

Professional services pricing

8 September 2012



Agenda

1. Contemporary pricing theory
2. Leading practice in pricing professional services
3. Improving your pricing outcomes

1. Contemporary pricing theory

No lever has a greater impact on profit



The right price

*What are the characteristics
of the right price?*

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The ideal price

Fair to the client

- They choose you
- They willingly pay
- They believe they obtained value
- They are loyal and willing to refer

Fair to the firm

- Profitable
- Meets your objectives
- Captures a fair share of the value created

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Frame of reference

What are clients comparing your price to?

- Direct competitors
- Competitors in a different market position
- What you charged them yesterday
- Discount from standard rates
- The cost of doing it themselves
- The client's perception of your costs
- The benefit to them
- Estimates you provide
- Options you create

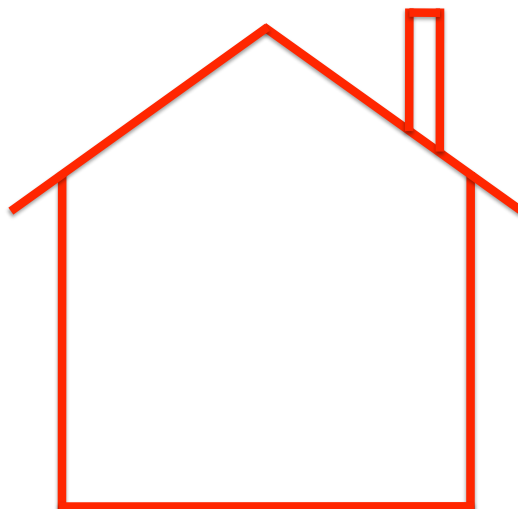
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Methods of setting a price

- Value-based
- Market-based
- Cost-plus



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What do we mean by pricing?

Pricing is the process of determining what a firm will receive in exchange for its services

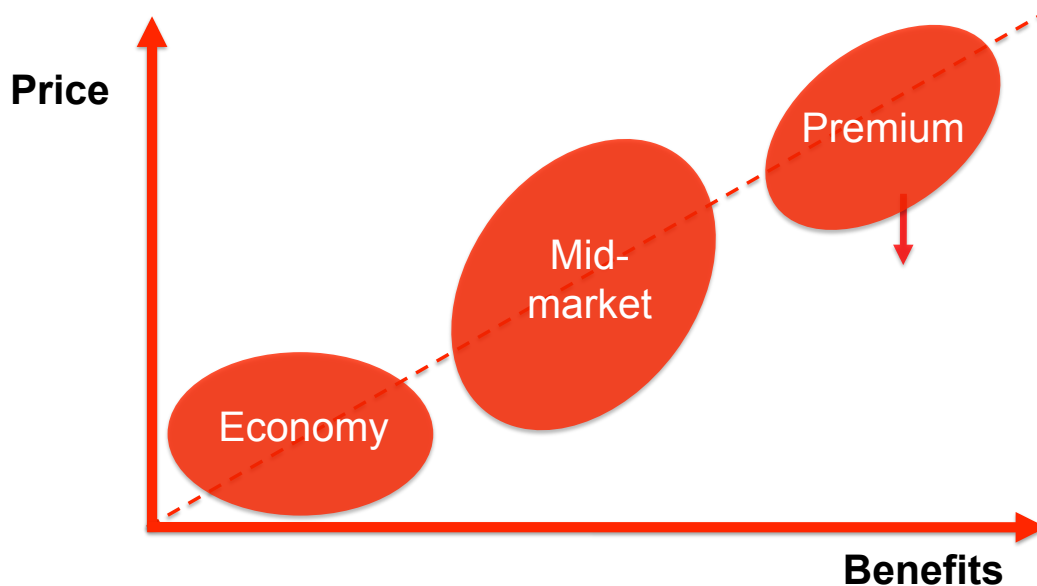
- Key inputs
 - Objectives
 - Costs
 - Competitors
 - Client value
- Process elements
 - Who - Roles
 - What - Strategies
 - How - Tools
 - Monitor, control and feedback
- Components
 - Fee level
 - Fee structure

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Price levels



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Pricing structures

Hourly rates (e.g. \$450 hour)

Variants include:

- Discounted hourly rates
- Blended hourly rates
- Volume discounts

Fixed fees (e.g. \$10,000 for a defined project)

Event fees (e.g. \$3,000 per patent renewal)

Monthly retainer (e.g. \$2,000 a month for on call IP advice)

Value billing (e.g. a \$40,000 fee if project is successful)

Variants include:

- Success fees
- Contingency fees
- Performance-based billing
- Percentage of project

Hybrid structures (e.g. capped fee)

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Price structures



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2. Leading practice in pricing professional services

Focus on and sell value

Value Spendthrift	Value Merchant
<ul style="list-style-type: none"> Trade more business for lower prices 	<ul style="list-style-type: none"> Gain more business at the same price
<ul style="list-style-type: none"> Make unsupported claims about greater value to clients 	<ul style="list-style-type: none"> Demonstrate claims about superior value in monetary terms
<ul style="list-style-type: none"> Focus on revenue / volume 	<ul style="list-style-type: none"> Focus on gross margin / profitability
<ul style="list-style-type: none"> Give price concessions without changes in market offering 	<ul style="list-style-type: none"> Give price concessions in exchange for cost-saving reductions in the offer
<ul style="list-style-type: none"> Complain that charge out rates are too high 	<ul style="list-style-type: none"> Complain that the firm lacks proof of superior value
<ul style="list-style-type: none"> Give services away for free to close a deal 	<ul style="list-style-type: none"> Strategically employ services to generate additional business
<ul style="list-style-type: none"> Prefer to give quick price concessions to close deals 	<ul style="list-style-type: none"> Are willing to negotiate hard to gain better profitability out of each deal
<ul style="list-style-type: none"> Pursues a volume-driven strategy 	<ul style="list-style-type: none"> Pursues a value-driven strategy
<ul style="list-style-type: none"> Sells primarily on price comparisons with competitors 	<ul style="list-style-type: none"> Sells primarily on benefit comparisons with competitors
<ul style="list-style-type: none"> Tell you that clients are only interested in price 	<ul style="list-style-type: none"> Provide client insights to improve the value of the firm's offering

Adapted from *Value Merchants*
by Anderson, Kumar and Narus

Deliver on clients' needs

- For most clients, if they find a firm:
 - who is credible,
 - delivers high levels of service,
 - with whom they have a strong relationship, and
 - who is constantly improving,
 - *then price will be a non-issue.*

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Work with clients to reduce total cost

- Effective pricing should be fair to the client and fair to the firm
- Explore ways to deliver your services at a lower cost
- This may involve encouraging the client to do more or to change their processes for how they engage you
- Break down the barriers between the firm and the client to think of it as one entity

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Ensure partners' have appropriate pricing skills

- Pricing basics
 - Role of price
 - Components of pricing
 - Pricing structures
- Clarity regarding the firm's pricing
 - The pricing process, guidelines and their role
 - Use common definition and language of pricing within the firm
- Understand value
 - Focus on and sell value
 - Understanding of value and how lawyers create it
 - Confidence in the value they create
- Pricing communication:
 - A willingness – An understanding of the impact of not communicating
 - The right mindset – Fair to client and firm
 - Confidence – Comfortable discussing price
 - Negotiation skills
- Understand financials
 - Importance of the firm's financial health
 - Drivers of profitability
 - Impact of write-offs & discounts
- Scoping and project management
 - Preparing accurate estimates
 - Capture variations

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Align individual objectives

- The objectives of some individuals may at times conflict with the firm's overall goal's including:
 - Partners wanting to practice
 - Client relationship partners focused on revenue rather than profit
- The partner performance management system in many firms focuses primarily on revenue
 - In such circumstances it may be better for partners to provide a 10% discount to obtain 90% of the revenue, despite the fact this may reduce profitability by 25%

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Segment your market

- While rates may need to reduce in some parts of the firm, it is equally likely that opportunities exist to improve pricing outcomes in other parts of the firm
- Consider
 - Which of your offerings are highly differentiated and highly valued by the market, and hence were less sensitive to price pressures
 - Which of your clients are primarily focused on the benefits the firm delivers, rather than the price
 - Which partners will be fully utilised even if their rates are increased
 - Which existing clients are not part of the firm's long-term plans

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Price sensitive markets

Price Sensitive	Price Insensitive
<ul style="list-style-type: none">• Repetitive volume projects• Small transactions• Low margin businesses• Insurance• Real estate• Large sophisticated clients• Private companies• Clients in cost-cutting mode• Not-for-profits	<ul style="list-style-type: none">• One-off transactional work• Large projects• Resources sector• High margin businesses• High value transactions• Referred international clients• New York• Critical / high risk• Relationship clients• Litigation, Corporate, Tax, M&A

Example only

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Financial Analysis

- Characteristics of profitable / unprofitable projects
 - Office, practice group, sector, type of project, partner
 - Analyse segments and outliers
- Characteristics of profitable / unprofitable clients
 - Office, practice group, sector, type of project, purchasing approach
 - Analyse segments and outliers
- Impact of costing assumptions
- Identify characteristics of write-offs
 - Office, practice group, sector, type of project, partner
- Identify mismatches between supply and demand
 - Practice group, office and any billable relief

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Levers analysis

Practice group	Blended billing rate	Blended cost rate	Margin	Utilisation	Leverage	Earnings per partner
Banking and finance	388	289	34%	1,236	3.8	463,104
Energy and resources	447	294	52%	1,149	3.2	562,550
Government	371	277	34%	1,213	6.4	725,859
Intellectual property	415	303	37%	1,016	3.1	353,385
Litigation & dispute resolution	439	309	42%	1,183	3.4	519,668
Property and construction	386	275	40%	1,206	5.2	692,968
Telecomm & technology	430	315	37%	1,142	3.8	501,658
Workplace relations	420	304	38%	1,067	3.6	444,043
Firm total	412	296	39%	1,152	4.1	542,761

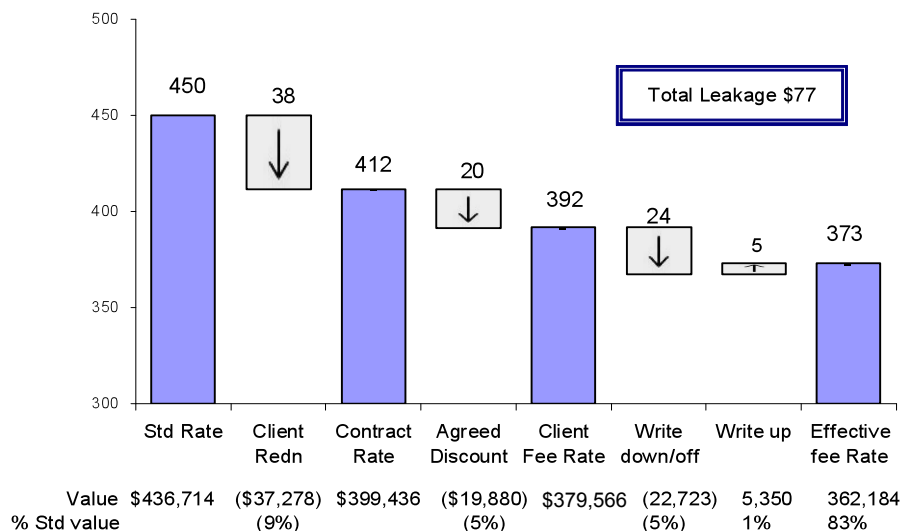
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Waterfall analysis

The fee rate leakage analysis highlights total leakage of \$77m, which represents a significant opportunity to improve profitability



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Waterfall analysis by practice group

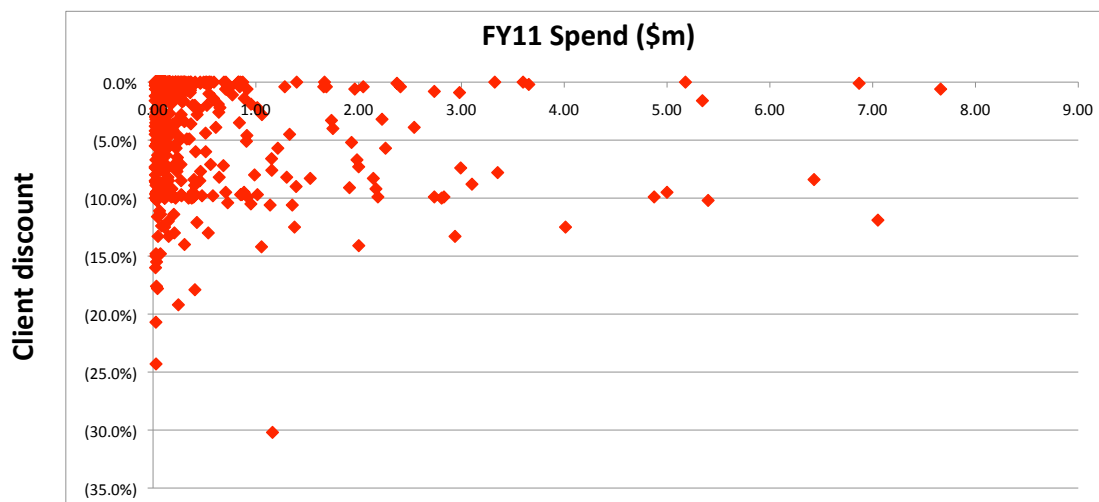
Practice Group	Rack rates	Discounts	Write-offs	Revenue
Banking and finance	100%	2.8%	2.7%	94.4%
Energy and resources	100%	5.1%	0.7%	94.2%
Government	100%	6.6%	3.8%	89.6%
Intellectual property	100%	10.5%	3.4%	86.1%
Litigation & dispute resolution	100%	8.9%	5.8%	85.2%
Property and construction	100%	14.1%	1.7%	84.2%
Telecommunications & technology	100%	1.1%	17.9%	81.0%
Workplace relations	100%	23.1%	2.7%	74.3%
Total firm	100%	10.1%	3.9%	94.2%

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Client discount analysis



Implication: Tightening discounts for small clients should deliver significant profit to the firm.

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Five levels of world class pricing

Level	Characteristics
1 – Baseline process is inefficient (About 30% of companies)	<ul style="list-style-type: none"> Political gamesmanship and departmental “turf” wars impede sound pricing decision-making. Pricing decisions tend to be reactive, and based on gut instinct rather than facts. Firms are constantly under pressure to lower prices. Threats of lost deals and unhappy clients lead to fear, which in turn leads to discounting.
2 – Internal process is in place (about 40% of companies)	<ul style="list-style-type: none"> Have instituted tighter control on the pricing process. Have clearly defined roles and responsibilities and use facts and analysis in the process. While this has brought discipline and control, savvy managers are left thinking: “we can execute pricing really efficiently, but are they the right prices?”

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Adapted from The five levels of world class pricing – Pricing Solutions Ltd.

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Five levels of world class pricing

Level	Characteristics
3 – Value processes in place (about 20% of companies)	<ul style="list-style-type: none"> • Have consistent and repeatable processes for looking externally to quantify the value their offering delivers. • Assess value by client segment, and translate this knowledge into pricing decisions. • Client value information is used to make decisions about price structure and price level.
4 – Optimisation processes in place (<10% of companies)	<ul style="list-style-type: none"> • Benefits from a dynamic, data-driven approach. • Have the analytical precision to optimise profits by segment. • Views its robust pricing process as a strategic capability, and regularly tracks how much money price optimization is contributing to its profit performance.

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Adapted from The five levels of world class pricing – Pricing Solutions Ltd.

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Five levels of world class pricing

Level	Characteristics
5 – Excellence in execution (<1% of companies)	<ul style="list-style-type: none"> • Have addressed all gaps in sub-processes that prevent optimal performance. • Usually has outstanding profit performance, well above industry peers. • It is often outsiders who recognise the strategic capability of your pricing process • The CEO is well aware of the benefit that this capability delivers, and will not want to see it eroded.

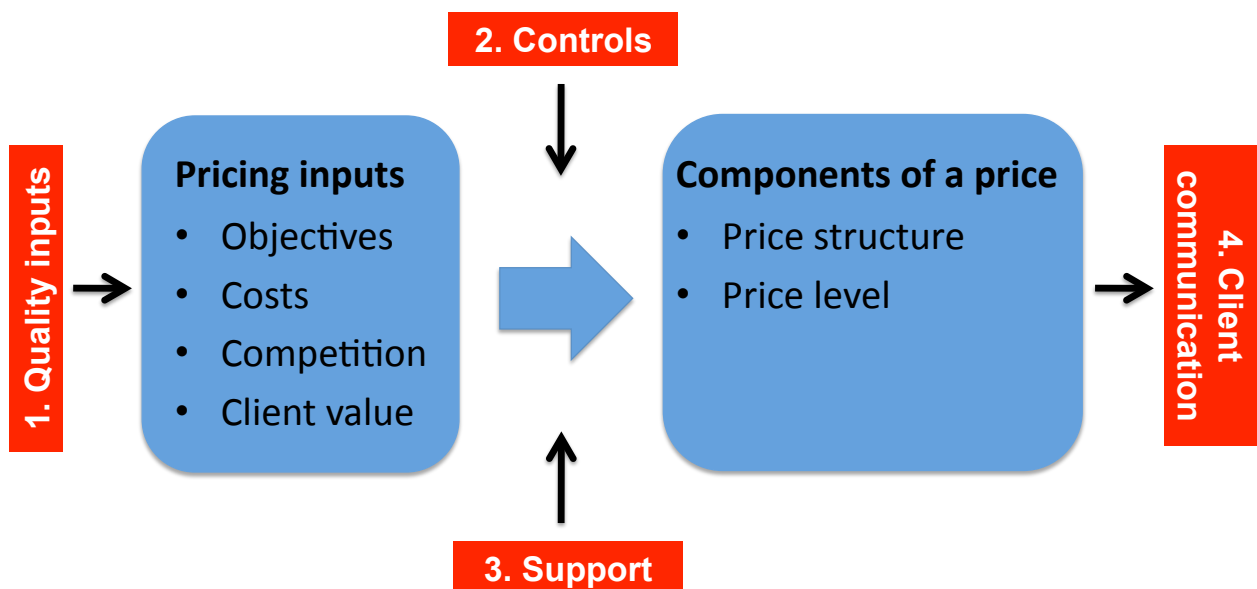
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3. Improving your pricing outcomes

The keys to the pricing process



Price positioning



Wrap-up

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