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The need to push for value-based pricing

By ROBERT SAWHNEY

THERE was a recent article in The Business Times about the challenges for distressed companies as the reason they are distressed is because they are cash strapped yet have to pay hefty hourly rates for turnaround and insolvency experts. This highlights the very real problem of hourly billing and conflict of interest between client and firm since speed would be one of the key success factors in turnaround projects. This is highlighted in the article as a partner of Ernst & Young Solutions LLP states that time-based pricing in this case is counter intuitive. In my opinion, hourly billing in most cases is counter intuitive as it links time and value, even though value may have nothing to do with time spent on a project and turnaround work is a classic example of this.

Many professionals cite the difficulty in estimating the amount of work involved in such cases and hence determining a fixed fee is not feasible. I find this surprising because in the engineering and construction professions, they are able to bid on massive projects involving time frames of many years with an all inclusive fee as part of their tender offer. It seems to me that firms experienced in turnaround work would have a pretty good idea of the time and costs involved. Additionally, as they become more experienced and learn from the process, they should become more effective, generating additional value for the client in terms of speed and outcomes.

Value pricing is not new in the Western world but is still relatively unknown in Asian professional service firms. There are numerous alternative billing methods but the key thing is that firms must understand the value they offer clients and communicate that value clearly. Outcome based fees and fixed fee agreements are common methods of value pricing and this type of structure negates the conflict of interest between clients and firm when bills are itemised on an hourly basis. What incentive is there for professionals to improve productivity when they are billing on an hourly basis? The answer is none.

Strategy and Firm Pricing

How and what you bill is strongly related to firms' overall strategy. Leaders in their field are able to communicate value much more strongly than their counterparts who have not built recognized areas of expertise.

According to research conducted at the Centre for Management of Professional Services (Said Business School, Oxford University), a firm's ability to differentiate itself and create a sustainable strategy relies on four factors:

- Expertise - knowledge and experience
- Relationships - clients and other stakeholders
- Reputation - expertise, experience, and engagement
- Service - processes, services, and engagement

According to the authors, a sustainable strategy can be built around these four factors whereby they create a virtuous cycle of innovation, organisation learning and knowledge management, as well as

access to new markets. The authors' research demonstrates clearly that for a firm to create differentiation that means something (ie value perceptions to client), a firm must spend time on factors aside from technical quality of work.

This is the catch. If a firm lives and dies by the billable hour and follows the archaic practice of maximum leverage and utilisation, what incentives are there going to be for the people in the firm to spend time on non-billable activities that enhance the practice management abilities of the firm? According to the Management of Accounting Practice (MAP) in the US, billing and pricing are one of the key issues facing the accounting industry. What this provides is evidence of a contradiction within the accounting profession, on one hand, many accountants roll their eyes at clients who only care about price, yet on the other hand, the same accountants do not fully understand what value they offer and resist marketing thought and practice in their operations even though more fulfilling work and better clients is what they want

The Move to Value Pricing

Whilst it is probably too much to expect accounting firms to do away with hourly billing in its entirety, once firms ensure they have the appropriate mind set and culture in place (that is one that supports the ideas of a marketing culture and innovation), they can start to experiment with value pricing alternatives given the right context and timing. Value pricing is nothing new and it has been applied in numerous business sectors.

In other words, instead of deciding price by calculating the number of hours needed to complete a job or arbitrary hourly rates, one should base pricing on the value created and delivered for the client. However, to do so means that the professional services firm must be able deliver value that is perceived by the client as both meaningful and differentiated from other professional service providers. This comes back to the idea of realisation rates and the concomitant area of partner compensation. If one believes that their compensation is based upon the old model of revenue, it is unlikely that you would spend time on non-billable activities, even though it is these times that are the lifeblood of creativity and innovation.

In fact, hourly billing is rooted in the culture of accountancy and other professional service firms and it will take a mindset and culture change for value-based pricing to be accepted. No other industries in the world charge after the fact and indeed not many customers would accept such a proposition. Research by various accounting bodies, such as the American Institute of Certified Public Accountants, shows that it is clients who are pushing for alternative billing methods and accounting firms would do well to take heed. They must recognise that in the new dawn of competitiveness in the professions, adopting a new and innovative mindset is the key to a sustainable advantage.

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