

Adding value

Antony Smith explains how value pricing can boost profitability for law firms

In his speech to the Association of Cost Lawyers on 11 May this year, Lord Neuberger identified the concept of value pricing as being worthy of further investigation as an alternative to the billable hour. Clearly, the master of the rolls would like to see litigation costs come down, but interest in pricing legal services is not confined to cost containment. Some of the larger law firms in the US and UK employ staff with commercial backgrounds as pricing or revenue directors, responsible for helping to set and manage the firm's pricing policy as a means of increasing profitability.

While some firms are showing increasing pricing sophistication, others seem to take little interest in pricing strategy, with some lawyers professing not to know, nor care about, concepts such as value pricing. This is surprising. Put simply, effective pricing strategies can have a significant impact on profitability, with even small variations in price having a big effect on profits.

A pricing strategy can be made up of many techniques (the most common in the legal sector being cost plus pricing, and competition based pricing). But what really matters is whether changing pricing capabilities can achieve sustainable improvements in profits. Generally, moving to a value pricing regime will be the surest way to boost profitability compared with other pricing strategies.

In this article, I will explain some principles behind value pricing and suggest a project-based approach to implementation. I cannot do full justice to pricing theory and practice in an article of this length, but it is hoped that this article will stimulate your thinking about pricing and the delivery of legal services.

HOW VALUE PRICING WORKS

Value pricing is where prices are set according to the seller's estimation of the value placed on the product or service by the prospective purchaser. In essence, in the context of legal services, value pricing is about quoting fixed prices for clearly defined and properly scoped services. Value pricing is not based on quoting for time spent on providing the service, although analysing time and cost of previous similar matters is an oft suggested transitional strategy to true value pricing.

Successful value pricers will offer buyers different prices for a range of differentiated products and services. Moreover they are comfortable with the notion of fair discriminatory pricing – charging variable prices to different buyers for products and services which have the same production costs – because they understand that the decision to accept and pay the price lies with the customer. Indeed, in a value pricing environment, buyers and sellers determine the price together, before the work is performed.

So how can value pricing be implemented? Pricing consultants (see Ronald Baker's *Implementing Value Pricing – A Radical Business Model for Professional Firms*, John Wiley & Sons, 2011) suggest the following process:

1. Understand the client
2. Develop pricing options
3. Present options to the client – to be done before the work commences

4. Document the arrangement (fixed price agreement – FPA) and agree with client before the work commences
5. Manage matters being worked on
6. Manage scope creep (apply change control)
7. Review and refine the process

To price properly, first you must understand the client's needs and wants. Let us suppose you have a medium-sized commercial client, which has brought you a number of employment disputes over the past few years. Obviously, the client needs to resolve the disputes, but what it really wants is for the disputes not to happen in the first place. Furthermore, the client may want to be seen as an exemplary employer, achieving high employee satisfaction ratings from its employees as part of its regular process improvement review. How can you help the client achieve these aims?

When developing pricing options, sophisticated price setters think in terms of value recognition, service differentiation and multi-band pricing. Let us say that with our client with employment issues, you were to:

1. Offer a fixed price to service all of their employment litigation matters on the existing 'reactive' basis, with the fixed fee reviewed after 12 months. An obvious way to begin estimating the basic fixed fee is to review the previous work done for this client, and then estimate time taken to service a very similar caseload in the coming 12 months. The attraction for the client is that they can budget a fixed fee for legal

Create a pilot, where value pricing is applied to a small sub-set of clients for a limited time

services regarding all their employment litigation, hence the fixed fee itself has some intrinsic value. However, you should look to build up value delivery, even when compiling this basic offering. You could perhaps also guarantee that an initial case review of all cases will be conducted by a senior lawyer (obviously, you could add other value added points as well). You are now in a position to quote a price which has its origin in time estimates, but also includes an uplift reflecting additional value added. So let us say that you suggest a fixed fee which is a 10% increase on your fees generated by this client's employment cases last year (the percentage figures are for illustration only).

2. Your second-tier offering might be to also include employment law bulletins, on-site seminars and free telephone advice of up to two hours a month about employment law issues. Estimate how long it will take you to prepare the material and, most importantly, then assess the likely value of these activities to the client; then price. This pricing option could perhaps be an extra 10% on top of that quoted for the basic fixed fee service above.

3. Lastly, you might suggest working much more closely with the client, including offering to do all their employment-related work (assuming you have the capability), not just the contentious work, and offering your firm's HR expertise to help them directly with the recruitment, retention and improved satisfaction of their staff. This is your premium offering, and you might pitch this at, say, an additional 25% above the basic fixed fee service.



Research, and everyday consumer experience, shows that in most instances a middle option offered is chosen. The lowest offering is your base price, the highest your stretch price, with the middle the most likely to be accepted if the pricing offerings have been calibrated correctly. The point is that the client is given a choice, with concerted effort made to focus on delivering additional value. Options need to be considered carefully in light of each client's circumstances, and it should be apparent that successful value pricing requires a lot of thought and effort early on during the client relationship. Pricing discussions should take place as early as possible, with agreement reached with the client before substantive work is done. Work that is already done is of less value to the client, as it now resembles a commodity for which the client is likely to focus solely on price.

REACHING AGREEMENT

The next stage is to document the value pricing arrangement properly in the fixed priced agreement (FPA), and agree this with the client. The scope of work should be recorded in the FPA, along with any timeframes for completion. Many lawyers are wary of quoting fixed prices, mindful that circumstances could change resulting in the original fixed price quote becoming inappropriate and leading to a financial loss. What to do in such circumstances? The FPA should refer to a change control procedure whereby, if something unforeseen arises during the engagement, work stops and a change request is raised with the client. The change request should propose a revised quote to take into account the further additional, or revised, work required.

One concern with the notion of change control – and indeed a documented FPA – is that lawyers have a tendency to go for detailed definitions and robust interpretation of wording. Arguing with clients over the minutiae of an FPA is not a good strategy for long-term success. Common sense and sensitivity should be applied as a counterweight to an overly legalistic interpretation of the FPA, and what amounts to 'change' in any given set of circumstances.

After a value pricing arrangement has been documented properly as part of an FPA, matters then need to be project managed rigorously to ensure that client needs are in fact being met, and costs do not spiral out of control. There is no point in putting in effort to get this far, only to be let down by poor matter (project) execution. Ideally, project management techniques should be incorporated as part of the standard processes for delivering legal services quickly and efficiently. The techniques need not be overly complicated. Essentially, project management is about scoping, monitoring, reviewing and reacting to change. The last is often the hardest to do, and it cannot be done without understanding initial objectives, progress to date and any issues which are impeding further progress. In operational terms, competent project management is the key to making value pricing work. Indeed, when you think about it, it is also required to deliver legal services effectively, regardless of the pricing method.

IMPLEMENTATION

The best way to start implementing value pricing is to create a pilot project, where a value pricing approach is applied to a small sub-set of clients for a limited amount of time. Perhaps the best clients to start with are new ones, as this avoids potential for confusion among existing clients who will have been priced and charged on a different basis previously. Alternatively, it may be possible to start with a long-established client with whom you have a high degree of trust, and whom you already understand well in terms of value assessment. At the end of the pilot project, review what worked well and what did not. Inevitably, some mistakes will be made along the way, and you may have to accept some short-term losses for long-term gains.

The ultimate gain however is that you acquire, maintain and enhance a reputation for fully understanding client needs, delivering value and sustaining profitability.

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