A business is defined by the value it creates for its customers. Your price speaks volumes about your value proposition, more so than any other component of your firm’s marketing. The business world pricing revolution began in the 1980s, when many of the Fortune 500 companies began to employ professional pricers, and organizations such as the Professional Pricing Society were founded to assist companies in achieving excellence in pricing for value. Yet many law firms are still defined by “hourly rates.” The legal profession has taken its collective intelligence, experience, judgment, education, wisdom, knowledge, and intellectual capital and commoditized them into a one-dimensional hourly rate. This article will illustrate that pricing by the hour is the wrong measure to determine the value created for the client—like plunging a ruler into your oven to determine its temperature.

Theories of Value

Professionals undervalue their services because they are operating under the labor theory of value, which posits that the value of a service is determined by the amount of labor used in its production. Conversely, professionals who subscribe to the subjective theory of value believe that the services they offer are only valuable to the extent that there is a potential buyer desiring them. Value is
in the eye of the beholder. For any transaction to take place, both the buyer and the seller must profit from the exchange and receive more value—in their subjective perception—than what they are giving up.

Today, thousands of firms price their services according to the external value created—as perceived and determined by the client—rather than internal costs incurred in generating those services. Changing the pricing culture in your firm will not be easy. It requires confronting the inherent challenges involved with pricing—all of which take hard work, commitment, leadership, creativity, innovation, and dedication of resources to continuing education.

All Transformation is Linguistic

The word value has a specific meaning in economics: “The maximum amount that a consumer would be willing to pay for an item.” Therefore, Value Pricing can be defined as the maximum amount a given client is willing to pay for a particular service, before the work begins. This is not to suggest we can capture 100% of maximum value, but rather that we have the potential to access more of it with strategic pricing.

This definition contradicts the popular term value billing. The difference is Value Pricing is always done before the work begins, whereas value billing is usually marking up—or more frequently, marking down—the invoice to the client after the work has been performed.

A cardinal rule on behalf of clients in firms that value price is: no surprises. Just as no auto mechanic performs work not pre-authorized by the customer, these firms only provide services after price, payment terms, and scope have been predetermined and agreed to by the client. This creates a better client experience, with fewer write-downs and write-offs, lower collection and financing costs, and greater client loyalty—not to mention superior profitability for the firm.

Transitioning from Hourly Billing to Value Pricing

Not all pricers in a law firm are created equal. Firms should establish a value council and appoint a Chief Value Officer (CVO) in order to centralize the pricing function and make it a core competency within the organization. Pricing is too important to the profitability and health of a firm to accept anything less than excellence in this vitally important skill.

If you diagram hourly billing, a form of cost-plus pricing, it would look like this:

Service → Cost → Price → Value → Client

Value Pricing inverts the above chain by recognizing the economic fact that the client is the ultimate arbiter of value:

Client → Value → Price → Cost → Service

Thus, Value Pricing turns the order of cost-plus pricing inside out. Goods and services do not magically become more valuable as they move through the factory and have costs allocated to them by cost accountants. The costs do not determine the price, let alone the value. It is precisely the opposite: the price determines the costs that can be profitably invested in to make a product desirable for the customer at an acceptable profit for the seller.

A coat is not worth eight times as much as a hat because it takes eight times as long to make it. Rather, manufacturers are willing to devote eight times as long to the making of a coat because customers value it eight times more than a hat. The cause and effect is the exact opposite of the conventional wisdom of cost-plus pricing.

Firms that value price do not ask, “What prices do we need to cover our costs and earn a profit?” Rather, they ask, “What costs can we afford to incur on this project given the price obtainable from the client and still earn an adequate profit?” Costs in a law firm are
largely fixed, but pricing is a policy. In most law firms, services are being priced based on the costs being incurred and not the value created. These firms have ample data on their costs, hours, activities, efforts, and other inputs, but a paucity of information on the value they create for clients.

For a firm to value price effectively, it must understand the five Cs of value:

1. Comprehend value to clients.
2. Create value for clients.
3. Communicate the value you create.
4. Convince clients they must pay for value.
5. Capture value with strategic pricing based on value, not costs and hours.

These five components determine the wealth-producing capacity of any firm, and will drive internal profits in the long run.

In firms that use value pricing, costs only determine if a service should be provided, and in what quantities. Costs do not play a role in determining external value to the client, or setting prices (except as a minimum). Firms that value price know their costs before they begin the work, not afterwards with timesheets.

Value pricing reverses what is now an artificial ceiling on firm income, inverting the ceiling into a floor.

The Eight Steps Required for Implementing Value Pricing

Follow these eight steps on every major engagement, and your firm will be on its way to pricing based on value created for the client.

Step 1

Have a conversation with your client to determine their needs and wants before every engagement. Begin the conversation with a phrase similar to the following: “Mrs. Customer, we will only undertake this engagement if we can agree, to our mutual satisfaction, that the value we are creating is greater than the price we are charging you. Is that acceptable?”

This question will initiate a value quest, with both the firm and the client focused on uncovering every aspect of value. Then ask them the questions in Exhibit 1. This is your opportunity to comprehend and communicate the value you can add, establishing the scope of value and then the scope of the work to be performed. Sometimes a member from the value council attends this meeting, especially if the client relationship partner is not a member of the value council, or is uncomfortable with pricing.

Step 2

The information gleaned from Step 1 is then presented to the value council, where three options, at three levels of service, are established. For example, American Express’ Green, Gold, and Platinum cards vary in price based upon the value and services they deliver. Firms should offer clients options, not a take-it-or-leave-it single price. This allows the client to convince himself or herself of value. It also reveals the client’s individual price sensitivity, which the firm can use in future pricing. It helps the firm answer the question: Did we leave money on the table? Timesheets, hourly realizations, and financial statements cannot answer this question.

Step 3

This step involves narrowing the range of acceptable prices to the client, then constructing three different value/price options. It is important to remember that the firm can lose a client by pricing not only above the range the client is willing to pay, but also below that range. We simply must get over the false idea that there is one optimal price for a client. There is a range of optimal prices, commensurate with the value being created. Dutch psychologist Peter van Westendorp developed the van Westendorp Price Sensitivity Meter by posing five questions, to which I have added two more:

1. At what price would this service be so expensive the client would not consider buying it?
2. At what price would the service be expensive, but the client would still buy it?
3. At what price would the service be perceived as inexpensive?
4. At what price does the service become so inexpensive the client would question its value?

5. What price would be the most acceptable price to pay?

6. What costs can we afford to invest in at the target prices and still earn an acceptable profit?

7. At what price would the firm walk away from this client?

The value council then goes through the twenty questions to ask before establishing a price (Exhibit 2). Based upon the answers, the council then conjectures three internal prices for each level of service, based upon their assessment of the client’s subjective value and price sensitivity. In tough economic times, this three-tier pricing model is a great opportunity for firms to offer less expensive options for struggling clients. When times get better, many clients will often choose to upgrade to a higher level. Establish the following three prices:

1. Reservation price. Below this price, the firm would turn down the work. It must get this price. It will generate a normal profit.

2. Hope for price. A firm should get this price more often than not. It will generate a supernormal profit.

3. Pump fist price. This is an aspiration price, when the firm is adding extraordinary value. It will generate a windfall profit.

Many firms use the Five Ts of constructing options to develop their Platinum, Gold, and Green offerings. The Five Ts are:

1. Timing. When will the work be done? The quicker the turnaround, the higher the price.

2. Terms. Payment terms are just another word for pricing. The lower the price, the quicker the terms, or even payment is due upfront.

3. Talent. Who will work on the matter? A partner will cost more than an associate, who will cost more than a junior associate.

4. Tailoring. How will you deliver your knowledge to the client? Written opinions, seminars, attending board meetings, etc.

5. Transference. Does your firm provide educational opportunities, such as seminars, classes, or internal education? You can make these available from zero price to full price, depending on the option level selected by the client.

Many firms use the following nine-box model, developed by the obscure Austrian economist, Barron von Joseph Neinbach:

<table>
<thead>
<tr>
<th>Reservation</th>
<th>Hope for</th>
<th>Pump Fist</th>
</tr>
</thead>
<tbody>
<tr>
<td>Platinum</td>
<td>$C</td>
<td>$B</td>
</tr>
<tr>
<td>Gold</td>
<td>$M</td>
<td>$N</td>
</tr>
<tr>
<td>Green</td>
<td>$Z</td>
<td>$Y</td>
</tr>
</tbody>
</table>

From this brainstorming session, the value council then determines at which price the three options will be presented (obviously, not all nine prices are presented to the client). The upper bound of these prices should be based upon the value being created, yet all will be lower than that value so as to ensure the client also earns a profit. This way, you’re selling profit at a discount.

For example, if you know the client is highly price sensitive, you may only present the reservation price for all three options. However, if there are some services that are adding marginal value, a hope for price may be quoted for the Gold and Platinum levels. If extraordinary value is being created, quote the pump fist price.

This is where the art of pricing comes into play. It requires judgment, but the more the value council does it, the better the members will get, since pricing is also a skill.

Firms that use this model report that it makes a firm “compete with itself.” To receive a pump fist price, the firm must conjure up ways to add extraordinary value. This is a worthwhile thought experiment that focuses on value, not time.

Offering the client three options is superior than offering one price, take-it-or-leave-it. It’s also far more strategic than offering the client a range of prices, since they focus on the low price, the firm considers it can go as high as the larger price, setting the relationship up for failure right from the start.

Many people ask how to ascertain value since it’s subjective and there’s no formula. The answer is with a deep understanding of your client’s value drivers, which requires a deep conversation with the client.
MCLE SELF-STUDY ARTICLE: Burying

**Step 4**

Present the options to the client. A member of the value council should attend this presentation, especially if the relationship partner is not a member of the council, or is uncomfortable discussing price.

**Step 5**

The option selected by the client is then codified into a Fixed-Price Agreement (FPA). The firm can include as much detail as required as to the scope of work, client responsibility to provide information, timelines for delivery of work, etc.

**Step 6**

The firm would perform adequate project management on the scope of work, detailing who will perform the work, timelines for delivery to the client, and other planning details.

**Step 7**

If the firm finds scope creep while performing the work, the client is informed, given the option of how to proceed, and a Change Order will be issued if the firm is to perform any additional work. This policy also applies to any new services the firm provides not specified in the FPA.

**Step 8**

The U.S. Army has a policy of performing After Action Reviews (AAR), which take place after every mission. After assisting many firms in implementing AARs, I am convinced it is a practice that would have numerous benefits for firms, especially as it relates to the roles of the CVO and value council, helping them evolve pricing into a core competency. For a sample of AAR questions the value council would answer after every major engagement has been completed, see Exhibit 3.

**Conclusion**

There is nobility in earning what you are worth. Yet if a firm’s leaders do not think it creates more value for its clients than is reflected by hourly billing, clients may never understand a value proposition beyond hourly rates.

Hourly billing is a risk-averse and simplistic tradition that has been taught for multiple generations. Your firm will be unable to adopt value pricing if it continues to denominate everything into hours, thus remaining mired in the mentality that you sell time.

Now is the time to change your conversations with clients from hours to value. Do this upfront, before you begin any work—a service needed is always valued more than a service delivered. Appoint a CVO and establish a value council—a group of intellectually curious leaders who will become, over time, experts in creating and capturing value.

Make your firm one of the pioneers that is blazing the trail for others by burying the billable hour and pricing based on value. Your firm will become obsessed with value. Your clients will appreciate it, and they will not bother asking about hours. I guarantee it.

Ronald J. Baker started his accounting career in 1984 with KPMG Peat Marwick’s Private Business Advisory Services in San Francisco. Today, he is the founder of VeraSage Institute, a think tank dedicated to transforming professional service firms to professional knowledge firms. As a frequent speaker at events and conferences, and an educator to professional knowledge firms on implementing Total Quality Service and Value Pricing, his work takes him around the world. He has been an instructor with the California CPA Education Foundation since 1995 and has authored sixteen courses for them.

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Exhibit 1: Questions to Ask the Client

• What do you expect from us and how do you see us helping you address challenges and opportunities?
• What specific results do you hope our services will help you achieve?
• How do you define a successful relationship?
• Ideally, how would you like to measure, or judge, success?
• If price were not an issue, what role would you want us to play in your business?
• What resources can we expect your organization to devote?
• What if you did nothing?
• What if the matter fails?
• What will you be able to do that you can’t do now if we succeed?
• What will the difference be to your reputation, brand image, and customer loyalty?
• What are the three greatest benefits from this matter’s success?
• We know you are investing in total quality service, as are we. What are the service standards you would like for us to provide?
• How important is our service guarantee to you?
• How important is rapid response on legal issues and questions? What do you consider rapid response?
• Why are you changing firms? What did you enjoy about your former firm? What did you not like about your former firm that you do not want us to repeat?
• How do you suggest we best learn about your business so we can relate your operations to the legal issue involved and so we can be more proactive in helping you maximize your business success?
• What is your budget for this type of service? (Remember: budgets are elastic; if the value is there, the money will be found).
Exhibit 2: 20 Questions the Value Council Should Ask Itself Before Establishing a Price

1. What is the client’s cost of not solving this problem in dollars?
2. What is the economic benefit to the client if they solve the problem?
3. With whom on the organization chart are we dealing?
4. Who referred this client to us? Why were we referred in the first place?
5. Do they have any time-sensitive deadlines for the completion of this project? Why do they need to do it now and not in six months?
6. Who’s paying for the service? Are they spending other people’s money?
7. Do we have any competitors? If so, who?
8. What price information do we have about these competitors?
9. How profitable is the client’s company? How long have they been in business?
10. Have they engaged with someone else prior to us to do similar work? Who was the prior firm and why are they changing?
11. How sophisticated is the client?
12. Does client add to the firm’s skills or markets?
13. Do we like this client?
14. How do we help reduce the client’s risk of hiring our firm? (Offering a guarantee is very effective)
15. Does this client represent significant long-term business potential?
16. Are we dealing with the economic buyer? (This is the person who can decide to hire you immediately).
17. Is this a client we’d hate to lose?
18. Does this client serve as a reference for other clients?
19. Are we competing with the client “doing nothing?”
20. What is the risk of this client to the firm? (There is no actuarial model to price risk based on the billable hour).
**Exhibit 3: After Action Review: To be completed by the Value Council/CVO after each major engagement**

<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Did we add value for this client? Any unexpected value added?</td>
<td></td>
</tr>
<tr>
<td>How could we have added more value?</td>
<td></td>
</tr>
<tr>
<td>Did we capture value?</td>
<td></td>
</tr>
<tr>
<td>Could we have captured more value through a higher price?</td>
<td></td>
</tr>
<tr>
<td>If we were doing this type of matter again how would we do it?</td>
<td></td>
</tr>
<tr>
<td>What are the implications for product/service design?</td>
<td></td>
</tr>
<tr>
<td>Should we communicate the lessons on this matter to our colleagues and how?</td>
<td></td>
</tr>
<tr>
<td>How could we have enhanced our client’s perception of value?</td>
<td></td>
</tr>
<tr>
<td>What did we teach this client?</td>
<td></td>
</tr>
<tr>
<td>What other needs does this client have and are we addressing them?</td>
<td></td>
</tr>
<tr>
<td>Did this matter enhance our relationship with this client?</td>
<td></td>
</tr>
<tr>
<td>What impact has this matter had on developing our client’s trust in us?</td>
<td></td>
</tr>
<tr>
<td>How would you rate our client’s price sensitivity before and after this job?</td>
<td></td>
</tr>
<tr>
<td>How has this matter advanced us?</td>
<td></td>
</tr>
<tr>
<td>Did we have the right team on this matter?</td>
<td></td>
</tr>
<tr>
<td>How high were the costs to serve?</td>
<td></td>
</tr>
<tr>
<td>What could we do better next time?</td>
<td></td>
</tr>
<tr>
<td>Do we need to update our client complaint register?</td>
<td></td>
</tr>
<tr>
<td>How could we thank this client for their business?</td>
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