On Value Billing

I recently attended a two day seminar entitled "Firm of the Future," sponsored by Sage through the good offices of **Ed Kless** of Sage. Ed shared the presentation with **Ron Baker** of Verasage Institute, who is known to many readers as the fellow who thinks we don't need timesheets. I came as a skeptic, but I left a convert. That's a pretty radical shift for a fellow whose business is based in timesheets!

Ron Baker's thinking goes way beyond discarding timesheets. Timesheets are not the issue here: their loss of relevance is simply a byproduct of changing the business model from hourly billing to value billing. Baker claims that the use of the billable hour as a cost-plus means of setting price is an outdated model that results in a poor experience for both the client and the firm. It's only real advantage is that it is measurable and has the *appearance* of objectivity. Baker also states clearly that value pricing, the business model he suggests for replacement of per hour pricing, is not trivial to master.

The problem with pricing by the hour after the fact. As Ron discoursed on these matters, I began to relate his ideas to our experience at Commercial Logic and I realized that we have already abandoned the billable hour as our standard and are 100% fixed price based. I also realized that our experiences with pricing a project after the fact by the hours expended had led us into trouble with our clients in the past. Two examples of this:

Example One. Formerly when we implemented a new practice management system for a client we did a rough estimate based on experience with similar firms and then billed for the actual time incurred. This sometimes resulted in billings that were double, even triple (!) the original estimate. This caused dissatisfaction with the client and a demand for a substantial reduction in the bill.

Now, thanks to training from APS, we provide our new clients with a detailed implementation plan, a fixed price, and a payment schedule. The key here is the detailed plan. Both we and the client know what we have agreed to do and expansion of that scope requires another value and pricing conversation. In the example above neither we nor the client were clear about the scope of the work we were "estimating," and as a result misunderstanding grew apace.

I believe that one of the key differences here is *no surprises*. The client knows in advance the cost of what he is buying and approves it because the value to him is greater than the cost. When we base our pricing on an after-the-fact assessment of time and cost, unless we are quite close to our original estimate, it is a negative experience for both parties (if we come in way under our estimate, we look like we didn't know what we were doing in the first place; trust is eroded even if the bill is promptly paid).

Example Two. Formerly we offered a PowerPM technical support alternative to the annual contract fee that was based on actual hours used. We abandoned this because we found that clients would hesitate to call when they needed to, because they wished to avoid charges. This resulted in a poorer operation of our software and a negative experience for our clients.

Because of the above hesitation, when an ad hoc client finally did call, the situation was often much worse than it might have been and more costly to address than if we had been brought in at an earlier stage. This resulted in what the client experienced as too large a bill and another negative experience with Commercial Logic and our software.

In many cases, when we presented our bill we would get pushback from these clients, resulting in argument, wasted time, loss of revenue, and a negative experience of Commercial Logic for our clients.

We now only offer the annual contract to both our PowerPM and APS customers. We position this as not only pricing a valuable service, but also as *insurance* against a major problem for our customers. If you do not need to collect on your insurance in a given year, is that a bad thing?

We believe our support is the best in the business and have received good feedback that this is so. I feel that has a lot to do with our value pricing of that support.

I suspect that if you think about your own operation, you will find that you are already offering fixed prices in advance on many of your services. In a word, you are already value pricing and billing.

You may also find that you can think of examples from your own experience where hourly billing has created a negative response from your clients and a consequent diminishment of that relationship.

The advantage of value pricing prior to rendering the service. There are many such but the essence of it is that you and your client have agreed on the details of the service to be rendered and the price of that service. That makes you and your client *allies* on this engagement, whereas in the hourly billing model you are somewhat adversarial. Any non-trivial engagement requires good communication between you and the client, but in the hourly billing module the client is distracted by the recurring thought, "how much is this costing me?" There are exceptions of course, but I suggest that a value billing approach to such exceptional clients would realize more revenue for the firm *and* more value for the client.

Another advantage is that the client can measure the proposed cost of a project against his internal assessment of the value to him and say "no" if the value does not exceed the cost. We have had that occur many times at Commercial Logic. One of our customers will call and say, "would it not be nice to have a report that …." We say, "Right. Great idea. Here is what it will cost to provide that." Often we find that this serves to clarify the value to the customer quite wonderfully and that often the answer is, "no thanks." The exchange between Commercial Logic and the customer has been clear, professional, and useful and I would suggest that the relationship has benefited from it.

It is worth noting that our standard mode in most of our daily transactions is to make a value decision based on a fixed price offered in advance of receiving the product or the service. The lunch counter doesn't charge me based on the time it takes to make my sandwich. We know in advance what we will pay for a book, even though the cost of the book is primarily labor and highly variable.

Another advantage to value pricing in advance is ease of billing. Most accountants in my experience resent the time they have to put into billing. They feel it is unproductive time that could be better spent doing almost anything else. Pricing the engagement in advance permits you to predefine the billing arrangements and specify those in the engagement letters. In **APS Advance** these agreements can be recorded in the billing system and the bills issued on schedule (or on completion of certain milestones) – *automatically!* The bills themselves can be much simpler. Instead of pages of detail or yards of justification prose, they can simply refer to the engagement letter. Billing becomes a simple bookkeeping task that no longer requires large investments of partner time.

Some of the time thus saved must go into the front end: specifying and pricing the engagement and having the value conversation with the client. But is this not better than negotiating with yourself over whether or not certain billable hours are justifiable? It seems to me that to the degree that you review and mark down your billable hours you are engaging in value pricing, but after the fact and thus of little benefit to you and your relationship with your client.

What about the timesheet? Ron Baker is on a mission to eliminate timesheets. He feels (and I agree) that most professionals dislike and resent the requirement to keep a timesheet and that the firm that does NOT require then will have an enormous hiring advantage over the traditional firm. I think he is on to something there. Nonetheless, the timesheet can be useful even in firms that have adopted a value billing approach. A billable hour model may be required by the client or by the courts – bankruptcy work, for example. Or timesheets may be useful to track hours on a complex audit for a new client, just to get a handle on whether or not your initial pricing was sound. But the point is not the elimination of timesheets; it is the elimination of the billable hour as your basis for pricing services. If timesheets become vestigial, then you can eliminate those, too, at a later date. It's your choice.

What about complex, open-ended engagements? To reiterate, value pricing is not simple. Nowhere is value pricing more difficult than in the open-ended engagement. My favorite example is litigation: you don't know in advance if this will be a one-day settlement negotiation or a 30-day trial with double that in preparation. How can you price it in advance? The answer for such situations is to price it by *phases*. Generally there is a phase in the near future that you can see clearly enough to price. You can also help the client by *estimating* the cost of later phases depending on the circumstances ("if we go to trial, you can expect the cost of the trial to be in the neighborhood of $100,000"). You can still offer fixed prices on a set of uncertain outcomes, but you the price should factor in the uncertainty. With such an engagement I would prefer to price each phase as it comes up and both the client and I can see the scope as clearly as possible.

What about work outside the scope of the engagement? This is another key topic that Baker addresses. The first step in avoiding scope creep is a clear and detailed plan with specific deliverables. If you don't have that, arguably almost anything is within scope! The second step is training your staff to be conscious of the parameters of the engagement and to let you or the engagement manager know when the work is going off track. The third step is to stop the off-scope work and have a pricing conversation for the additional work with the client at your earliest opportunity! One of the problems with the after-the-fact billing model is that this may be the first time the partner has reviewed the work on the project, the out-of-scope work may be finished and delivered and your only option is an argument with the client about whether or not this work was "extra."

A cautionary note. Shifting from the after-the-fact billable time model to the value-pricing-in-advance model is not as simple as perhaps it sounds. This is a profound shift in your business model and your business culture. It is not for everybody and firms have been known to implode when value billing was introduced before the firm was sufficiently ready. Ripeness is all.

On the other hand, some 7-10 percent of accounting firms are now using the value billing model and there are a number of law firms using it as well. In the end I would rather spend time with our customers planning and pricing an engagement to our mutual satisfaction than spend time working over the billable hours to present a bill that I hope the customer will not find *too* offensive!