

# An introduction to value pricing and some practical suggestions for implementation

**Antony Smith** offers a no-nonsense approach to pricing strategies that will help maximise profitability and improve client satisfaction

Some of the larger law firms now employ people with commercial backgrounds as pricing or revenue directors, with responsibility to help 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. In this article I will discuss some principles of value pricing and suggest a project-based approach to implementing it successfully. I cannot do full justice to all the issues raised by such an interesting – and somewhat controversial – topic in an article of this length, but I hope to stimulate your thinking about pricing and the delivery of your legal services.

## What is value pricing?

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 true value-pricing environment, buyers and sellers determine the price together, before the work is performed.

There can be few law firms which now price and bill wholly and exclusively by time taken to do the work. Surveys repeatedly and consistently report that both individual and business consumers of legal services much prefer pricing certainty and transparency, compared with the uncertainty and opacity usually associated with pricing by time which is then billed towards the end of the matter. Research by the Legal Services Consumer Panel (LSCP) shows that almost 60% of those paying privately for legal services are now quoted fixed fees (see the LSCP 2012 Tracker Survey). If private client work is becoming increasingly associated with fixed fee quotes anyway, why bother with value pricing?

One reason is that over the last few years 'fixed fees' have increasingly become synonymous with a race to the bottom of the barrel in terms of price quoted, with perhaps Will writing being the practice area most exposed to this downward pressure. It seems the notion of 'commoditisation' of legal services goes hand in hand with revenue and profit reduction for the suppliers of services such as these. However, this need not always be the case. Every product and service can be differentiated in some way; once differentiated it can then become possible to set a price reflecting the differentiation.

According to the LSCP 2012 Tracker Survey, overall satisfaction by consumers about the outcome of legal work remains relatively high – over 80% – although satisfaction with the level of service

received seems to have fallen year on year. Indeed, service level satisfaction falls to noticeably lower levels in areas such as probate (about 65%), 'family matters' (70%), 'problems with consumer goods' (about 68%) and powers of attorney (72%). Now, although satisfaction levels appear quite high, the point is that there is room for improving service level satisfaction; hence there is room for distinguishing and differentiating your service and, therefore, potentially being able to charge higher prices for those services which stand out from the crowd.

It sounds really obvious, but identifying 'value' and agreeing a price for it is notoriously difficult. Value pricing is most often discussed in the context of a commercial setting, where professional buyers can make a considered assessment of 'value' and there is much greater scope to differentiate the wide range of legal services required. However, value pricing private client work can be done, as examples from the USA demonstrate.

## Implementing value pricing

Before reviewing experience in the USA, it is worth pointing out that pricing consultants such as Ron Baker (see in particular his book *Implementing Value Pricing: A Radical Business Model for Professional Firms*) advise a process for implementing value pricing along the following lines:

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

In the USA some small and sole practice lawyers in the field of family law actually begin their value pricing work by thoroughly understanding the time and cost it has taken for them to complete a series of different types of family law matters. All the data can be found in law firm practice management systems. Whatever your particular specialism, look for trends in your previous case data, ask questions and develop metrics. Some initial questions to ask (and I am sure you can think of others), include:

- What percentage of matters of a particular type would you categorise as being 'hard', 'medium' or 'easy'?
- What factors (legal, administrative or human nature) contribute to being placed into each category?
- What is the range of time spent on each category of matter?
- What ranges of fees were recoverable?
- What were the factors contributing to writing-off time?

I suspect, particularly if you are an experienced practitioner, that you intuitively already know much of this. However, writing things down, and perhaps doing some kind of spreadsheet analysis with the data generated from the line of questioning above will help nonetheless. It will help you as an individual to see trends more clearly and identify appropriate benchmark metrics – human memory and perception is rarely as reliable as hard fact. Reviewing past data will also help your practice, and younger lawyers within your practice, by providing guidelines based on experience backed up by data. Establishing benchmark indices is an important aspect of good project management practice – and successful implementation of value pricing is invariably underpinned by a project-based approach to legal service delivery.

There is a huge temptation when considering various forms of alternative fee arrangements, most of which will inevitably include an element of fixed pricing, to simply estimate the amount of time the work is likely to take (based on previous experience and case data) and then add an uplift for contingency purposes.

As noted earlier, as a means of transitioning to value pricing, looking at similar work done in the past is a good starting strategy. It is, however, only a start: the whole point about value pricing

is for both parties to focus on 'value'. Once you have the background benchmark data about the range of typical matters you normally deal with, you can then move on to understanding the client needs and wants. Ultimately, value pricing is about pricing the client, not the work; it is about assessing what the client values and then agreeing a price with the client to reflect that value.

Private client lawyers in particular should be in an excellent position to do this, as value assessment begins by having conversations with the client. Successful value pricing requires a lot of work to be done early on in the client relationship and it is essential that the emphasis on value delivery is communicated clearly and consistently. Rather than simply 'taking instructions' and launching into immediate consideration of the technicalities of the legal work, take time to discuss the need for legal services and preferred outcomes with the client. What, for example, does the client really want to achieve? (Don't think in terms of legal outcomes – what practical aims does the client have?) How does the client judge, and measure, a successful outcome? Is such an outcome realistic? If the price of legal services were not an issue, what would the client like you to do? How would they like you to do it?

Price will no doubt become an issue at some point, but this line of enquiry (which of course you should develop further) will help you assess what the client really wants and what they are willing to pay for. Consequently, you can tailor the range of services you can offer to this particular client and how they may be priced.

## Pricing options

Needless to say, pricing options need to be considered carefully in light of each client's circumstances. Based on the initial discussion with the client you can develop scenarios and options, and then price accordingly. I referred to Will drafting earlier as being highly commoditised and subject to (severe) downward pressure on fees. But even here the service element can be distinguished and differentiated. For example, suppose you had a client with a 'medium' difficult Will and you quoted him a fixed fee for it. Why not quote him another fee for a differentiated service? You could perhaps include the Will drafting plus a free yearly review (where you contact the client) for, say, the following five years? Individual

circumstances change, and some people may be prepared to pay a small premium to be called in to discuss any relevant changes with their solicitor and have their will amended accordingly. I am sure you can think of lots more ways of being creative, adding value and agreeing a price for the added value with your clients. This is the essence of value pricing. It is essential that value assessment and pricing discussions 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.

## Documentation

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 the existence of 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 minutiae of an FPA is not a good strategy for long-term success. Common sense and sensitivity should be applied as counterweight to an overly legalistic interpretation of the FPA and what amounts to 'change of scope' in any given set of circumstances.

## Project management

After a value-pricing arrangement has been documented properly as part of an FPA, the matters then need to be project managed properly to ensure that client needs are in fact being met and that 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 your 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.

Although there is growing recognition that there is much scope for improvement of project management capability in law firms, it is equally true that successful lawyers already possess some project management skills – they must have, simply to have managed their workload thus far and become successful. Often, however, the project management skills are not recognised as such and are not referred to explicitly. Project management skills should supplement a lawyer's core competence, not obscure it. Therefore project-based processes which are 'light touch' and applied sensitively in light of individual law firm culture should be devised and implemented. For example, you may wish to consider capturing key matter details in one document which can act as a matter review reference point, a basis for the FPA and a source of reporting information for billing purposes. In this document you could capture things such as:

- Client aims (what does the client want to achieve?)
- Scope of work (a few bullet points listing the legal work you will do and the deliverables)
- Success criteria (expressed in terms the client understands and agrees with)
- Resource requirements (for example, if you need to do some research, what sources do you need?)
- Cost budget estimate (after discussing and agreeing the scope of work with the client, the question then becomes: what costs can you afford to incur given the price obtainable from the client and still earn an adequate profit? Obviously, once you have estimated costs, you then need to manage the matter and deliver within cost)
- Key risks associated with the matter (along with a note of how, if any risk

transpires, you could mitigate its impact)

- Proposed schedule of work, with milestones (and I would suggest that most of the milestones should include communication of progress to the client).

The above might look daunting and contain some terminology infrequently used by lawyers, but I suspect you would usually collect and store much of this information anyway. Unfortunately, the storage may be in different places: on file, in various computer systems and in your head! Capturing and storing it in one place could really help. Moreover, if you keep the document updated regarding matter progress then, as noted above, it becomes a useful aid for reporting and billing purposes.

### Pilot projects

I would suggest 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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