15 big questions for law firms making the switch to value pricing

In this article, John Chisholm explains some of the key considerations for law firms that are considering moving from time-based billing to value pricing – and the key pitfalls to avoid.

1. A lot has been written about why firms should switch from the billable hour to value-based pricing. How difficult, though, is it for firms to make the transition? Perhaps it might be handy to define first what I at least mean by ‘value-based pricing’. Value pricing to me means your fee is based on the value you are providing, or will provide, to your client by concentrating on outcomes and results rather than inputs, activities and time. It means lawyers need to understand that the value of what they provide is determined by their clients’ perception of value, not theirs.

Some are now using the term ‘aligned value pricing’, which to me explains the concept well – that the price charged reflects the value provided by the lawyer to the client, and the fact that the fee reflects a fee for the lawyer which provides a reasonable profit. Those firms that are most successful in making the transition are those which are confident in their service offerings and mature in their approach to their relationship with clients. They understand that clients are now informed purchasers and are looking for more creative engagement arrangements.

The benefits to firms and their clients that have made the transition include:

- more profit, higher revenue
- clients pay faster
- fewer price disputes
- fewer and better clients
- attracting and retaining talent that loves working in a timeless environment
- better client relationships (and the client not worrying about the clock)
- lower administration costs
- a better focus on value
• matching value with expectations at the start of a relationship
• competitive differentiation in the marketplace
• better team relations, collaboration-less hoarding, and a flatter structure
• focusing on more innovative solutions with a client.

2. What is the first step a firm must take as it makes the transition to value-based pricing?
Value-based pricing is easier for lawyers who are specialists or experts at what they do. It
does, however, require a change in mindset, a paradigm shift – it is not simply a billing
model change. It means turning on its head the ‘we sell time’ business model that has been
ingrained into a generation or two of lawyers and looking at the value a lawyer creates for
their client – but from their clients’ perspective, not their own.

The first thing a firm needs to do is learn how to have a value conversation with the client.
To understand what your client values, you must discuss what they see as important and
valuable, what they are trying to achieve, and then agree with your client on a scope of
value, a scope of work and price(s) before you commence any work. It is also important to
remember that pricing happens before you do any work, billing happens after the work is
completed.

3. Do you have any examples of firms that have successfully embraced value-based
pricing? And what was the key to their transition?
While still in the minority, it is no longer hard to find professional firms world-wide,
including in Australia, that do not bill by time and do not time record. Some never have and
some have ‘seen the light’.

To date, most of the firms that have made the transformation to value pricing have been
smaller to midsized firms: it is far easier to change the minds of five, 10 or even 100 than it
is to change the minds of 1000 or 2000 professionals. The traditional partnership model
makes any material change hard enough (usually firms require consensus and therefore
compromise) and this is heightened when it is a paradigm shift requiring a business model
change.

Most start-up or NewLaw firms have not adopted a time-based billing model and, as is the
case with most innovation and new ideas, it is often easier to start afresh. It is not
impossible to transition an existing firm; it just takes longer because when you think about it
so much of the firm is built around time – partner compensation, performance management
etc. Often a lot of resources, such as practice management systems are also built around
time.
There are many others, but some of the Australian law firms that practice value-based pricing include:


4. **Based on your experience over the years, what are some other key, practical steps that firms have taken to successfully adopt value-based pricing?**

   Like all change management, it has to start with strong leadership. If there is not an internal champion or champions at the leadership level, forget about making any transition. Genuine adoption of value-based pricing is not something that can be delegated as some type of administrative task.

   Most firms that have successfully made the switch have taken small steps and dipped their toes into the water. Some firms trial value-based pricing on new clients, and others decide they want to work on new pricing models with their longer-standing trusted clients. There are pros and cons for each approach, but whichever approach is taken it is important firms hold the course. Firms will make mistakes on pricing – they do now with their hourly rates (we call it write-offs). Pricing for value will not only improve a firm’s pricing competency; it will learn what is and what is not of value to their clients.

   A great way to start is to read, read and then read some more. Then talk to some professionals who have made the transition. Compared with say 10, five or even two years ago, there is now a wealth of information on pricing in professional firms (legal, accounting, IT, consulting, etc) in the form of books, articles and case studies. There is also a vast and growing community of professionals, including many lawyers, who are prepared to share their experiences of what it is like to move to a timeless culture – the pros and the cons, the benefits and the traps for new players. An important skill is learning how to scope, plan and manage work, and therefore upskilling in legal project management is crucial.

5. **Conversely, what typically are the key errors firms make during this switch?**

   Firms that see it as only a billing model change – not a business model or mindset change – will never achieve the true benefits that value-based pricing can give.

   Another mistake is thinking that the transition to non-time-based pricing alone will automatically lead to increased prices and profitability. Clients will not allow you to increase your prices unless they are satisfied you are delivering them greater benefits, so firms have to work very hard in understanding what benefits each of their clients.

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Continuing to track time is a major mistake as it is too easy to revert to tying the price to
time spent, and this has no connection with the client’s perception of value. Sooner or
later, firms have to decide whether they want to cross the Rubicon. The longer that firms
continue to track time the longer they will continue to default to time and the slower it will
be for them to genuinely improve their pricing competence.

Continuing to do their work the same way under a value-based pricing model as they did
under a billable time model is another error. Firms that do that will also not reap the
benefits.

6. What are some of the greatest challenges for firms that seek to embrace value-based
pricing?
While the benefits and rewards as mentioned above are significant and well worth it, many
firms face challenges, which can include:
- determining value is difficult – firms do not recognise how much value they
  create
- lacking confidence in their pricing skills
- creating some risk for the firm
- spending more time up front to price matters
- possibly losing team members who prefer the old way
- learning new processes
- requiring lots of re-education.

7. Can you outline some of the key principles that are important during this transition to
value-based pricing and how the switch works in a legal context. And is the approach for
legal practices different to, say, accounting firms or other businesses?

To give firms the greatest chances of success in any transition, the leaders have to
remember and continually reinforce that:
- you need to learn to price your client, not your services
- no one in the firm should price their own work alone
- understand each client’s value drivers
- know your real costs and scope before doing work
- don’t rush pricing – the sooner you price, the more likely that the price is wrong
- provide at least three options to your clients if you can (with different benefits
  and different prices). Clients love the power of choice and when you provide
  options your clients will consider more how they are going to work with you
  rather than whether they will work with you
- If you use a formula, your price will result in money being left on the table.
And always remember – price is never the only negotiable item.

8. Do sole practitioners face any particular challenges in trying to implement value-based pricing, and how can they be overcome?

In many respects sole practitioners have benefits over larger firms in making a transition to value-based pricing.

For starters, they only have to teach themselves and their clients, not all the lawyers in a team. It is also easier to experiment with pricing and learn from any successes and mistakes. The flip side is that as a sole practitioner you are always pricing your own work and when you price your own work you tend to leave more value on the table (that is why larger firms have pricing or value councils or a policy of no one in the firm pricing their own work). Some sole practitioners will often discuss pricing with team members they might employ, or engage an external pricing consultant to assist them on pricing larger matters, in particular, or even form a relationship with a colleague where they can call upon each other to bounce off pricing considerations. Sole practitioners can also get some pricing guidance from online tools such as Joel Barolsky’s Price High or Low App http://www.pricehighorlow.com/.

9. Some firms will be tempted to offer hybrid pricing models rather than make a complete change to value-based pricing. What are the pros and cons of such an approach?

Yes, many firms do this – because they might have existing clients on long-term time-based billing arrangements, or they are scared of losing work and/or because time-based billing is ingrained into them. So they continue to offer a variety of “pricing” models to clients, including time-based billing.

I well understand why firms do this. However, as mentioned before, if firms continue to track time (which, of course, you need to do to offer time-based billing) firms invariably default to time as their key measurement. It is difficult, if not impossible, to be both a good time recorder and a creative pricer. Ultimately, professionals have to choose one path and the anecdotal evidence of firms that have made the change to a timeless culture is that they should have burned their timesheets earlier.

10. Is there a big difference between making a switch to fixed pricing and value-based pricing. And what are the key differences?

There is this misconception out there that there are essentially only two ways for lawyers to be compensated – by time-based billing, or fixed fees. That is so wrong. When firms free themselves from the self-imposed restrictions of time-based billing and time-recording, the pricing options are almost endless. Firms can be really creative in coming to agreements with their clients on pricing. Some of the more common non-time pricing options firms are using include phased fees, milestone fees, success fees, portfolio-based fees and retainers.
Not all fixed fees are value based and not all value-based fees are fixed. Fixed fees based on time, especially if the work model does not change, are in reality little more than capped fees for lawyers and that is not good for anyone.

11. What upfront – and ongoing – conversations do firms have to have with their clients during this change to an alternative pricing model?
It is really interesting because firms worry so much as to how clients might react to a change in their pricing model. In my experience, clients are the easiest stakeholders to accept such a change, particularly if firms take the time to explain to clients why the firm is making the change and what the benefits are to the client. Predictability and certainty are the major advantages, of course, but there are many others.

There are five Cs of value which lawyers need to understand and implement any pricing change to be successful:
1. Comprehend the value you are providing to your clients
2. Create that value for your clients
3. Communicate the value you create
4. Convince your client they should pay for value
5. Capture value with strategic pricing based on value, not hours.

And remember your clients need to make a profit out of using your services and if they cannot then you are probably the wrong firm for them. Focus on increasing your clients’ profit and yours will follow.

12. What if clients push back and say they are happy to be charged based on billable hours?
In my experience this happens with far fewer clients than what firms expect. If it does happen, then that tests the resolve of the firm to both their pricing and brand strategy. No one wants to lose a good client simply based on a pricing model, but again anecdotally those firms that no longer bill by time will tell you they have far happier clients under a value-pricing model.

When you agree on a price up front, provided you did what you agreed to do you will virtually never have a pricing dispute with your client. What is more, firms that price up front get paid quicker than firms that bill in arrears.
No matter how a firm prices their services, there should always be some clients or potential clients you should say ‘no’ to, otherwise you adopt the mentality of ‘I have never met a billable hour I don’t like yet’, which is a race to mediocrity or even worse.
13. Internally, who within a firm should manage the transition to value-based pricing?
The leaders – the transition is not something that should be delegated as an administrative
task. Having said that I am a great believer in involving everyone in the firm in a
transformational change like this. Firms that have involved everyone at the outset have by
far been the most successful in making the most effective and quickest transition.

14. When and how should firms assess the impact of switching to value-based pricing?
I do not think I can answer that, except to say if you are making the transition solely based
on client pressure rather than because you believe it to be a better way of practising law,
then you are probably making the transition for the wrong reasons.

15. Are there any new – or proven – tech tools that can assist firms with fixed or value-
   based pricing?
Absolutely. Technology is a great benefit to firms that wish to move away from time-based
billing. I smile when I hear and read of firms that are investing in technology to help them do
things quicker and yet persist in billing by time. Where is that strategy going to lead to?
While most of the off-the-shelf law firm practice management systems are deficient in ways
to effectively manage value-based fee arrangements, there are some great legal project
management software options around that firms can utilise.

It would be remiss of me not to mention Ray D’Cruz’s Performance Leader After Action
Reviews software http://www.performanceleader.com/software.html that is a must for any
timeless law firm.

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