HBR CONSULTING

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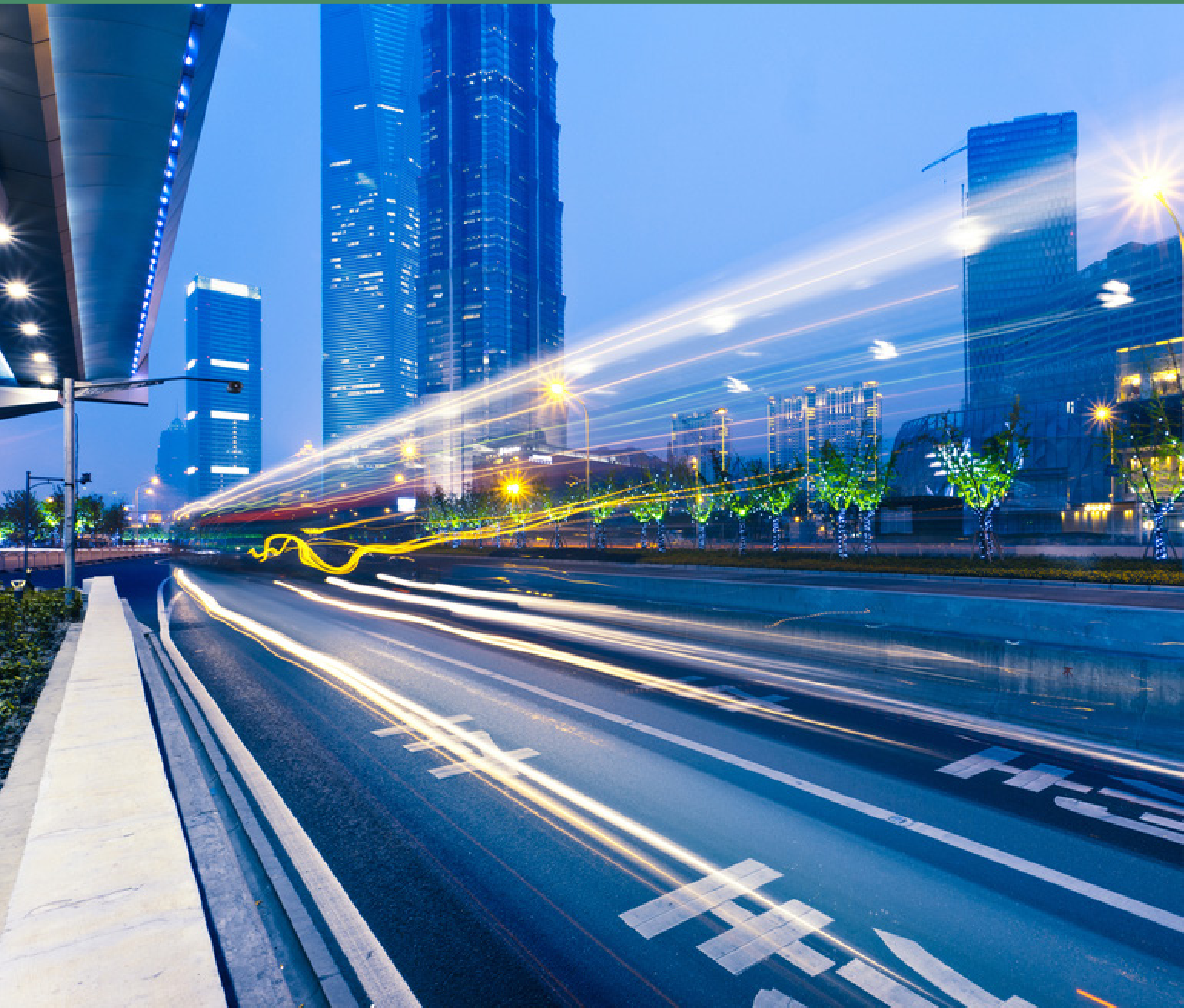
TOP 2023 PROCUREMENT PRIORITIES FOR LAW FIRMS



INTRODUCTION

The more things change, the more things stay the same—and the more pressure law firms feel to cater to client demands. Though we have emerged (we hope) from the pandemic, firms are now looking for ways to distinguish themselves as client spending continues to normalize. But they are also looking for ways to serve clients more efficiently, given the risks that a looming recession and uncertain political future pose.

Law firms that have already strengthened and centralized their procurement function are likely better prepared to address the coming shifts. But unless demand grows, law firm margins will remain under pressure. As clients continue to expect better service at a lower cost, procurement teams must play a bigger role in finding new ways to improve the client experience while meeting client expectations for efficiency, diversity, and sustainability—all without adversely affecting firm operations or headcount.

In this year's Law Firm Procurement Survey, we once again asked procurement leaders across the country to identify their current and future concerns. From those discussions, and our own ongoing client experiences, the team at HBR Consulting has selected three strategic priorities to guide the efforts of law firm procurement offices in the new year: managing vendor risk, expanding vendor governance, and broadening environmental, sustainability, and governance (ESG) efforts.

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MANAGING VENDOR RISK

The average law firm uses more than 2,000 vendors to fulfill its operational obligations. To put that in financial terms, 62 percent of firms have more than $75 million in current spend under management; 44 percent have more than $100 million.

With this heavy reliance on outside vendors, it is no surprise that 52 percent of firms reported that vendor risk management is a priority for 2023, up significantly from 35 percent last year. Heightened client expectations and increasing exposure to risk mean law firms must be more proactive than ever when they outsource operations and share access to their networks and client information.

Implementing a vendor risk management program is no small undertaking. Because most law firms have a decentralized power structure, partners and departments may engage vendors freely and without a full risk assessment. To mitigate these dangers, the procurement team should be empowered to monitor and address vendor risk.

Procurement is ideally suited to manage vendor risk because it is already responsible for managing both contracting and the policies and procedures that govern vendor performance. To ensure effective risk management, the firm will need to offer supplemental training to educate the procurement team about the potential risks of working with vendors.

Here are three steps that procurement teams should take to build a sound vendor risk management program.

1

Survey the risk landscape.

The initial step in any risk management effort is evaluating the size and scope of the potential risk. To do this, procurement should identify all active vendors across the firm. A centralized spend visibility system that gathers all vendor data can simplify the process of uncovering vendor relationships. With this list in hand, procurement can then inventory what sensitive information and networks each vendor can access. The firm should also determine how critical each vendor is to the firm. A good gauge for criticality is total spend with each vendor.

The team should then define and categorize the risk of interacting with each vendor, assigning each a potential risk impact in dollars if a catastrophe were to occur, such as information breach or loss, vendor insolvency, or physical damage to a vendor's location due to a weather event or other act of God.

A best practice is to use a quantitative methodology for measuring risk, such as a scale from 0 to 100. To inform each score, procurement should solicit input from the stakeholders engaging each vendor and the vendors themselves. Scoring should include attributes such as the degree of access to information, the duration of the relationship, the vendor's performance to date, and the vendor's reputation. With these metrics, the team can sort vendors based on which relationships carry the most value and which pose the highest risk.

2

Create policies and procedures to mitigate risk.

Guided by its research, the procurement team can design a program to meet stakeholders' needs without undue risk. Procurement should solicit feedback from different departments and offices from around the firm to prevent blind spots.

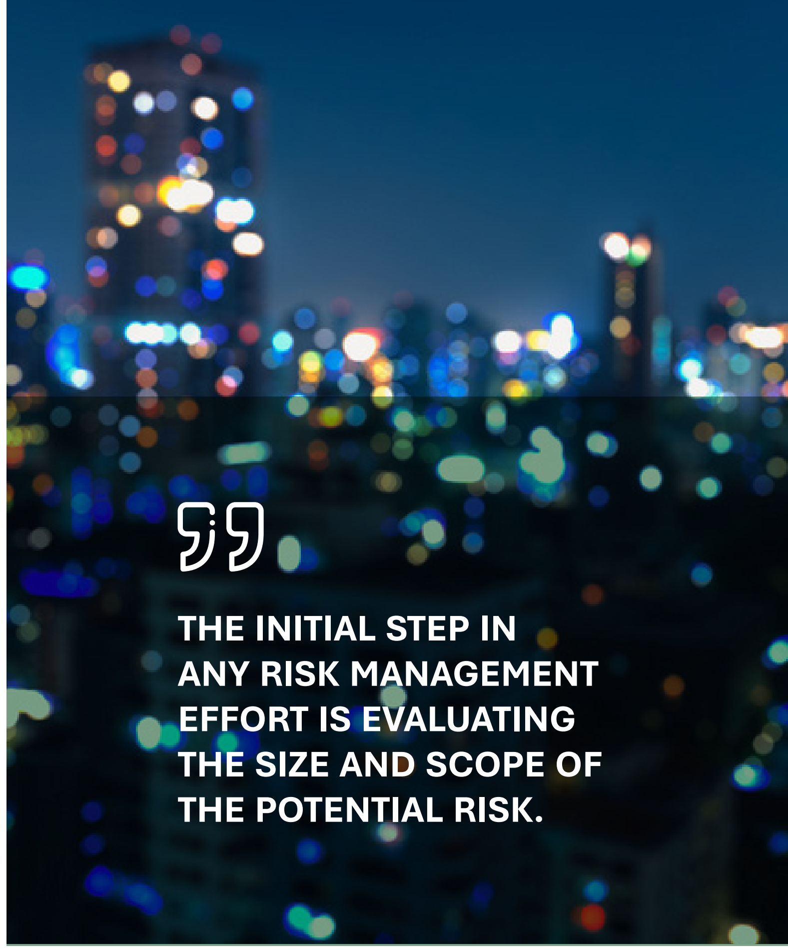
The team can then embark on a comprehensive risk management program that spans the entire lifecycle of a vendor relationship. This may include sending pre-onboarding questionnaires to assign risk ratings, validating vendor compliance with firm guidelines, collecting information on data sharing and access, and more.

One element that any risk management program should include is a performance measure using the key performance indicators that are defined in vendor agreements. Explicitly tying a vendor's risk to its contract increases its vigilance and can help the firm get ahead of possible threats. The contract should also specify clear obligations and triggers for breach provisions, including the proper indemnification level based on each risk factor.

The procurement team should also include the following terms and conditions in its vendor contracts to mitigate risk:

- Remediation timelines and methodologies for identified security risks
- Breach notification guidelines
- A policy requiring employee and subcontractor background checks
- A policy managing data access rights
- Minimum insurance requirements, including general liability, cyber liability, and errors and omissions
- Notification requirements before deploying updates to technology
- A right to audit clause

3 **Monitor risks and measure program activity.** The procurement team should set a cadence of regular reviews, preferably quarterly, to evaluate key performance metrics for each vendor and track how each vendor is performing against its service-level agreement. Stakeholders should also be consulted to offer qualitative feedback and guidance.



The team should also monitor the effectiveness of its own program. Metrics to track here include the following:

- The number of vendors onboarded
- The number of vendors identified as critical or high risk
- The number of vendors flagged for additional review
- The number of vendors that failed the risk assessment process

Procurement teams should use a system that minimizes the manual effort required to maintain the program. Dashboards that automatically update can reduce some of the burden and ensure that the firm's vendor base aligns with the firm's risk appetite.

The vendor risk management program should also build in flexibility, allowing the team to adjust the program to match changing regulations and firm needs.

Centralization reduces the amount of effort required for vendor management and improves contract consistency and expense management.

INCREASING THE SCOPE OF VENDOR GOVERNANCE

Given the uncertainty in the legal market and the prospect of a recession, nearly half (48%) of law firms are prioritizing the expansion of their vendor governance program in 2023, an 18 percent jump from 2022. In addition to the risk and reputation management efforts described above, vendor governance programs help law firms identify potential areas for cost reduction.

To achieve these objectives, the vendor governance program should be centralized, with clear leadership. Centralization reduces the amount of effort required for vendor management and improves contract consistency and expense management. The centralized governance function should oversee five service pillars:

1. **Assessing risks.**
Measuring the risk of working with vendors

2. **Sourcing.**
Achieving the best price by leveraging the full scale of the relationship and price benchmarks

3. **Contracting.**
Mitigating risks by defining vendor obligations

4. **Buying.**
Guiding staff to make the most cost-effective buying decisions

5. **Relationship monitoring.**
Monitoring risk and improving service delivery

The prior section covered the first and fifth pillars above. This section will focus on the remaining three pillars, explaining best practices that will help firms create and sustain cost savings and reduce the impact of a downturn on their profits.

EVALUATE SOURCES

Law firms should consider how they can best leverage their vendor relationships to enhance their efficiencies and cost-effectiveness. Scale may influence pricing; firms can identify preferred vendors that are willing to consolidate less complex work at an agreed price so they can reserve funds for services that demand a higher level of expertise. The procurement team can bring its market knowledge to bear to help negotiate a competitive price.

NEGOTIATE MORE FLEXIBLE CONTRACT TERMS

With every new agreement, the firm should find flexible ways to address a fluctuating, unpredictable market. Each contract should include terms that allow the firm to change the type or level of services or, if appropriate, cancel agreements altogether. The length of the contract and payment terms also deserve analysis. The firm should negotiate termination for convenience and other clauses that can add flexibility in a downturn.

UNDERSTAND AND CONTROL COSTS

The first step in controlling a law firm's budget is mapping its spending and contractual obligations against its current needs and priorities. Begin by bucketing expenses into fixed and variable categories. Then review the firm's contracts and identify key obligations, terms, and conditions. Finally, compare how well the firm's expenses and obligations correlate with the firm's overall needs and priorities. Consider what are "must haves" and what are merely "nice to haves."

Procurement should also build mechanisms for controlling costs, including policies and procedures and proactive budget tracking. Examples include adjusting payment processes from daily or ongoing to a fixed cycle, restricting or adding an approval hierarchy for spending over defined levels, and setting a policy to ensure compliance with the expense management program.

STRENGTHENING SUSTAINABILITY AND SUPPLIER DIVERSITY

Clients continue to pressure law firms to do their part to make the world a better place. This year, 43 percent of law firms reported that sustainability is a priority, up from 30 percent last year. Yet only 49 percent of law firms say supplier diversity is a priority, down from 75 percent last year. It is unclear whether this drop indicates that firms believe they have made progress toward their supplier diversity goals or simply that other priorities have taken precedence.

Nearly half (44%) of law firms plan for their procurement teams to play a greater role in sustainability and supplier diversity initiatives in the future. Here is how procurement teams can start fulfilling that role now.

SUSTAINABILITY

Many companies hold their law firms accountable for meeting vendor policies and codes of conduct regarding sustainability, and firms need to establish clear ESG goals and report on their internal progress toward those goals. Firms also need to be wary of greenwashing: it takes more to support ESG efforts than changing out lightbulbs. Procurement teams can play a substantial role in helping law firms improve their ESG maturity, especially since 90 percent of a firm's carbon footprint is based on its vendor footprint.
These three steps can help firms mature their sustainability efforts.

1. **Determine the firm's footprint.**
Before setting goals, the team must understand the firm's current footprint. Start calculating the firm's carbon footprint and understanding what category its emissions fall into using the Greenhouse Gas Protocol standards:

   - **Scope 1**: Direct emissions from company facilities and vehicles
   - **Scope 2**: Indirect but owned emissions, such as energy bought for a firm's use
   - **Scope 3**: Indirect emissions that you do not own, such as travel, waste generation, purchased goods and services, leased assets, capital goods, and other downstream activities

2. **Determine what procurement can control.**
After detailing the firm's baseline, the procurement team can work with firm stakeholders and vendors to decide what metrics the firm should include in its overall program. To select metrics, the team should identify key areas of emissions and waste where the firm can make meaningful progress. Specifically, the team should identify opportunities to reduce the consumption of resources such as energy and water, promote recycling, reduce travel, and downsize real estate holdings.

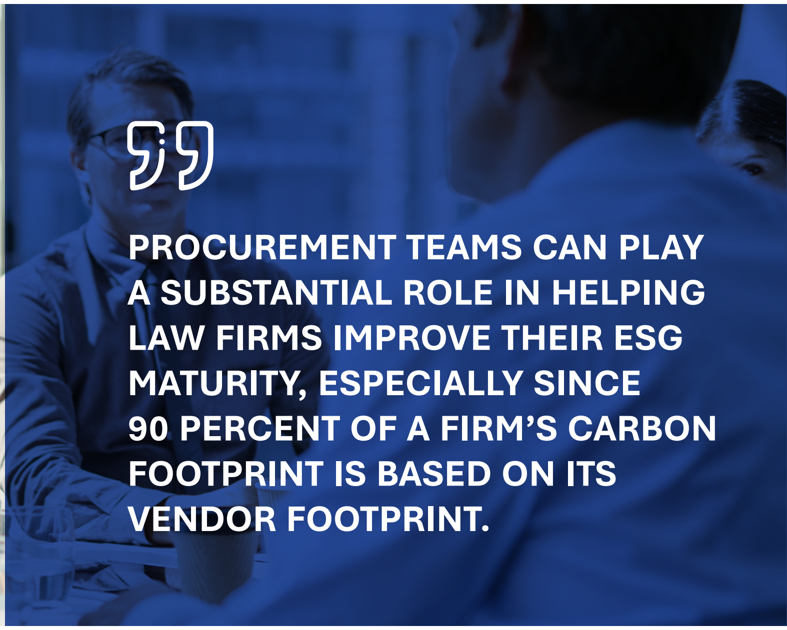
Consider these sample goals:

Early stage maturity

- We will form green committees in every office.
- We will strive to reduce our paper consumption by using email instead of paper whenever possible, discouraging printing, employing double-sided printing, and repurposing used paper for notes.
- We will buy renewable energy credits to offset the electricity we use for business operations.
- We will commit to achieving an annual greenhouse gas reduction of two metric tons per year through our recycling program.
- We will only operate from LEED-certified office buildings.

More mature programs

- We will report publicly on targets and greenhouse gas emissions by 2023.
- We will reduce our scope 1 and 2 emissions by 5 percent per employee by 2025.



Law firms are lagging behind other industries in diversifying their supply chains.

- We will set a business air strategy by 2026.
- We will reduce our energy usage by 20 percent by 2028.
- We will reduce our annual global carbon emissions by 50 percent by 2030.

The procurement team should then set the appropriate measurements for year-over-year progress toward these goals. Finally, it should benchmark the firm's metrics, goals, and accomplishments against its peers.

3 **Communicate the firm's progress toward its goals.**
Procurement leaders should set clear policies and science-based targets for sustainability goals. The more transparency, the better when it comes to sharing this information.

SUPPLIER DIVERSITY

Most (88%) of law firms say supplier diversity is a goal. However, law firms are lagging behind other industries in diversifying their supply chains. Only 44 percent of firms have or are in the process of implementing a formal supplier diversity program. Of these, procurement plays a role in supplier diversity in about half (53%) of firms.

Businesses expect the law firms they work with to give underutilized and underrepresented vendors equal access to sourcing and purchasing opportunities. These vendors include small business enterprises and businesses in historically underused areas as well as those owned by women, underrepresented racial groups, veterans, LGBTQ+ individuals, and people with disabilities.

Procurement teams are in a unique position to engage more diverse vendors because they handle contract review and administration. But only 45 percent of law firm procurement departments take a supportive role in identifying diverse vendors and reporting progress.

Here are three steps that procurement teams can take to build a more formal program and start increasing diverse vendor spend.

1 **Create a formal supplier diversity program with clear standards and goals.**
Many law firms take an informal, haphazard approach to identifying diverse vendors. More than a third (37%) have no active plan for diversifying vendors, while others rely on research and word of mouth.

The key is for procurement to align the goals and mission of the program with the firm's long-term goals. Then procurement should establish clear, meaningful metrics that lead toward those goals. The procurement team should also draft a supplier diversity policy that establishes reporting requirements on supplier diversity spend and conduct regular reviews of vendor diversity classifications to demonstrate progress or spot problems.

2 **Look for new opportunities to engage with diverse vendors.**
Thirty-nine percent of firms have no formal process to increase their use of diverse vendors. It takes proactive research to identify, engage with, and add diverse vendors to the firm's preferred vendor list. Procurement should take the lead in this research and ensure that firms look beyond their current partners and networks to find more diverse options.

To find new options, procurement teams should join diverse business groups and ensure they include diverse vendors in their RFP process. Procurement teams should also scrutinize their bid selection criteria and contracting requirements to ensure they do not have a disparate impact on smaller vendors.

3 **Find ways to help diverse vendors grow.** Diverse vendors are often newer to the market and consequently less experienced, which may cause them to lose out on work that they could, with a little coaching, readily provide. Procurement teams can go the extra mile to support diverse vendors by helping them navigate the complexities of bidding a nd certification processes. Because vendors benefit from clear, specific feedback on RFP submissions, firms should provide that feedback, particularly to diverse vendors. Procurement leaders could also create training, onboarding, or mentorship programs to nurture diverse vendors' progress.

FIRMS NEED TO FULLY TAP INTO PROCUREMENT'S VALUE

As law firms adjust to changing market conditions, they should not overlook the potential of their procurement teams. Procurement is a vital partner as firms strive to find efficiencies, but where firms have relied less on procurement—and where procurement can add more value than most firms realize—is in managing vendor governance, sustainability, and supplier diversity.

With that said, the procurement team may find that it needs to convince law firm leaders of the value of providing greater oversight for the firm's vendor program. If procurement succeeds in reminding leaders that winning market share means positioning the firm to compete not just on fees but on a holistic package of service delivery—one that encompasses risk management, vendor governance, sustainability, and supplier diversity—firms will be better prepared for future financial challenges.

CONNECT WITH OUR EXPERTS

To discover how HBR Consulting can help your firm meet its 2023 procurement priorities, please connect with one of our experts.

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