



Value pricing and pricing innovation

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Summary of discussion paper:

- My interest in the business of law
- Why are you here today?
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- Lawyers price like Marxists
- Challenging pricing fallacies
- Current pricing theory in professional services
- Professional regulation of value pricing
- Project managing work as an enabler
- Inefficient production techniques
- Specialisation and marketing
- Failing in the business of law
- References

My interest in the business of law

- Lawyer with an MBA, moving from solo practice to developing a business
- Interested in small firm improvement: Cash flow, pricing, business processes
- The purpose of the discussion is to challenge thought in the profession and encourage other lawyers to consider their business models

Seminar notes:

The first question to address is: Why am I here? I'm not a marketing consultant looking to sell a methodology but I am interested in the future of our profession and in particular, the future of small firms. This seminar is principally focused on small law firms but future changes in technology are going to affect the larger firms too. I'm not defending a business model because I think that a lot of changes are going to be forced on lawyers by disruptive technologies and a market that demands "more for less".

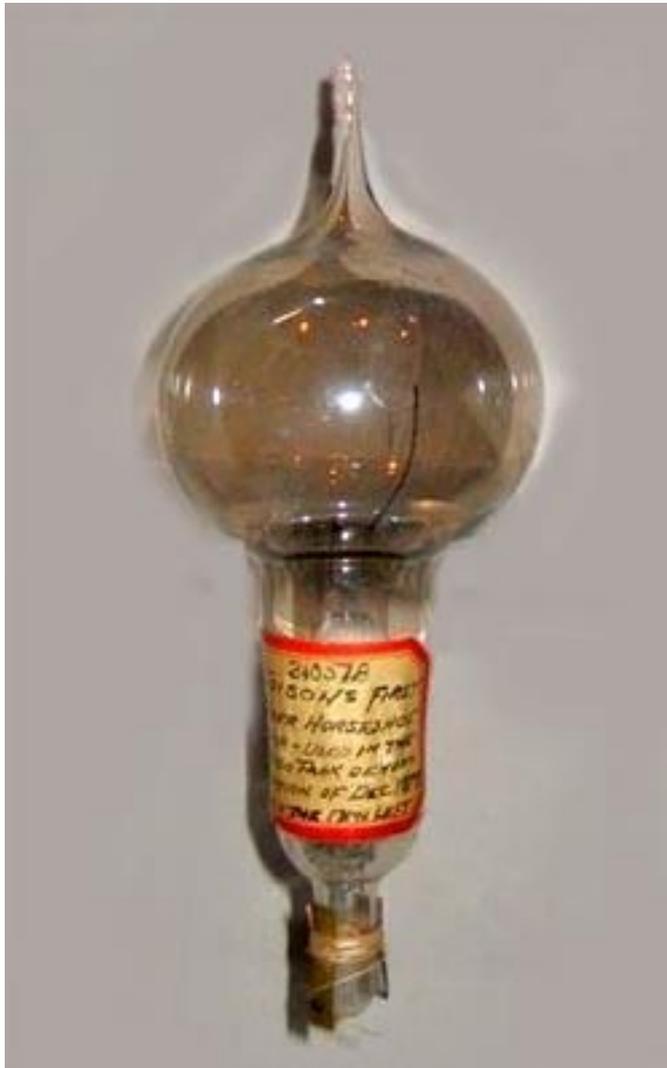
I have no intellectual property in any of the ideas discussed today because none of these ideas are mine. I have included referencing material at the end of the notes so that you can follow up on points of interest.

I'm developing my own practice from a solo practice, started in 2006, into a business. A lot of my development has come through trial and error and so I feel like Thomas Edison because it has taken many attempts to put together a working business model. The start of my journey was realizing that although I was becoming a good lawyer, I was ineffective at pricing my professional services.

There is no textbook on value pricing or pricing innovation that is recognised by the NSW legal profession. I have therefore drawn together a variety of books and articles to create this seminar. I believe it is clear there is going to be a paradigm shift in the business model of small firms and there is a risk that a lot will be left behind. The retail sector is a good example of large numbers of small to medium sized enterprises being left behind in a paradigm shift caused by a radical change in information technology and consumer behaviour.

Take-away policy

When I go to seminars I make sure that I note one or two 'take-aways' but before attending the seminar I commit to implementing these changes within 24 hours. This is not an academic seminar so please feel free to take away these ideas and use them in your own practice.



Picture: Thomas Edison's early model of light bulb

Why are you here today?

Pull of the market: from bespoke to commoditisation

Bespoke > Standardized > Systematized > Packaged > Commoditized

Technological change will be exponential and disruptive to legal practice:

- Automated document assembly
- Relentless connectivity
- Electronic legal marketplace
- E-learning and online legal guidance
- Legal open sourcing and closed legal communities
- Workflow and project management

- Embedded legal knowledge

Seminar notes:

The next question is: Why are you here? But I would like to change this question to: Why should you be here today?

The first point is that the history of professional services shows that the work you are doing today as a value-add service is likely to become a commodity tomorrow. The second point is that exponential growth of information technology is the norm, and this will have a profound effect on the legal profession in our generation.

The below diagram shows the “pull of the market” and the continuum between bespoke work and commoditised services.

Pull of the market

Bespoke > Standardized > Systematized > Packaged > Commoditized

Bespoke means individually customised, one-to-one consultative work, such as Court advocacy. At the other end of the continuum are commoditized legal services such as an online legal package that is perceived as commonplace. If a legal service is commoditized then no differentiation is possible and therefore premium pricing would not be tolerated by the market.

The pricing model that most private firms use is hourly billing with an emphasis on personalised advice from a trusted adviser. This pricing model works best in the bespoke end of the market for legal services. I conduct a number of business-to-business (B2B) debt recovery matters at any one time and this work is standardised and/or systematized through use of paralegals and document assembly. This favours standard pricing for work and checklists to make sure there is process integrity.

The second challenge that we face is exponential growth in information technology. What does exponential mean? I'll start by talking about 3 examples of flawed thinking about the pace of change in IT:

1. In 1943 one of the founders of IBM said that the world market for computers would be about 5.
2. In 1977 the founder of a leading early computer maker Digital Equipment Corporation asserted that there wouldn't be any reason for someone to have a computer in their home.
3. Could you have imagined internet banking in the 1980s, or even the 1990s?

Without exaggerating, if you look at the history of change in information technology the pace of change has been exponential. Therefore using a conservative approach you should expect that change is going to be exponential in the future. This is important because it will be disruptive to the current business model of small law firms.

I've taken the following examples of disruptive information technology from *The End of Lawyers* by Richard Susskind and I'll summarise each now:

1. Automated document assembly

This involves the creation of legal documents through standardisation of text based on user inputs. I use Hotdocs, a software package linked with Microsoft Word that generates documents from a Letter of Demand to a Winding up Petition using a single data set. It took a while to code the Word documents but it means that I can instantly create all documents in a standardised debt recovery process using a single reliable data set. It also makes charging by the hour a poor charging methodology.

2. Relentless connectivity

There will be continued growth in the technologies that make you engage constantly with your clients. The best example of exponential change is comparing the development of fax machines to the adoption of the Blackberry. With Skype there is instant messaging where your contacts ascertain whether you are online.

3. Electronic legal marketplace

Consumers are buying all sorts of products online and this will include legal services. So far the impact of the internet has been bigger in the world of goods than services. Purchasing legal services in the future may not be based upon price auctions but reputation systems (i.e. recommendations and evaluations of past services). This goes beyond advertising because your clients will be able to post adverse comments about you online and this may be instantly accessible by new clients. If you do one thing from today I recommend that you go on the internet and look up Odesk (www.odesk.com. au). This is a genuine professional services platform on the internet that signals the commoditisation of many professional services.

4. E-learning and online legal guidance

E-learning represents the use of multi-media to deliver presentations and information. This is powerful because people prefer seeing a presentation to reading an article. The growth of online legal guidance is an obvious threat where you are competing with a lawyer who can provide advice via the internet. They may be a specialist offering cut price solutions and they may even be based overseas.

5. Legal open sourcing and closed legal communities

These two developments are counter-intuitive because one suggests there will be more open source material while there will also be closed online communities of legal knowledge.

Legal open sourcing is where legal knowledge will be available free online and the best analogy is to compare the World Book encyclopaedia with Wikipedia. Wikipedia is a free online service where the users generate the knowledge. On the other hand, closed legal communities will be online closed

communities that share information, knowledge and experience with members. The second may be a subscription service of up-to-date legal advices and documents that your clients may subscribe and contribute to. They may even contribute the work you created to an industry-based community.

6. Workflow and project management

Workflow and project management systems inject efficiency and consistency into complex processes and activities. These systems will undermine the efficacy of hourly-based charging as a pricing model because it does not reward efficiency.

7. Embedded legal knowledge

The idea is that more and more legal processes will become embedded into online system so that a lawyer will not be required as a gatekeeper. For example, you don't need a card dealer for Solitaire online because you can't cheat.



Picture: Traditional law firm business model

A picture can tell a thousand words. Imagine this as a traditional small law firm and I'd like to take your comments on how Generation-Y will respond to this environment. I'll ask anyone born after 1980 for their comments.

Comment about pictures:

- High overheads- office – is it required?
- Front office/back office – is the internet the new front office?
- Clients waiting in waiting rooms – is this going to happen?
- Lawyers working on site – what about offsite lawyers?
- Geographical link to the local area – do you need an office so you can link up with the neighbouring professional firms?
- Going back to the disruptive changes in information technology discussed above:
 - Automated document assembly- clients will have drafted contracts/docs prepared in the waiting room

- Relentless connectivity- clients will not wait in the waiting room but will expect online response
- Electronic legal marketplace- clients will know about feedback from other clients and pricing information will not be asymmetric
- E-learning and online legal guidance- clients will have questions and proposed answers to legal questions from searches conducted in the waiting room
- Legal open sourcing and closed legal communities- clients will have draft contracts/docs prepared in the waiting room
- Workflow and project management- clients will question why the lawyer charges hourly if they are experienced in the area and should be able to give a set price
- Embedded legal knowledge- like the new PPSR- clients are doing their own registrations online

Disaggregation

The bad news for lawyers in larger firms is that there will be a trend towards disaggregation of legal services. This arises out of the principal that all larger litigation or transaction matters can be broken down into smaller constituent tasks and this will be a methodology of breaking the fee structure of larger firms. In the Tomorrow's Lawyers Richard Susskind asserts that litigation and transactional matters may be disaggregated into the following components:

Disaggregation: Litigation matters

- Document review
- Legal research
- Project management
- Litigation support
- Disclosure (discovery)
- Strategy
- Tactics
- Negotiation
- Advocacy

Disaggregation: Transactional matters

- Due diligence
- Legal research
- Transaction management
- Template selection
- Negotiation
- Bespoke drafting
- Document management
- Legal advice
- Risk assessment

Susskind asserts that in terms of litigation, only strategy and tactics are justifiably left in the hands of top litigation practices. The other tasks formerly conducted by junior lawyers charged at high hourly rates will be outsourced to low cost providers. Susskind is critical of lawyer's assertions that they are project managers when they have no training in the discipline.

The options Susskind outlines to handing over an entire matter to a law firm include in-sourcing, de-lawyering, relocating, off-shoring, outsourcing, subcontracting, co-sourcing, leasing, open-sourcing, crowd-sourcing, computerizing and nosourcing.

Lawyers price like Marxists

- Economic theory and hourly pricing: Marxist Theory of Value
- Optimal pricing: Not leaving money on the table
- Hourly pricing is a suboptimal pricing model
- Hourly pricing supports the inefficient and unethical

Seminar notes:

This is obviously a very provocative statement.

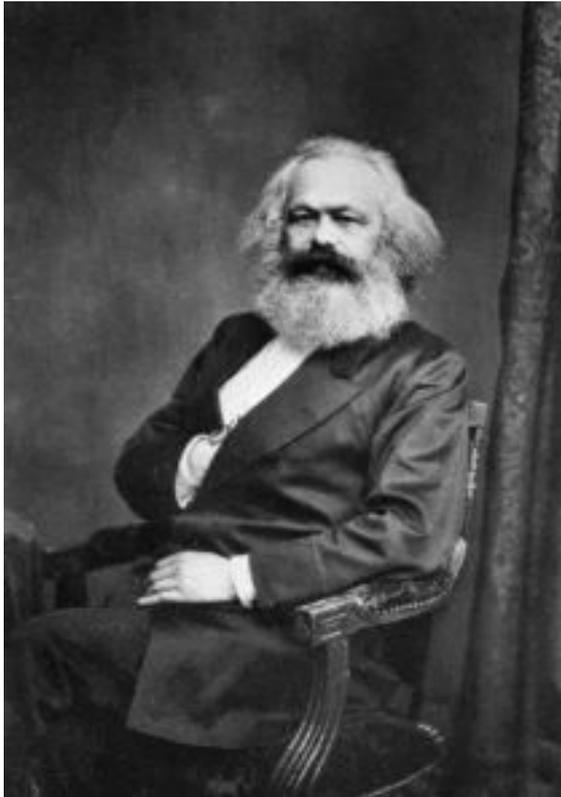
I think it would be fair to say that Karl Marx was a false prophet but an important thinker. The Marxist theory of value argues that the value of any economic output should be determined by the labour that has contributed to it. To quote from Marx's

"Value, Price and Profit" published in 1865:

A commodity has value, because it is a crystallisation of social labour. The greatness of its value, or its relative value, depends upon the greater or lesser amount of that social substance contained in it; that is to say, on the relative mass of labour necessary for its production.

This is the same rationale as pricing based on hourly billing pricing because it is based on the time it takes a lawyer to do the task. I know it isn't that simple because we adjust our hourly rates for different clients, and we write off time if it is outside an estimate. However, my argument is this: Hourly pricing is suboptimal simply from the perspective that you are likely to leave money on the table.

In my experience when you start to experiment with pricing you find that it is subjective, and the value of what you offer is determined by the customer. My goal behind using value pricing is to get to understand each client better and make sure that I don't under price. These are the two most important aspects of value pricing. The further criticism of hourly billing that I haven't touched on previously is that clients perceive it as encouraging inefficiency and unethical lawyers.



Picture: Karl Marx

Challenging pricing fallacies

- Relative, not absolute, price matters
- Do variable costs really matter to your firm?
- 5Cs You need: comprehend value for clients, create value for clients, communicate the value you create, convince clients they must pay for value and capture the value with strategic value based on value, not costs and efforts

Seminar notes:

The relative and not absolute price is what you need to consider so your firm's internal costing for "doing the task" are not relevant to the client's engagement decision. The price of water and diamonds is a good example to get your mind triggered into thinking about relative price. The price is based on the perceived value of the client, and it isn't about the needs of the client or the scarcity of the product.

A business is what it charges for and the value that it creates. We can sell good feelings and/or solutions to problems. I think that it is a fair proposition that no one is interested in buying our time.

What is one example of a business that started thinking seriously about benefits for their customers?

Black & Decker

Who can tell me what **Black & Decker** sell to their customers? Answer: **Power Drills**

The marketing department of Black & Decker realised some time ago that they weren't selling drills (that was their product) but the benefits customers sought were holes in the wall. By changing their thinking throughout their executive level to focus on the needs of the customers, the company then decided to get into the business of lasers. They got into the laser business because after putting a hole in the wall they found their customers were most concerned about putting the holes in a straight line.

The next argument that I hear in favour of hourly billing is that it is reasonable to charge this way because of variable costs. Variable costs (or marginal costs) are costs that rise and fall as a function of the level of output a business has. I would suggest that small law firms are not likely to have variable costs that are insignificant. Small law firm costs are largely fixed and therefore every additional dollar of income is likely to go to profit.

The difficult part for small law firms is finding the value in what they offer. It is not a problem I am going to solve today. How can we start to trigger thinking about the value (i.e. benefits) that a law firm offers to its client? The following points show a change of perspective from offering a "product" to offering a benefit:

- Don't sell me clothes- sell me a sharp appearance, style and attractiveness
- Don't sell me insurance- sell me peace of mind and a great future for my family
- Don't sell me a house- sell me comfort, contentment, a good investment and pride of ownership

What benefits you are giving as a professional firm requires depth of thought.

A general checklist for considering what benefits you are giving clients might start with the following points:

1. Comprehend value to clients

Understand your clients and the motivations of the clients when engaging a lawyer. Ask your clients why they picked you, and whether they would use you again.

2. Create value for the client

How you create value for the client is a subjective measure that means you need to get closer to the client. You may offer service guarantees or a satisfactory scope of work to give the client assurance.

3. Communicate to the client the value of what is being done

We all complain that clients don't appreciate the work we put in but we also need to give thought to how we communicate this. Tell them how good you are.

4. Convincing clients to pay for the value

There is no way to value price the wrong client. You need to have this value conversation at the beginning rather than the end of a matter.

5. Capturing the value by utilizing the appropriate pricing strategy

Can you charge at 10% of the value that you create or is there some other metric you can use? Current pricing theory in professional services

- Best time to price work is before work commences
- Value pricing acknowledges the primacy of the client
- First Step: Value conversation with a client
- Pricing to scope and issuing variations if work goes outside this scope

Seminar notes:

The point of this discussion is that hourly billing is a suboptimal pricing strategy. The first criticism of this approach is related

to the price being finalised after the work is complete.

The alternative approach is to price before the work commences and this is justified by research into the perceived value of professional services. The clients perceived value will be highest before you begin the work, and this value will drop as soon as you start the work. You have a unique opportunity to price the work at the time the client values you most. A price needed is always worth more than a service delivered and therefore most businesses provide a price to the customer before they buy so they can make the all-important value versus price comparison.

Value pricing is about identifying the value of the work to the client and pricing accordingly. The value of the work to the client is the driver of pricing.

First step is a value conversation. It helps to have a process to evaluate the client's optimal price point.

Attachment: Pricing review before engagement and Service Options documents

Professional regulation of value pricing

- Ethics of value pricing: Every other business does it so why shouldn't lawyers?
- Litigation lawyers can't charge based on outcome percentage
- Fair and reasonable: s 363 of the Legal Profession Act 2004

Seminar notes:

There was a report in the WSJ online about a fee approval from the Delaware Supreme Court in the matter of Grupo Mexico.

The Court approved \$304 million in plaintiff legal fees and noted the plaintiff's lawyers were being paid 19% of the judgment.

The article indicated that this worked out at \$35,000/hour. This is an extreme example and I would expect this to be reversed

if it were an Australian case through costs assessment because contingency fees are prohibited in litigation matters.

Section 325 of the Legal Profession Act 2004 provides:

Contingency fees are prohibited

(1) A law practice must not enter into a costs agreement under which the amount payable to the law practice, or any part of that amount, is calculated by reference to:...

(b) the amount of any award or settlement or the value of any property that may be recovered in any proceedings to which the agreement relates.

Maximum penalty: 100 penalty units.

(2) Subsection (1) does not apply to the extent that the costs agreement adopts an applicable fixed costs provision.

The second hurdle is that the criteria for costs assessment doesn't include the value to the client that is created by the legal work.

Section 363 of the Legal Profession Act 2004 provides:

(1) In conducting an assessment of legal costs, the costs assessor must consider:

(a) whether or not it was reasonable to carry out the work to which the legal costs relate, and
 (b) whether or not the work was carried out in a reasonable manner, and
 (c) the fairness and reasonableness of the amount of legal costs in relation to the work, except to the extent that section 361 or 362 applies to any disputed costs.

(2) In considering what is a fair and reasonable amount of legal costs, the costs assessor may have regard to any or all of the following matters:

(a) whether the law practice and any Australian legal practitioner or Australian-registered foreign lawyer acting on its behalf complied with any relevant legislation or legal profession rules,
 (b) any disclosures made by the law practice under Division 3 (Costs disclosure),
 (c) any relevant advertisement as to:

(i) the law practice's costs, or
 (ii) the skills of the law practice or of any Australian legal practitioner or Australian-registered foreign lawyer acting on its behalf,

(e) the skill, labour and responsibility displayed on the part of the Australian legal practitioner or Australian-registered foreign lawyer responsible for the matter,
 (f) the retainer and whether the work done was within the scope of the retainer,
 (g) the complexity, novelty or difficulty of the matter,
 (h) the quality of the work done,
 (i) the place where, and circumstances in which, the legal services were provided,
 (j) the time within which the work was required to be done,
 (k) any other relevant matter.

All work should be project managed

- Project managing means applying a methodology to focus on deliverables and execution
- What is your deliverable and is this agreed with the client?
- Initiation is the most important stage of a project

Seminar notes:

This is a big topic that should be the subject of a separate seminar but it goes to thinking about how we work.

The obvious

benefit of not working by the hourly rate is that we can think about managing our work more efficiently as a priority. Attached

is one document that I provide to clients each month to plan work and manage expectations in defended litigation that is

priced at an hourly rate. Where I work at a fixed rate I don't send out this report because the client isn't interested in how

long it takes to do the work, or the level of support I have from junior lawyers and paralegals.

Attachment: SLICE Report

Inefficient production techniques

- Completion plans for work
- Continuous process improvement: after action review
- Use of technology and outsourcing as an alternative to more employees

Notes:

So if we're serious about making legal practice more efficient the first step after adjusting pricing is to eliminate inefficient production techniques. It is easy for a lawyer to be swamped in paper, emails and telephone calls. Getting stuck in doing the work, and not thinking about how you are doing the work is normal.

Do you see McDonalds having this problem? The secret behind McDonalds is a thorough understanding of process so that a group of teenagers can execute the work. Law firms should look into creating completion plans to get tasks finalised efficiently. A completion plan is a step by step plan for finalising a task.

I've broken my business up into 4 areas and each of them has a different methodology for getting the task done. The strategic insolvency advice is bespoke work that needs to be completely project planned whilst the B2B debt recovery is standardised work that can follow a fixed process executed by non-professional staff. The bad news is that the only way I have developed these work completion plans is slowly through analytical review. An example of the sort of analytical review that can assist you to improve legal processes is named an "After Action Review" by Ronald Baker in Implementing Value Pricing.

Attachment: After action review

Specialisation and marketing

- Link between marketing and operations in professional services- is excellence possible with specialisation?
- Efficient processes and specialisation make it easier to promote the business because you have a better value proposition
- Thinking beyond the 7 Ps of professional services marketing, Product, Place, Price, Promotion, Physical evidence, People,

Process

- Start off by analysing your marketing roadmap

Notes:

Taking a serious look at pricing also forces lawyers to put the microscope on our operations, that is how we get the task done. My view is that there is a link between pricing, operations and promotions that favours specialisation. What I'm saying is that it is a lot easier to promote a business that has a specialisation because you can develop a coherent message and a better process for getting the task done. It is a lot easier to run a business that is specialised because you can develop work completion plans and processes that can be delegated and systematised. To develop the point further it is a lot easier to price the work because you have a better idea about what you are doing and the value to the client.

Where to start? Start with an elevator pitch

Attachment: SK Lawyers marketing roadmap

Elements of failing in the business of law

- **Business planning:** No concrete plan
- **Specialisation:** Taking all the work that comes in
- **Pricing:** Charges hourly rates and getting paid after doing the work
- **Operations:** No standardised processes for client engagement, work completion
- **Cash flow:** Difficulties resulting from not being paid up front
- **Lack of innovation:** Failing to improve processes over time

Notes:

This is most relevant to small firms and sole practitioners and I recommend that anyone starting their own firm read the E-Myth Attorney case study of Edward and Abigail. The essence of the case study is that any new law firm that lacks proper strategic focus is the result of business failure and frustration. Edward was employed by a law firm but became frustrated so he started his business without a concrete plan. Edward had no idea about the importance of cash flow and business operations and didn't create a concrete business plan or business processes. The result was frustration and burnout.

The symptoms are no business planning, lack of specialization, sub-optimal pricing and poor operations.

We aren't trained as lawyers in the business of law and careful strategic thought should be given to starting small firms.

Reference list of source material and link to subject of seminar

2. Why are you here today?

Susskind, R. The End of Lawyers? Rethinking the Nature of Legal Service [Chapter 2 The Path to commoditization and Chapter 4 Disruptive Legal Technologies]

3. Disaggregation

Susskind, R. Tomorrow's Lawyers: An Introduction to Your Future [Chapter4: Working Differently]

4. Lawyers price like Marxists

Baker, RJ. Implementing Value Pricing: A radical business model for professional firms (Chapter 4 A Tale of Two Theories)

5. Challenging pricing fallacies

Baker, RJ. Implementing Value Pricing: A radical business model for professional firms quoting:

Leboef, M. How to win customers and keep them for life paragraph 1183

Nagle, T. & Holden, R. The Strategy and Tactics of Pricing at paragraph 1129

6. Current pricing theory in professional service

Models for document attached [Pricing review before engagement and Service Options] Baker, RJ. Implementing Value Pricing: A radical business model for professional firms (Chapter 28 Step one: Conversation and Chapter 31 Step four: Presenting Options to the Customer)

7. Professional regulation of value pricing

Wilson, M. Costs – an insight into what practitioners are currently charging, Young Lawyers Seminar 11 May 2011

8. All work should be project managed

Kier, M. W. How to Eliminate Unfocused Litigation (Project managing litigation)

9. Inefficient production techniques

Gerber, M. E. & Ors The E Myth Attorney (Specialisation and Work Completion strategies, Case Study – Edward and Abigail) Baker, RJ. Implementing Value Pricing: A radical business model for professional firms (Chapter 35: Pricing after action reviews)

General reading list of sources

Allen, D. Getting Things Done (Productivity and time management)

Baker, R.J. Implementing Value Pricing: A radical business model for professional firms

Dunn, P. & Baker, R. The Firm of the Future: A guide for accountants, lawyers and other professional services

Gerber, M. E. & Ors The E Myth Attorney (Specialisation and Work Completion strategies, Case Study – Edward and Abigail)

Kier, M. W. How to Eliminate Unfocused Litigation (Project managing litigation)

Levy, S. B. Legal Project Management: Control costs, meet schedules, manage risks and maintain sanity (Project managing work)

Maister, D. Managing the Professional Services Firm [Marketing and operations integration]

Maister, D. Strategy and the Fat Smoker (Managing staff and self-awareness)

Susskind, R. The End of Lawyers? Rethinking the Nature of Legal Service

Weiss, A. Million Dollar Consulting: The Professionals Guide growing a practice (Business development)

Seminar paper:

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