business—*value leakage*; or
2. to help secure money comes into the business—*value realization*

Ultimately all efforts of legal should be directed to help ensure that the business prevents *value leakage* and secures *value realization.*

So, we have identified a value metric that legal can be measured by, but where does this value come from?

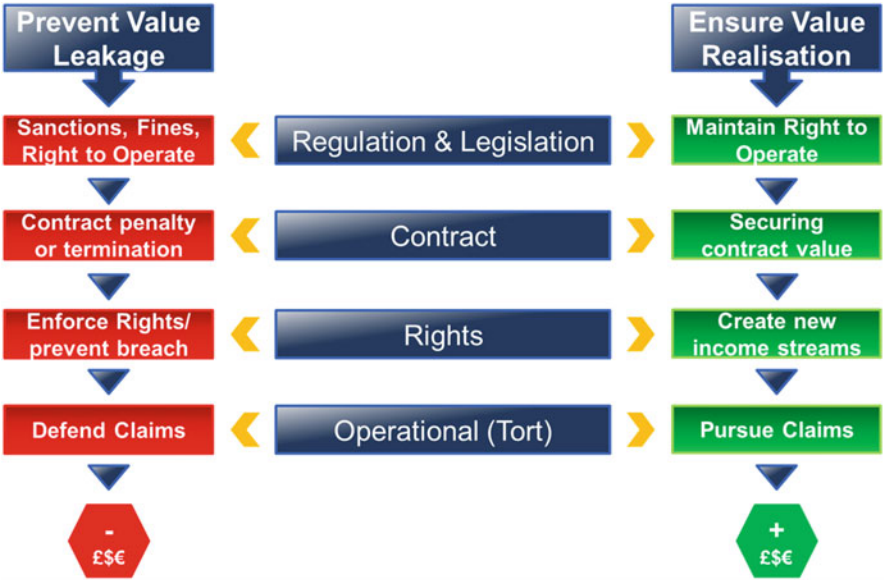


Fig. 2 LexFuturus 2014

Legal's role is to protect the business from risk. We often talk about *legal risk,* but when running legal as a business and looking at our role as creating legal value, we shouldn't be focused on "legal risk". Instead, the focus should be on what the risks of the business are and how they are crystallized in law.

As set out below, business risk is crystallized in law in four ways (Fig. 2):

1. Business Risk can be crystallized in **Regulation and Legislation**. Value can be lost through the business' failure to observe its obligations—as a consequence of which it could find itself fined, its operations limited, or its right to operate lost.
2. **Contracts** crystallize obligations which, if not met, could lead to penalties or termination, but they also enshrine rights that need to be secured in order to realize value.
3. **Rights** need to be enforced and breaches prevented.
4. Things happen, **operationally,** within all businesses and claims need to be both, defended and pursued.

Therein lies the challenge for the in-house legal team. Whilst there are business risks crystallized in law, and the responsibility for remedying failure sits with legal—these risks materialize within the operational parts of the business.

Things that trigger a risk event rarely go wrong in legal. Typically, a breach of contract occurs based on acts or omissions in the business, while the contract itself might be perfectly legally sound. Equally, the business may breach a policy or

Fig. 3 LexFuturus 2012

regulation even though legal has highlighted that risk in a policy manual or during training.

These risks are realized before legal is involved—("Pre-Engagement Legal Risk"); or after legal has been involved ("Post-Engagement Legal Risk") (Fig. 3).

In relative terms, the impact of value leakage or value realization on the profit and loss of an organization is higher than the cost of legal.

2.1 Running Legal as a Business

Therefore, if we are to run legal as a business, we need to start looking at the value impact legal can have. Companies need to be able to prioritize where they invest ("legal spend") and then look at the return on investment that it provides for the business.

This may mean that companies no longer look at how we reduce expenditure on legal cost from $100 to say $90 but, instead, they will look at what return on investment spending $100 delivers to the business and what the impact of increasing or decreasing expenditure may have on legal value realized. Would spending $90 still deliver the same return or would spending $110 deliver exponentially more?

What if legal were to measure and report the amount of legal value realized instead of how much was spent on costs?

If legal were able to measure, report and make decisions on where to "invest" *legal spend*, based on legal value realized, then they would be operating as a business.

2.1.1 Measuring Legal Value

So, all that is left now is how to measure legal value?

There are two ways to do this. One is to adopt a lawyerly approach by trying to identify the direct impact of the legal involvement in any outcome. To do this, you need to be able to calculate the value outcome to the business, had legal not been engaged (the *"but for legal" question*) and then be able to demonstrate that either

Fig. 4 LexFuturus 2015

Value Leakage would have occurred or Value Realization would not have been ensured, if had the legal team not been involved.

To do this, it is necessary to map the sources of legal demand, benchmark the outcomes and then repurpose the legal function to drive the outcomes that directly delivered value—i.e. ensure that "value in" happens and that "value out" doesn't happen.

This is a method that requires a large investment in time and systems to track. It is also a level of measurement that the rest of the business does not go into.

We can learn here from how marketing, procurement, finance or any other area of the business articulate their contribution. By adopting such an approach, legal can demonstrate the contribution it had made towards business outcomes.

To identify this value, it is necessary to collate data relevant to your business, an example of which is set out below (Fig. 4).

As this table sets out, gross legal value can be assessed through: recording and articulating the value of regulatory matters worked on (in terms of fines or sanctions); or the value of contracts written by legal; the value of litigation defended or pursued.

Recording this information by business line, and/or location, and/or department will aid the quality of data collected.

3 Conclusion

If we were to run legal as a business, we wouldn't just concentrate on cost. Managing cost is an important part of business but it must be managed in conjunction with realizing returns for the business. We need to focus on delivering legal value.

Therefore instead of calling this cost, call it spend. Look at how that spend is invested in terms of the true value it delivers to the business: does it assist the business to secure that money comes in, or does it protect the business against needlessly allowing money to flow out?

Decide where to invest to drive maximum value and use this as your business case to ensure that you have the funds necessary to invest to drive further value in the future.

Don't be a cynic. Know the value of everything.

Liquid Legal Context

By Dr. Dierk Schindler, Dr. Roger Strathausen, Kai Jacob

Meents and Allen challenge the very common and inhibiting fact that legal departments are mainly managed with an overemphasis on the cost-dimension. They conclude that if everything is viewed only through the "cost lens" then effectiveness is often overlooked—and "value" not understood. If cost is the perception and the center of the metrics we offer, we should not be surprised that we fuel the prejudice that lawyers need supervision when spending the company's money.

Even beyond that, as long as hourly rates, lawyers per billion of revenue etc. are the focus of C-level debates, any innovation offered will be viewed mainly in terms of how it can reduce cost—rather than in the context of the value it can provide to the department and the business at large. Meents and Allen point out the paradox in which corporate legal functions find themselves: ever increasing cost pressure while regulation explodes and compliance with new laws becomes ever more complex—and non-compliance ever more costly.

In order to break the vicious circle, the authors offer a change of perspective, based on the question: why do companies buy law? It is all about securing value, either by preventing value leakage from or by securing value creation for the company. The call to action is to cease stopping at legal cost—but rather call it legal spend and answer question if it was a reasonable investment into securing value for the company and if it was worth it. This directly links into the push towards value-based KPI's and performance management that Pauleau, Roquilly and Collard have established, as well as Timmer's concept on managing the legal function.

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