CRACK THE PRICING CODE

Implement Value Based Pricing and Generate Fortunes

SUSAN TRIVERS

Chapter Five
Step Two
PREPARE

If Value Based Pricng were as simple as flipping a switch from time-based pricing models, you would have done it already.

Instead you will PREPARE to implement Value Based Pricing. You are definitely not going to simply flip a switch from your current time-based model to Value Based Pricing. That's a recipe for resistance and failure.

Successful implementation of Value Based Pricing requires methodical preparation. It's not cumbersome, by the way, it's simply proceeding in a sensible order.

By the time you finish the PREPARE step you'll be at the all-important goal: determining the fees for the value you deliver to clients.

Mr. Ed Martin, Esq. founded his own business law firm with the goal of providing quality legal services to smaller, family-owned businesses in his region. His reputation as "good and fair" spread quickly. Business owners called for everything. He knew the calls were good for business, but since his practice was based on hourly billing, he either had to charge for these calls or forfeit revenue during the time he answered them.

When we met, Mr. Martin was struggling with cash flow and couldn't see how to both respond to people's needs and keep his own firm financially viable.

We reviewed his mission—providing family-owned businesses with excellent legal advice—and his firm's revenue and profit goals.

After I explained the ethics and the workings of Value Based Pricing, Mr. Martin COMMITTED to phasing it in.

We proceeded through the PREPARE steps you'll read about in this chapter.

Start a Value Delivered Reference File

Start a single Value Delivered reference file to hold all the lists you're going to make. This file should be easily accessible to everyone involved with clients. It does you no good sitting in a file no one ever looks at.

There are 4 discrete steps to PREPARE:

I. Articulate value delivered
II. Study the past twelve months
III. Sort your lists
IV. Establish fee to value relationships

I. Articulate Value

What is the value your firm delivers to its clients through your knowledge and expertise? There are many values delivered and it's critical to specify and list them all.

This step works the best when everyone who works with clients in any capacity gathers together to brainstorm.

I use the word 'brainstorm' to convey that you will collectively tap into knowledgeable people's brains and record every idea related to value delivered. This effort should create **a storm** of notes about value delivered. We definitely do not want people to make stuff up out of thin air, or to suggest what your firm *could* deliver. This is about what you currently deliver to clients.

Realism is the foundation of Value Based Pricing preparation.

The Owner or Executive should frame this discussion around three questions:

1. What quantitative value do we deliver to clients?

If your firm's offerings rely on a swath of knowledge and expertise, you'll want to answer this question separately for each area.

Examples:

- An accounting firm may deliver the lowest legal tax bill to business owners. Quantify that value by a percentage (tax divided by EBITDA).
- A law firm may ensure that a contract is favorable to the client and can quantify that with dollars saved or revenue generated.
- Designers of various types (graphic, interior, landscape, etc.) may quantify the value they deliver in terms of customer satisfaction (10 out of 10) or dollars saved.

Use quantitative terms such as increase, decrease, reduce, save, improve by a factor of X, and others.

If your group can't quantify value right away, make note of outcomes that may generate a quantitative value and get back to it later.

2. What qualitative value does our firm deliver to clients?

Qualitative value is described in non-numerical terms. These are often feelings (feelings are very important in businesses!) such as excited, happy, relieved, fulfilled, eager, innovative, creative, feelings of success, and so on. I encourage professional and business services firms to think in terms of what I call "tangible intangibles" such as speed, access, status, culture, and life-changing.

Don't let your mostly analytical and methodical left-brain block out your creative or artistic right-brain. We all have both abilities, and we don't have to be limited to the dominant one.

Examples of qualitative value include:

- Clients who are excited that they have more time for creativity.
- Clients who feel relief from a problem they engaged your firm to fix.
- Clients whose time-limited goal was fulfilled with time to spare.
- Clients who adopted your innovative ideas and created value their clients love.
- Clients who reached a goal with greater speed than they had imagined was possible.

Clients will pay for qualitative value delivered. You can't offer it until you recognize it yourself and are clear about how often a qualitative value is part of your work.

3. Comments and compliments from clients upon receiving the value you deliver.

All client-facing colleagues and associates should record comments from the client when they received delivery of the value promised.

There's nothing more convincing that the words of clients themselves. Each client has a unique way of speaking and you want to capture that. Don't look for uniformity or perfect English!

Use their language as best as you can recreate it. Do they use quantitative terms or qualitative terms? Write them down. Do they express appreciation? Write it down. Do they express hopes for the future? Those are really important.

Create Your Values Articulated List.

I'm illustrating the Value Articulation List with examples from Trivers Consulting Group:

Named services, processes, packages, strategic initiatives	Quantitative Value delivered	Qualitative Value delivered	Comments & compliments
LADRSM Leverage Assets to Deliver Results	Increase revenue. Reduce wasteful spending	Improve understanding the existence and completeness of the firm's 7 assets that create a successful company	"The LADR^{SM} analysis replaced our scattered approach with a structured one where all the assets tie to together and build on each other. We have generated 25% more revenue in the first 6 months."

Profit Optimization Roadmap	Increase revenue within one year. Create operational efficiencies to reduce costs.	Build confidence that the plan is based on reality. Help everyone focus on specific and time-based goals.	"We did really well with the 4 specific segments, each one getting a little longer. The year-end result was amazing!"
GO CURVE (Growth & Opportunity Curve)	Reduced common offerings to save time and money. Increased sales of our Uncommon services to existing buyers.	Visuals convey in moments what it takes minutes or hours to convey via spreadsheets or financial statements.	"The GO CURVE modeling approach showed us how to make the right choices about what we offer and who we offer it to. So much better seeing in on the GO CURVE than trying to understand it from a spreadsheet."

Mr. Martin, Esq. listed the following:

Contracts Writing and Review	Ensures any financial terms and penalties are aligned with client interests.	Ensures all obligations are completely spelled out and balance the needs of both parties.	"Mr. Martin took the lead on my office space contract and saved me a few thousand dollars in build out costs."
Employment agreements	Ensures all financial obligations of employers are clear and enforceable.	Gives peace of mind when hiring a new person who has access to proprietary property.	"I was relieved to have an employment contract with a new hire that protected the firm while also making clear how much we were looking forward to this new person joining our team. Mr. Martin had the right touch.'

Business litigation	Saves as much money as possible in the course of litigation. No frivolous requests or delays that cost money.	Points a spotlight on critical issues to ensure they get addressed first and won't derail a settlement.	"We had a legal complaint against a vendor. Mr. Martin gave us 2 options to get resolution. We took the one that allowed us to get back to business quickly, rather than pursuing the one where the potential monetary award was not worth a prolonged fight."

II. Study the Past Twelve Months

Once you have your lists of quantitative and qualitative value delivered, keep it handy for the next step.

Now it's time to analyze the firm's actual past 9-12 months of client engagements. If you have lots of short term client projects, 9 months will be sufficient. If your work encompasses longer periods, use 12 months. You want enough to be meaningful, and what is enough varies by firm.

The same group that brainstormed the lists of value delivered should look at each past engagement or client project and determine which of the quantitative and qualitative values were delivered.

This may take some sleuthing because time-based pricing models don't generally focus on outcomes or value delivered; they enumerate inputs and time.

The technique that produces the best analysis is to have each client project separately reviewed by 2 or 3 individuals. One of the individuals may be the provider who worked with the client, while the others should be people who did not. Many times, people who are farther away from the work see the value delivered more clearly than those deeply involved.

This is not a time to be modest or hesitant about the value you deliver to clients.

This step is helping your firm prepare for the phasing in of Value Based Pricing. It's impossible to price for value until you know what value you're delivering.

Document the following:

- the work you performed using your typical nomenclature.
- the period of performance.
- the fee paid.
- the quantitative and/or qualitative value delivered, using the same language you used in Step 1.

Here are some illustrative examples from various Trivers Consulting Group client companies to help you start thinking about your firm's work. These examples are from 5 different companies.

Your own firm's project list will look different in that it will include only the work from your firm. Projects will be closer to each other in line with your knowledge and expertise.

- **Project A.** A CPA firm added cash flow forecasting and monthly P&L analyses to their "business growth services" for their business clients. Clients using these new services were able to accelerate receivables which reduced use of their line of credit. Most clients increased profit by 1.5%. The period of performance was 12 months. Hourly billing averaged $152 per hour. Average monthly hours were 8.

- **Project B.** A "conflict resolution" expert convened a 3-hour meeting of a neighborhood sports organization that was on the verge of collapsing after 40 years due to defensive leaders competing with each other. The process she used allowed all sides time to share their perspectives; she took them through various exercises that brought them to agreement on enough issues that they were able to remain active and united. The period of performance was 14 days; this included several one-on-one meetings with the key leaders as well as the 3 hour public meeting. The fee was $5800 which was 15 hours at $375 per hour.

- **Project C.** A “fractional CFO” worked for a growing IT services firm, helping them improve their contract language, their pricing and billing systems, and their cash forecasting. He worked 6 hours per month for 12 months at $285 per hour.

- **Project D.** A “compliance” consulting firm served as an exporter’s in-house compliance expert for 6 months, helping them receive the revenue from the sale of their controlled product, at a rate of $255/hr., for 20 hours per month.

- **Project E.** A business law firm offers a package of services to small companies to help them form LLCs. The cost is $950 per LLC. It takes 2.5 weeks to complete.

III. Create Two Lists

Once you have your firm’s examples in your spreadsheet, sort them in two different lists. One list is ranked by period of performance and the other is ranked by hourly rate or fee paid. Rank the fee list from high to low and the period of performance list from short to long.

Each example will be in both lists.

What do you see?

Look for these occurrences:

- Which types of projects are at the top of each list and which are at the bottom?
- Are any at or near the top or the bottom of both lists?
- Do you see certain kinds of projects falling in the same place on each list?
- Do certain clients fall in the same place on each list?

Make note of any patterns and any anomalies that you see.

Look for the following:

- High fee/short period of performance
- High fee/long period of performance
- Low fee/long period of performance
- Low fee/ long period of performance

What insights do you take away from the lists and your answers?

You may find that high fees are paired with long periods of performance. This is typical of time-based pricing models.

With a successful implementation of Value Based Pricing, you should see high fees paired with high value delivered, and that period of performance is not a determining factor in the fee.

IV. Establish Fee to Value Relationships

This is the "art" part! There's a lot less science than most companies feel comfortable with at this stage. As you progress through the next 3 Steps, ESTALISH, TRAIN, GROW, and do more client projects using the Value Based Pricing model, you will have data that increases the science part.

I caution you now that you should NOT try to make everything about a data-driven pricing policy. The "art" part never goes away.

Value Based Pricing depends in large part on the perspective of the buyer. When you listen to what the buyer feels is important, and you deliver that value to the buyer, the right fee will be evident.

If you eventually try to create a menu or data-driven price list, you will subvert the whole point of Value Based Pricing.

Customer Perspective

Gather the same group to providers and staff together and ask this question for each project on your list:

If you were the client, would you be happy with X value delivered for Y fee for Z period of performance?

Put one of these answers next to each project: Yes, No, Partially

Now sort your list into Yes, No, or Partially.

Generally, your conversation has to be about "what do we see?"

- What surprises us?
- What did we expect?
- What seems really great?
- What seems really wrong?
- What opportunities do we see?

Fee-to-value ratios

A ratio requires two numbers and right now you only have one number, the fee ($).

We're going to step through the process of creating the second number.

This may seem hard but do not quit! You'll be tempted to default back to the period of performance, or the time something took. Don't do that.

Create the number that represents value delivered

- Re-organize the projects on your list in order of the **value of value delivered**.
- Assign the number 100 to the highest specific value delivered. Each smaller or less valuable value delivered will be assigned a smaller number. I recommend reducing the numbers by 5 to make variations easier to see and understand. Thus:

  Value ❶ 100
  Value ❷ 95
  Value ❸ 90
  Value ❹ 85
  Value ❺ 80

And so on.

Now you have the two numbers you need for a ratio.

- Re-arrange the list after you assigned the value number to each. The outcome with a 100 should be first, a 95 next, and so on.

Taking the time to think of **value delivered in relation to other value delivered** helps get clarity on what is the key to Value Based Pricing.

Here's what Mr. Martin's list looked like. (This is a tiny sample for illustrative purposes.)

Contracts Writing and Review Value Ranking 95	Ensures any financial terms and penalties are aligned with client interests.	Ensures all obligations are completely spelled out and balance the needs of both parties.	NOTES: Contracts have extended duration, so value delivered lasts a long time.
Employment agreements Value Ranking 100	Ensures all financial obligations of employers are clear and enforceable.	Gives peace of mind when hiring a new person who has access to proprietary property.	Employees are the heart and soul of the company. The value of getting it right is the highest.

Business litigation Value Ranking 90	Saves as much money as possible in the course of litigation. No frivolous requests or delays that cost money.	Points a spotlight on critical issues to ensure they get addressed first and won't derail a settlement.	When litigation is necessary, a speedy and effective resolution is worth a value of 90.

Value Based Pricing is about setting fees commensurate to the value delivered.

Being able to see value in juxtaposition to other value delivered gives you confidence in your pricing for each specific project and helps you explain the value based fee to clients.

What Fee: Value ratios look like

There's an important caveat right here.

The list below uses the illustrative Projects A-E, which, as you recall, are examples culled from different firms. There really is no relationship between them, like there will be with a list of projects from your one firm.

This exercise does help to see where we're going though—that price should be commensurate with value.

The ratios of fee to value delivered for the Projects A-E look like this.

Project A $152/hr:100
Project B $375/hr:85
Project C $285/hr:95
Project D $255/hr:90
Project E $950 FFP:80

Pretty crazy, right?

Here's where the real illumination comes.

The highest value delivered (100) does not command the highest fee ($152/hr.).

My experience tells me that lists that look like this indicate that a firm priced their hours without regard to value delivered.

- Maybe they chose seniority, or some credentials related to the provider personally.
- Maybe the rate is intended to cover all the firm's costs. That's not relevant to the client.
- Maybe the firm priced just a bit more or a bit less that their competitors.
- Maybe the current rate represents an annual escalation that is only related to the calendar. Not to any value or quality.
- Maybe the fee is just picked out of thin air!

How do these ratios look if we calculate total fee paid?

Project A. $14,592:100
Project B. $5,800:85
Project C. $20,520:95

Project D. $30,600:90
Project E. $950:80

These fees represent total time spent, not value delivered.

Imagine if the fee for your highest value delivered (100) was value based, not hourly. What would that that fee have been? Remember, the value delivered in Project A by this CPA is so powerful it **changes the lives of the firms and their owners**.

Don't get giddy about the fees for Projects C and D. These projects are ranked near the very top of the value delivered list and you have to wonder if the fees are commensurate with the value delivered? Was that the highest, best use of your provider's knowledge and expertise?

On the other hand, you could worry that the provider was not up to the demands and therefore billed many hours to compensate. What was the client's response to the fee with regard to the value they received? Did the firm get more business from this client?

Mr. Martin would order his list according to each service's value ranking and then assign Value Based Fees that align with the ranking.

- Employment Agreements $X:100
- Contracts $Y:95
- Litigation $Z:90

Conclusions

Each of the PREPARE steps helps your firm understand more deeply the relationship between fees charged and value delivered. Many firms that have been heavily invested in hourly billing or other time-based pricing models will have a hard time connecting value to fee paid.

This is because the fee depended on time spent and the more time spent, the better the firm's revenues.

From now on, your firm will live with a different mindset: the fee is commensurate to the value delivered, no matter how much or little time it takes.