

CRACK THE PRICING CODE

Implement Value Based Pricing
and Generate Fortunes



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Chapter Three

Enterprise Value Creation Not Value Protection

While it's clear that Value Based Pricing is broadly and deeply beneficial to clients and customers, your firm won't COMMIT (Step 1) to implementation unless there are clear benefits to the firm.

Above all, Value Based Pricing is the key to enterprise value creation. The firm barely protects its value with the use of hourly billing.

How Value Based Pricing Leads to Enterprise Value Creation

1. Ethical powerhouse.
2. Unlimited inventory. One can only charge for X number of hours per week. If you reach the end of the week, and have unsold hours, you have lost them permanently. There is no limit to value inventory and no loss.

3. Compensation for value not time. There is no intrinsic value to time. It's your knowledge, expertise, speed, and quality that have value. As value increases, fees increase.
4. Compensation for additional value delivered. You can always write a new Value Based Pricing agreement as new opportunities arise. You aren't stuck charging the same hourly rate for all work.
5. Increase revenue with understandable justification. Clients never think a date on the calendar, or a cost of living increase is fair to them. When you offer your services for Value Based Pricing, it's easy to show the value to the client. The more value, the higher the fee.
6. No competition on price. You (your company) are the only one who can offer the value you offer.
7. Create positive cash flow. You bill in advance and have the payments in hand before the work begins. There's no time spent reviewing invoices, adjusting, or reducing fees or chasing ARs.
8. Happy and productive employees.
9. Rewards the development of product and services of increasing value because you know you'll get compensated for them.
10. Generosity
11. Wow experiences.
12. Enterprise value and owner wealth grow.

Ethical Powerhouse

1. Ethical powerhouse. An ethical firm is a long-lasting firm. An ethical firm increases profits; retains clients for

years; attracts other like-minded clients; and grows in value which increases owner wealth.

Value Based Pricing requires the firm to analyze what value it truly delivers. This analysis pushes the firm to create more value, benefitting clients again and again. Ethical firms pursue more knowledge and expertise which allows them to increase their value and fees, and also helps their clients reach their own goals.

Ethical firms' employees build solid trust with clients. Client lifetime value increases: turnover costs decrease; marketing and sales increase.

Ethical firms enjoy all of the following benefits of Value Based Pricing.

Profitable Revenue Potential is Unlimited

2. Unlimited inventory. An expert can only charge for X number of hours per week. If you reach the end of the week, and have unsold hours, you have lost them permanently. There is no limit to the inventory of value and no loss.

I'm using 40 hours as a proxy for your firm's particular "work week."

Let's say that past experience shows you that your best providers require 5 hours per week for admin tasks and other non-billable activities. Your inventory is now reduced to 35 hours.

Which means that your revenue *ceiling* is $35 \times \$X$ hourly rate. No matter how knowledgeable and skilled the person is, that person can only generate this amount of revenue. All expenses have to come out of that revenue: the admin costs, the person's compensation, overhead and other obligations.

Let's now imagine that there's a conference, a weather issue, or something else that reduces the inventory further by 3 hours. Now total inventory is at 32 hours for that week. But the costs have not decreased. So, your profit is reduced.

Let's now imagine that for any number of reasons the full inventory of 32 hours isn't sold. Fewer clients want your services that week, the provider has to attend a continuing education class, a client cancels a previously scheduled appointment.

When all is said and done, you've only sold 30 hours for the week.

That is 25% less revenue off the maximum of 40 hours. Expenses haven't decreased by 25%, so net profit takes the full hit.

If ethics doesn't convince you to adopt Value Based Pricing, this simple math problem should!

The inventory of value is not tied to time and therefore is never reduced.

3. Compensation for value not time. There is no intrinsic value to time. It's your knowledge, expertise, speed, and quality that have value. As value increases, fees increase.

This is another perspective on the fact that the inventory of value is unlimited. Value Based Pricing allows you to work quickly while delivering the required quality, and get paid for the value, rather than being penalized for your speed.

A highly skilled graphic designer could understand her clients' vision and quickly translate them into visuals the clients loved. Before she phased in Value Based Pricing, she was struggling to make money commensurate with her high skill. When she adopted Value Based pricing and learned to articulate it (Step 2 PREPARE) and speak to clients about it (Step 4 TRAIN) she increased her fees and had more business than ever.

4. Compensation for additional value delivered. You can always write a new Value Based Pricing agreement as new opportunities arise. You aren't stuck charging the same hourly rate for all work.

There are two aspects here: 1) if, in the course of a current project, the client wants more value, there's no risk of scope creep. Simply write a new separate engagement agreement with a new value based fee; 2) The new agreement will accurately reflect the value of the new outcome.

5. Increase revenue with understandable justification. Clients never think a date on the calendar, or a cost of living increase is fair to them. When you implement Value Based Pricing, every fee is based on value. It's easy to show the value to the client. The more value, the higher the fee.

Don't:

"I'm excited that the new year is coming," the CEO of a specialty consulting firm told me. "Why?" I asked. "Because we raise our rate every three years, and the next rate hike is scheduled for the coming year."

It was December 15 and the founder of her own law firm told me she was getting ready to raise her billable rate on Jan. 1. When I looked puzzled, she explained that she raised her rates on the first of each year, just to keep pace with expenses.

I advised each of these owners to stop timing increases in fees to the calendar or to your expenses. Instead, I told them to spend some time understanding the value they deliver and analyzing the fees that would be commensurate with that value. And, as the specialty consulting firm knew from years of stagnation, profit and growth will never keep up if you only increase revenue once in three years.

Phase in Value Based Pricing and the firm's fees would increase as value increases. This is the work of Step 2 PREPARE.

Do:

A bookkeeping services firm implemented Value Based Pricing after analyzing their work and practicing speaking about the value they deliver to clients (Steps 2 and 4, PREPARE and TRAIN.) As they added services that deliver higher value to their clients, and as staff became avid continuing education learners, they were able to charge

accordingly. They have a 98% retention rate and profitable revenue is increasing steadily.

When you're able to justify fee increases based on delivering great value, you won't be stuck to the calendar or to a profit tied to expenses.

6. No competition on price. You and your company are the only ones who can offer the value you offer.

Value Based Pricing compensates your firm for value delivered. The more value, the more compensation. Increasing value delivered derives from innovation and creativity, which resides within your employees. No other firm has them nor can they create what you create.

When you bill hourly for inputs, every input can be compared to the inputs of other providers. The clients then have ammunition to compare prices and demand adjustments where they see you are higher than the competition. The end result is commoditization.

Over time commoditization doesn't even protect revenue; it decreases revenue and margins.

Enterprise Value Creation

7. Creates positive cash flow. You bill in advance and have the payments in hand before the work begins. No time spent reviewing invoices, adjusting, or reducing fees or chasing ARs.

In addition to the fact that clients pay for value delivered, Value Based Pricing is the only pricing model that guarantees positive cash flow, while reducing expenses related to invoicing, collections and tracking receipts.

We'll get into the details of this in Step 3 ESTABLISH. At this point it's enough to know that every Value Based Pricing engagement begins with an invoice being created and sent immediately upon signing the agreement. Payment terms are either in full in advance, or equal monthly payments, invoiced automatically and due upon receipt. The work stops if payments aren't received.

In addition to creating positive cash flow, Value Based Pricing reduces the costs associated with time keeping, invoicing in arrears, and collections. We help professional and business services firms reallocate that money to growth activities, such as client relationships, customer service, and innovation and improvement of offerings.

Value Based Pricing ensures every possible cost contributes to growth.

8. Happy and productive employees.

Knowledgeable experts love work that calls upon them to exercise their knowledge and expertise. Great ones love to be creative, enjoy flexibility, and thrive on responding to intricate situations or challenging problems.

Value Based Pricing rewards the clients with extraordinary value delivered by these experts. On the other hand, hourly billing

reduces all of their expertise and energy to 60-minute increments. No matter how brilliant and how extraordinary their work, every 60 minutes generates the same revenue. They can't be faster, because that reduces revenue and there's no point in going above and beyond because there's no reward for exceptionalism.

Value Based Pricing supports steadily increasing value creation because fees climb whenever the value increases. Great people most often leave jobs or companies when their natural exuberance and creativity is stymied and restricted. Value Based Pricing rewards them for their contributions.

Value creation via innovation and creativity is unlimited in an environment that rewards it. The professional or business services firm that creates that environment will retain its best people while company value increases steadily.

9. Rewards the development of product and services of increasing value because you know you'll get compensated for them.

Hourly billing treats all services the same, based on the time it takes to deliver them. While the hourly rate for staff members may vary based on some criteria, the very nature of hourly billing defines value as time. And since the firm is desperate to sell as much of its time inventory as possible, and doesn't generate revenue for non-billable hours, there is little incentive to devote high quality resources to new services development.

With Value Based Pricing, all new value pays off via fees commensurate with that value. Spending time during the normal work week on development is an investment

in future revenue and profit, not a cost charged against current revenue which reduces profit.

10. Generosity

How does generosity increase with Value Based Pricing, and how does it help the firm increase profit?

We think of generosity as munificence, giving from a place of abundance. We do it to feel good, to be kind, or because we believe in the “givers gain” philosophy of reciprocity.

But with hourly billing, there is no abundance. There’s a fixed number of hours to sell, and each unsold hour reduces revenue. It’s hard to be generous beyond the typical activities. You can’t help but think, “While I’m being generous, my firm is losing X dollars.” Since it’s so critical to sell hours, each bit of value you give away feels like taking a bit of value away from inventory for no compensation.

Even though professional and business services firms are stalwarts at networking events, no-fee speaking and publishing downloads and newsletters, the underlying feeling is anxiety, that all of these require giving time away which reduces revenue.

Value Based Pricing supports greater generosity. Why?

Value Based Pricing allows experts to be generous with a clear conscience. No time is wasted, no money is taken from the firm.

Generosity is the tie that binds value delivered to client relationships.

The better the relationship, the more you learn about the client's or prospect's needs, wants and desires. The more you know about these, the better positioned you are to develop value you can deliver to that person. The greater the value, the more they will compensate you.

A book publisher offers a free webinar each month to help people get closer to writing their book. In addition to the 60 minute webinar, which is chock full of How-To, not just concepts, he gets on the phone with anyone who attends for another 60 minutes. I accepted that offer and he answered all my questions. There was nothing coy or withholding on his side. I thanked him and commented on his generosity and he said with pride “generosity is our brand. I never worry about giving away something of value. I just answer questions and follow my train of thought. It always comes back to me, sometimes sooner, sometimes later. But we have never regretted being generous.”

I immediately remembered all the speakers and sales trainers I've heard and read. They think they're, really clever. They urge experts to talk only about “what” and “why” but never about the “how-to.” They warn that when you give away the ‘how-to’ no one will buy what you offer. I spent too many years doing just that.

People love gifts and love being inspired. The generous expert who says freely, even eagerly, “Here's how to do this” taps into these human emotions. Certainly, there will be some who are able to execute the how-to. The very few who do will end up being raving fans!

The rest will be inspired because the generous expert will illuminate how hard, complex, time consuming, and risky it is to do it yourself. When the expert says there are forty three steps to publish your book, most of us will slap our foreheads and think “forty three steps, I can’t do that. I’ll hire the expert.” This may be immediate, or it may be months or years later. But it will happen because the expert generously shared his or her expertise.

There’s another reason why I love being generous. It feels great. During the many years when I kept my ‘how-tos’ a secret only to be revealed to paying clients, I was always cautious. I watched my words, hoped I didn’t slip up, and often felt my guardedness was a barrier between me and the other person. I regret having adopted that practice for so long.

Don’t let your firm practice “What and Why but not How-to.” Give it all away.

Remember that the number 2 objection to Value Based Pricing is that “clients will be suspicious.” Generosity is the perfect way to mitigate that objection. If they’ve experienced you giving it all way, they will know that you will deliver the value you promise.

11. Wow experiences.

Providing “Wow” experiences is another benefit of Value Based Pricing. Define “wow” in ways that are meaningful to your clients and include it in one or more of the options you give them. “Wow” is not about inputs, it’s about the outcome.

“Wow” adds to the value delivered; therefore, you will be compensated for it through your engagement agreements. What’s

critical to this approach is to be well aware of the value of the “wow” as delivered to the client.

This is the opposite of “under-promise and over-deliver.” That is dishonest to the client, and it cheats you. Instead, promise some, some more or a ton, and give clients options to choose. Each option is priced for value delivered, and whatever their choice, you will be compensated for it.

Hourly billing prevents “wow” experiences because you’ll have to charge for the time it takes to create and deliver them. Can you imagine the client reaction to a charge on their invoice for X minutes to deliver “wow”? If you think you’d just not include it, then you’re cheating your company of the revenue it deserves for that time. Hourly billing hurts you in more ways than you might think.

And often one of the most valuable “wow” experiences is speedy delivery of the value. Hourly billing penalizes you for the very thing the client values most.

Owner Benefits

12. Company value and owner wealth grow.

You’re reading this book because you’re the owner, founder, partner, or principal of a privately held professional or business services firm. A significant portion of your financial assets is tied up in the company. It is imperative that you think about how your decisions and choices affect the value of your financial assets.

Value Based Pricing increases profits, which increase the value of the company, which increases the financial assets of the owner. There is a direct connection between Value Based Pricing and owner wealth.

Company or enterprise value is calculated on three measures: 1) rate of company growth (revenue); 2) rate of earnings (profits) growth; and 3) reduction of risk.

Value Based Pricing improves all three of these factors.

Rate of company growth (revenue). As we've seen, hourly billing relies on generating revenue from a perishable and limited inventory of a non-fungible asset: time. No matter how smart, no matter how outstanding the value delivered, if it is sold via units of time, revenue is limited.

Value Based Pricing generates revenue based on assets that are unlimited: expertise, knowledge, and creativity. The more expert, knowledgeable, and creative your firm, the more and faster your revenue will increase year over year.

Rate of earnings (profits) growth. Your knowledgeable, creative experts can increase value without incurring additional costs. This increases profits and is the key to scaling up. As the company gets better and better at understanding clients' wants, needs, and desires, and delivers value to achieve them, revenue increases, expenses remain the same, and profits grow.

Reduction of risk. There are several risks that are mitigated by Value Based Pricing.

- The risk of perishable inventory of hours is non-existent.
- The risk that clients demand lower costs which means fewer hours billed.
- The risk that the client cancels, thereby putting sold inventory back on the shelf (and unlikely to be sold again.)
- The risk of price competition. You may think you're selling something special, but the client thinks your hours are no different than the other guy's, and demands you lower your hourly rate.

Value Based Pricing is the pricing model that improves all other measurable assets of your company: revenue, profit, costs, growth, employees, competitive position in the market, longevity, and ability to deal with rapid changes. When these each improve over year over year, the value of the company, and the owner's wealth, increase.

If you're ready to increase value creation by implementing Value Based Pricing, you'll find the extensive and detailed "How-Tos" of each step in the following 5 chapters.