mp
managingpartner

November 2013
Volume 16 Issue 3
www.managingpartner.com

Double meaning

Improve client relationships with cultural intelligence

Pricing alchemy
Why your firm needs a blend of pricing options

All ears
Create a firmwide client listening programme

Jonathan Agar
Why leading lawyers is a lot like leading soldiers

Pricing alchemy

Stratified pricing and a range of payment options give clients greater cost control and your firm more repeat business, says Richard Burcher

In a recent survey of general counsel in Australia and New Zealand, just four to six per cent said hourly billing is the optimal method of pricing legal services. When asked which pricing method they would prefer, the general response was a collective shrug of the shoulders – "we will know it when we see it", they said.[1]

Credit where credit is due: there are law firms of all stripes – international, national, city, regional and high street – that are making real strides around smarter pricing. Firms leading the way in London include: Eversheds; Addleshaw Goddard; CMS Cameron McKenna; Bond Dickinson; Charles Russell; and Field Fisher Waterhouse.

But, the capital city does not have a monopoly on innovative pricing. Progressive UK regional exemplars include: SAS Daniels (Stockport); Lupton Fawcett Lee & Priestley (Leeds); Lanyon Bowdler (Shrewsbury); Stephens Scown (Devon and Cornwall); Beswicks (Stoke-on-Trent); and boutique media firm Wiggin (Cheltenham).

But, for the time being, they remain a very small minority.

Pricing models

People often ask what new pricing models their law firm or practice team should be using. However, this is the wrong approach, for three reasons:

1. clients buy (or seek to buy) outcomes rather than inputs, effort and time;

2. value is the difference between what clients get from a lawyer and what they have to pay a lawyer – if they attach higher value to what they receive than what they are asked to pay, that represents good value (and vice versa); and

3. value, like beauty, is in the eye of the beholder.

Clients now expect their lawyers to provide greater:

- cost consciousness;
- pricing and payment options;
- client involvement and engagement in pricing;
- pricing transparency;
- pricing certainty and budgetary predictability – a 'no-surprises' policy;
- correlation between price and perceived value of the outcome; and
- price risk-sharing.

Most firms are relatively poorly equipped to deliver these requirements. There is a mistaken belief among many that, if only they could learn the latest pricing buzzwords and strategies, all would be well. Unfortunately, it is not that simple.

In this context, practitioners are talking about pricing execution. But, without pricing governance, leadership, training and analytics, pricing execution is likely to be suboptimal or even a complete failure.

"Pricing alchemy occurs when the most judicious blend of pricing and payment options are conceived and deployed on a case-by-case basis"

For each partner to achieve the optimal pricing outcome, he must have the skills, knowledge and confidence to develop a bespoke pricing solution for each particular client on each particular file.

Therefore, there is no right or wrong method of pricing. It is only right or wrong for a certain client on a particular matter. Pricing alchemy occurs when the most judicious blend of pricing and payment options are conceived and deployed on a case-by-case basis.

Aside from hourly rates and fixed fees, pricing options that your firm can adopt include the following:

- flat fees;
- blended fees;
- portfolio fees;
- waterfall pricing;
- fee ranges;
- caps;
- cap and collar;
- guarantee fees;

"The client is put at the centre of the pricing conversation and invited to choose and take responsibility for that choice"

- abort/success fees;
- retainers;
- bundling;
- unbundling;
- volume pricing;
- peak load pricing;
- penetration pricing;
- skim pricing;
- demand elasticity pricing;
- first-mover pricing;
- turnaround pricing;
- conditional fees (contentious and non-contentious);
- contingent fees (contentious and non-contentious); and
- damages-based fee agreements.

Balancing risks

All pricing strategies available to lawyers sit on a price-risk continuum, a concept that remains poorly understood other than as a by-product of partners' instinctive reluctance to give clients firm quotes.

However, price risk is capable of being priced itself. Risk-based pricing is a methodology adopted by many lenders in the mortgage and financial services industries. It has been in use for many years by lenders to measure loan risks in terms of interest rates and other fees.

The interest rate on a loan is determined not only by the time value of money but also by the lender's estimate of the probability that the borrower will default on the loan.

Similarly, the upfront agreed allocation of price risk between the firm and the client presents challenges and opportunities. Poorly executed, it will produce lost margins or even large write-offs. Assessed and deployed effectively, it can have a swift and profoundly positive effect on margins and pricing palatability from the clients' perspective.

Payment choices

Law firms do not need to confine themselves to offering clients pricing choices alone. They also have the ability to offer payment choices, a strategy that is largely ignored or dismissed.

The default setting is that the client must comply with the firm's standard terms and conditions around payment. But, that inflexibility not only irritates clients, it also obscures opportunities to secure work that:

a) the firm might otherwise win; or
b) the firm might secure a premium on if only it was a little more accommodating.

Your finance director will rightly say that this negatively affects the firm's cashflow and that it has payment risk implications. True, but both of these issues can, with a bit of imagination, be managed and priced. Payment options might include:

- monthly;
- staged;
- front-loaded;
- back-loaded;
- 'balloon' payments;
- deposits;
- trigger events; and
- partial accrual.

In summary, providing clients with well-conceived and articulated pricing and payment choices greatly increases the prospect of striking a deal that works well for both the client and the firm.

Pricing strategy

So, how can you develop a usable pricing strategy? There are many pricing and payment options and almost limitless combinations of these that can be deployed. However, what follows is one that is well worth any firm of any size thinking about because it has not only practical application but also strategic implications.

Much like airlines that have first-class, business class, premium economy and economy class services, law firms can increase their revenues (and market share) by developing a range of offerings that

appeal to a broader audience than a single price point. This requires constructing a series of packages in which clients are invited to decide for themselves which combinations of price and features they wish to trade off.

This approach has been successful in a range of sectors and matters, in everything from residential conveyancing to M&As and IPOs. A number of the firms referred to earlier are adapting this concept to their particular practice areas, sectors and constituencies, as it is capable of being applied to virtually any sector or practice area.

There are very rarely any objections from clients to this sort of offering menu. On the contrary, it is precisely the sort of innovation and flexibility that they are desperately wanting from their legal advisers.

Rather, opposition frequently comes from within the law firm. Common objections include the following.

1. "As a professional, I would find doing anything less then a perfect job each and every time a dereliction of my professional duty and rather unsatisfying." This is understandable, but it is not something the client cares about. Doing a thoroughly competent and professional job on part of a project is not demeaning.

2. "Anything less than a perfect job and being involved in the project from end to end will expose the firm to additional risk and liability." Yes, potentially, but this problem only arises from a failure to adequately scope the retainer.

3. "We will damage our brand by offering less than 'top shelf'." Potentially, if the execution is poor, but many premium brands – from L'Oreal to Hilton to Emirates Airlines – manage to provide cut-down offerings without incurring any brand damage.

4. "If the client chooses the 'bronze' instead of the 'platinum' version, we won't be able to charge as much, and that will negatively impact our revenues and profits." Very true, but if you don't accommodate clients' increasing desire for this, you may well lose the work anyway. If it is a £100,000 job to do the whole thing properly, but the client can't or won't spend that, surely it makes more sense to offer the 'bronze' version at £60,000 and only have to do £60,000 worth of work, as opposed to doing £100,000 worth of work and only getting paid £60,000 (which currently passes for business as usual) or, worse, losing the job and the client completely.

"The firm is conceding revenues, not margins"

Stratified offerings

So, how can your firm sensibly differentiate these stratified offerings? The key to achieving this differentiation is to first develop an acute understanding of what your clients value and what they don't.

By way of illustration, consider mobile phone packages. Young people may see greater benefit in a plan that includes a large number of text messages, while businesspeople may be happy with a fraction of that text messaging capacity in exchange for more 'calling minutes'. The different plans differentiate the customer base, so that each solution represents the best possible fit in terms of features and pricing.

On an M&A matter, your firm's 'platinum' package could include, in addition to the basics: full-blown due diligence (as opposed to 'due diligence lite', in which the client does much of the due diligence itself); project management of the deal; and responsibility for the data room. Conversely, the extras could be stripped out and offered to the client as a 'gold' package, at perhaps 25 per cent less cost.

Crucially, while the cost to the client is less than it might otherwise have been, it is not a discount as such. The firm is conceding revenues, not margins. The trade-off is that the client is kept happy and retained, and the firm earns a reputation for pricing flexibility, which drives referrals – a virtuous circle if done well.

The same concept could be integrated into contentious work, with differentiated offerings around disclosure/discovery work, for example. Some in-house teams have the resources and the capability to do the 'donkey work' on disclosure, with the firm providing high-level advice on issues of privilege and other key strategic decisions.

The point of all this is that the client is put at the centre of the pricing conversation and invited to choose and take responsibility for that choice. It is also completely consistent with cost consciousness – a phrase first coined and researched by Dr Margaret Beaton in the mid 1990s. In their own words, this is how clients of law firms describe cost consciousness:

- "we are always kept up-to-date on costs and issued notice if extra costs or variations are envisaged so that we, as the client, are always fully aware of the cost position";
- "the firm is aware of the budget available for any matter and suggests options based on different budgets;" and
- "they always quote first and explain the cost estimates".[2]

Without these skills, knowledge, disciplines, resources and the prerequisite changes in pricing culture, firms are going to struggle to maintain profitability and satisfy the needs of an increasingly critical and intolerant constituency. mp

Richard Burcher is the managing director of Validatum (www.validatum.com)

Endnotes

1. See *Legal Department Benchmarking Report*, ACLA/CLANZ, 2010
2. See *Buying Legal: Procurement Insights and Practice*, ed. Dr Silvia Hodges, Ark Group, 2012