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Make it memorable – the 2-5-3 method of pricing

Pricing should not be rocket science for law firms, but it is important to ensure that there is clarity in terms of desired objectives, and sufficient flexibility to ensure that there is not a one-size-fits-all approach when billing clients, writes Joel Barolsky.

Pricing professional services can be a bit tricky. Price too high and you lose the client. Price too low and you leave money on the table.

One of the main reasons for this complexity is that the perception of value is different for every client and for every matter. Each time you make a pricing decision, it needs to be tailored to the specifics of the client, the context and the cost of delivery. A one-size-fits-all approach to pricing is a recipe for profit disaster.

Keep it simple
The 2-5-3 Method is a simple and memorable way to approach pricing every project. The '2' relates to your primary objectives in setting price. The '5' relates to the inputs or factors that should go into the pricing decision. And the '3' relates to the three pricing decisions that you need to make; that is, price structure, price level and the pitch.

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Two objectives
Pricing a matter starts with being shockingly clear on your pricing objectives. In most instances, there are just two: [i] getting the client to perceive good value and say 'yes', and [ii] delivering an acceptable profit to your firm. Pricing is largely about finding the sweet spot where both your client and your CFO are happy.

Undoubtedly, there will be times when your primary objectives will vary, such as winning an iconic brand-making project, getting on to a major client panel, buying share of wallet, positioning for future work, relationship building, or revenue (not profit) maximising, but these are more the exceptions or variations of the rule.

Five factors
Once your objectives are clear, you need to start to gather data to inform your pricing decisions. In the spirit of keeping things memorable, I have labelled these the five Cs:

- ***Cost*** – understanding the cost of selling and delivering the project is clearly important in determining your margin and your BATNA, which stands for Best Alternative To a Negotiated Agreement. It is recommended to use a simple spreadsheet to scope and cost the project before you price it.
- ***Client value*** – the client's perceptions of the importance of the project to their business and their relative price sensitivity will have a material impact on whether you can charge more or less. To help you explore what your project or service is worth to your client, you may find Bain's new 40 elements of client value framework particularly helpful.
- ***Competition*** – pricing is likely to be quite different if the work is sole-sourced or, at the other extreme, your price will be compared to many other capable firms.
- ***Capacity*** – most high-fixed-cost businesses like airlines and hotels use price as a key lever to optimise capacity utilisation. With large salary, rent and insurance bills, law firms should take a lesson or two from their corporate cousins. Offering large discounts when your team is doing 14-hour shifts is not the smartest way to do business.
- ***Connection*** – Your pricing will clearly be different if the client is a one-off transactional buyer (ad-hoc relationship) versus a long-term partner relationship. Interestingly, there are different views on the level of discounting for partner relationship clients. One opinion is that you should offer your best deal to these clients as a loyalty dividend. Another perspective is that your fees should be higher to reflect the extra value you're creating by knowing their business extremely well.

You might find our new IOS pricing app helpful in setting the right price level for all fixed-fee projects. It's an easy-to-use utility that takes all these 5C and other factors into account in setting the 'right' price.

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Three decisions
With clear objectives and the right data in hand, you're then in the position to make some choices. Pricing usually encompasses three inter-related decisions: what price *structure(s)* should we offer; what price *level* should we set; and what's the best way to *pitch* our offer.

In law and accounting firms, the most common pricing structure is still time-based hourly rates. Fixed fees, value pricing and retainers have been gaining in popularity in recent years. In consulting and engineering, project fees with variation clauses are most common. Investment bankers usually price with a percentage of transaction value contingency fee. An excellent reference article on different pricing structures can be found on the Patrick on Pricing website.

In my view, there is no one perfect pricing structure. The structure chosen will usually be a function of, among other things, client preference, relative bargaining power, the nature and level of risk, the depth of relationship, the scope and benefit certainty and degrees of co-creation. Quite often you can augment your pitch by offering clients multiple pricing structure options. My recommendation is to become expert in three or four structures along the risk-sharing continuum. This way you can offer clients more choices and respond to different contingencies.

Price level is the amount to be charged within the structure you've selected. So, if it's hourly rates, then the level is '*$350'* per hour; if it's a fixed fee, then the level is '*$8500'*. Pitching involves the strategies and tactics of communicating value and getting to 'yes'. It includes the approach to presenting different pricing options, project staging, pitch presentation, and the approach to conversations about price and value.

To illustrate the importance of price pitching, Qantas' website usually presents its customers with three benefit-price options for every flight. Interestingly, the 8am flight from Melbourne to Sydney (in a recent price check) has one option that's 598 per cent higher than another. These three options involve the same brand, same plane, same pilot, same airports, same flight duration, just a different level of amenity, status and flexibility. Qantas' pitch is noteworthy for three reasons:

- it optimises value capture; i.e. those seeking more benefits and/or are less price sensitive pay a lot more;
- it 'frames' the economy option to look like an amazing deal; and
- it discourages customers to shop around (if just one option was provided most customers would immediately jump on Virgin's site to compare).

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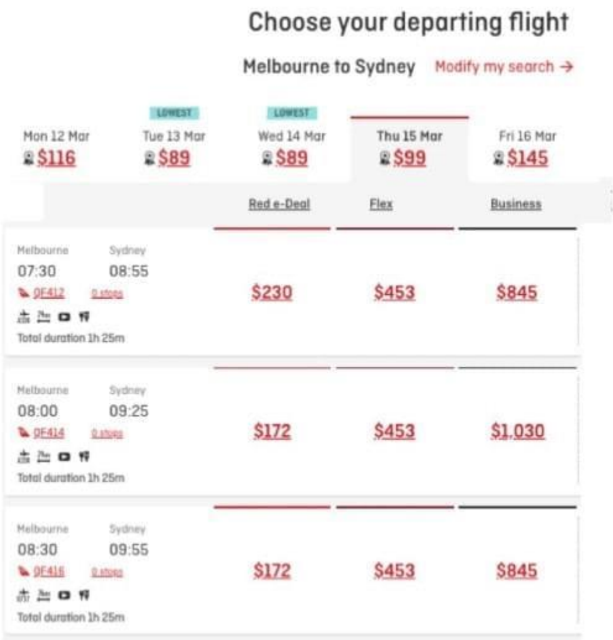

Source: qantas.com

In conclusion

So, lock the 2-5-3 method of pricing away in your brain. It's not rocket science, but hopefully it will make sure your next project is priced fairly and profitably.

Joel Barolsky is managing director of Barolsky Advisors, Senior Fellow of the University of Melbourne and creator of the Price High or Low smartphone app designed to help with pricing projects. Visit www.barolskyadvisors.com for more details.