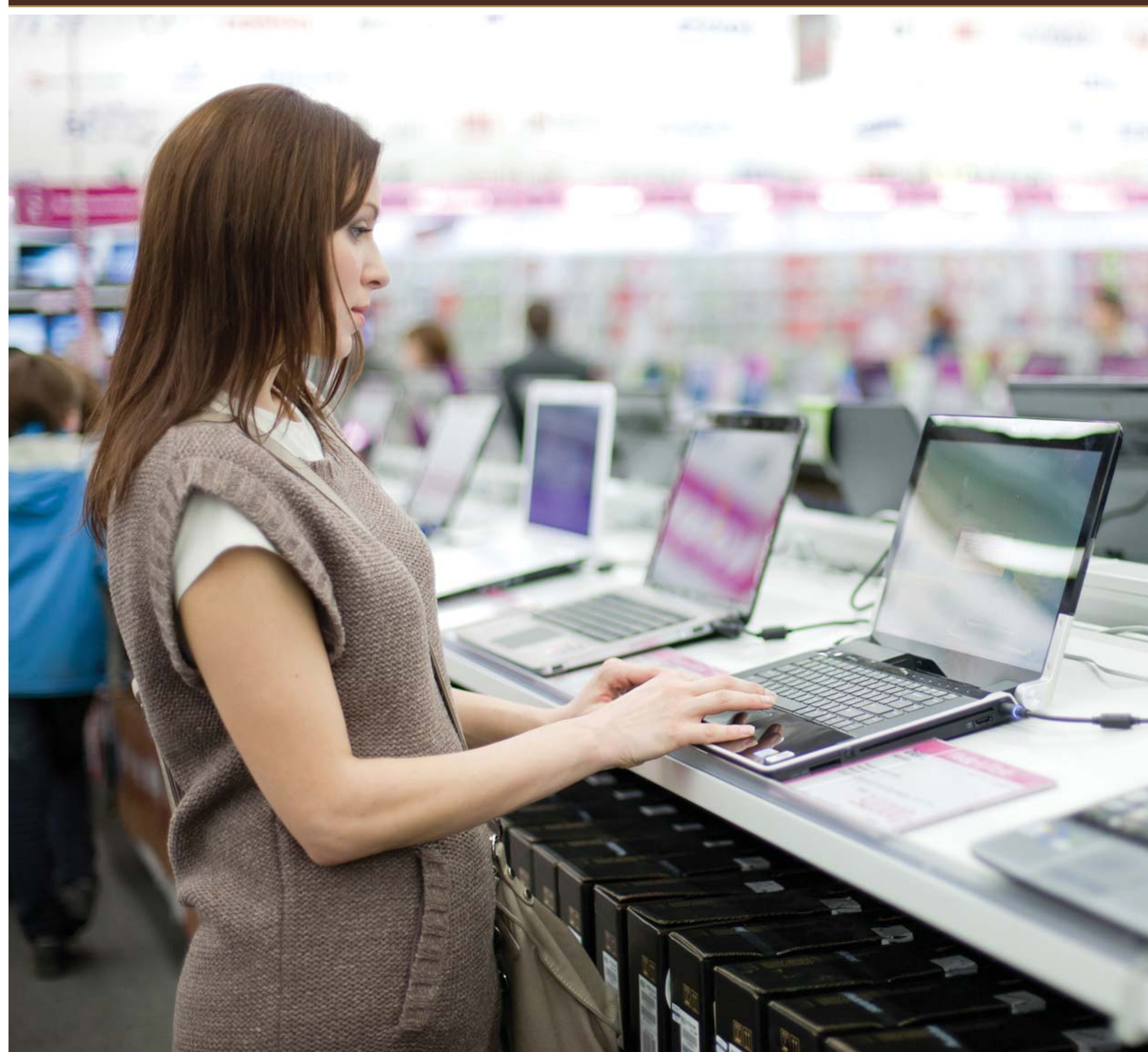

Technology Investments and Two-Handed Decision Making

How to determine ROI when considering hardware and software upgrades.

BY ED POLL

New computers, software and database research services are significant overhead costs for any law firm. The cycle of change for such technology is inexorable, and is in fact speeding up. Operating systems replace one another after little more than 18 to 24 months (think Vista to Windows 7 to Windows 8). Desktop computers are considered passé and laptops quaint when replaced by netbooks, portable viewers and smartphones.

Large firms typically make technology upgrades on a three-year cycle, with smaller firms going up to five or six years. The Great Recession has made firms stretch these replacement cycles out even further because of the high up-front expense, but that merely postpones the inevitable. One recent survey indicated that almost two-thirds of law firms were going to make significant expenditures on technology in the coming year. There are a number of fundamental reasons for the inevitability of this pent-up demand:

- Firms want new technology because it's cool and attractive (adjectives often applied to Apple products like the iPad or iPhone), or it helps them do more, faster.
- Firms worry that their existing technology will break down the older it gets, threatening a loss of client service capability while they scramble for a replacement.
- Firms have a strong competitive streak, and they either want to be the first to tout using a new technology, or don't want to admit others are using it and they are not.
- Firms have an ethical responsibility to stay abreast of current technology standards in their practice fields and geographic territory – failure to do so can be considered a breach of the duty of care, and thus a violation of the Rules of Professional Conduct.

ROI IS A MUST

No matter what the reason or replacement cycle, there has to be a return on investment (ROI) for the technology. There is no one right or correct rate of return. The return selected or expected is a function of personal choice, available alternatives and available resources for investment. ROI is positive when the cost of repair exceeds the cost of the investment minus the sales proceeds, if any, on the used equipment. And the expenditure is most manageable when the firm creates and buys according to a budget, not according to emotion fueled by what's cool or what other firms are doing – that is, buying with the head, not the heart.

Here is a typical way to calculate ROI. Say the slated expenditure is $1,000, and the expected savings or the expected increase in net revenues is anticipated to be $100 annually. Taking the savings as the numerator and the expenditure as the denominator, the percentage is 10 percent per year, which is the return on investment of the purchase. Another way to look at this is to figure that the $100, if it occurs each year, will result in a "recovery" of the entire investment after 10 years, or, said another way, that the "payback period" is 10 years.

ROI AND THE SMALL FIRM

ROI varies by circumstance and application. For example, new solo practices will likely find substantial spending on state-of-the art computer hardware and software difficult if not impossible. Certain tactics can provide a high ROI on very modest technology spending, while still offering adequate capabilities from the standard of care viewpoint. A beginning practice can start with a refurbished laptop or PC, rather than a new one, or skip Microsoft Office and Outlook, and go with open source software and a free email management program. Purchasing an expensive online research service can also be postponed by regular visits to the library at the most convenient courthouse or law school.

Any such tactics can give the benefits of technology to a lawyer newly in practice, without the big initial expense. But they are at best stopgaps, making a real investment in new technology necessary. Determining the optimum ROI for this investment depends on the source of funds or financing used. Paying cash eliminates finance charges, but means a big up-front expense. Leasing equipment provides tax advantages but typically only covers hardware. A third alternative is to borrow money from a bank, usually through an equipment loan no longer than the several year depreciable lives of the equipment and software. And because computers and software become obsolete so quickly, banks are reluctant to take it on as collateral. The needs and resources of the new firm determine the choice.

ROI AND THE LARGER FIRM

For the larger, more mature firm, the key to ROI analysis puts the greatest emphasis on efficiency. Large firms cannot ignore the way that global technology flattens the cost of legal services. Large multinational firms increasingly are pushed by large corporate clients into a flat or fixed fee billing mode. Increased profit by increased efficiency through the use of technology under a fixed fee engagement agreement is a definite contrast to the traditional American law firm model, where profit is increased by raising the hourly billing rate. The Great Recession caused corporate America to revolt against that model with its annual price increases.

There is inevitable pressure to reduce fixed fees and squeeze the firm's profit margins. But the efficiencies from continually updated computer technology are the firm's secret weapon to turn legal knowledge into a high volume commodity. With a lower price through fixed fees, client demand could increase volume, profits and ROI. Take litigation discovery as an example. E-discovery software can analyze documents required for litigation discovery in a fraction of the time for a fraction of the cost when compared to using lawyers for the task. Some programs not only find documents with relevant terms at high speed, they can extract relevant concepts and deduce patterns that would have eluded lawyers examining paper copies. Service and volume are thus both increased, which in theory at least should lead to more client work assignments. Higher ROI on the technology expenditure is the result.

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THE VIRTUAL WILD CARD

There are two wild cards that increasingly must be part of technology ROI calculations. One is the virtual practice of law: minimal expenditures on physical office space; contact with clients or professional colleagues largely by email, Internet portal or telephone; and use of online "virtual assistants" at another remote location for staff support. The Model Rules of Professional Conduct contain plenty of prohibitions (particularly in Rule 7.3, "Direct Contact with Prospective Clients") about using the Internet to solicit business. However, there would seem to be no formal ethical prohibition against having a virtual office. In fact, the eLawyering Task Force of the ABA's Law Practice Management Section has drafted guidelines for conducting a virtual practice. Dated October 2009, these draft guidelines primarily emphasize the need for a secure, encrypted website for maintaining client confidentiality in representation, in retainer agreement terms and in online payment. While still in draft form, the ABA provisions are a clear indication that the virtual law practice is here to stay.

A virtual practice may improve the technology ROI but it must not jeopardize the client service bottom line. If, however, service demands can be met, the virtual law office could ultimately be the salvation of the legal profession. With incomes shrinking and access to information on the Internet expanding, the temptation is great for people to assume they cannot afford a lawyer, and that they can do just as good a job for themselves using what they find on the web. If lawyers themselves embody the efficiency and low cost of the Internet, and bring creativity, judgment and experience to the table, their virtual practices will be viable.

WILD CARD IN THE CLOUD

A second wild card, one with ramifications that are still unclear, is the issue of cloud computing, where software and servers are owned by service providers and reside in a remote "cloud" location. The law firm that uses them does not make the substantial up-front technology expenditure, and thus does not have to justify a high ROI; technology services are purchased just like any other utility. The growing number of Internet-based document assembly, document management, practice management, time and billing programs for the legal industry makes cloud computing more feasible.

However, cloud computing services have already suffered major service breakdowns that make programs unavailable – particularly if specialized legal software is not backed up on different servers. The ROI decision on cloud computing thus becomes whether a firm should spend money to upgrade all hardware and desktop programs and keep all data onsite and under control, or switch to a web-based application knowing it may have connection or reliability problems but involves less upfront expense. Each firm's answer, once more, will be different. It's a situation that calls to mind the old story about the client who wished he could hire a one-armed lawyer. The reason? The client longed for someone who would not offer advice, then say, "On the other hand…" Unfortunately, calculating technology ROI will never be that simple. ❈

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