

### How to Price

By Andrew Sobel

Robust pricing is a key to profitability, yet most professionals spend little time seriously exploring how to price their services effectively. Worse, they chronically underprice as they over-react to client pressure to reduce fees and become afraid they will lose the sale.

Most of you reading this deliver a high value-added service. We're not talking about boxcars of grain or commodity chemicals that are priced by rigid supply and demand curves. What you do is infused with deep experience, knowledge, creativity, and ideas. Would some (or all) of your clients pay a few percentage points more for your services? Under the right circumstances, they most likely would. And obviously, a small increase in price yields a disproportionately large increase in net profitability. If you have a 20% net margin (not untypical in high-end service businesses), a mere 1% price increase creates a 5% increase in profitability, all things remaining equal.

This article is not about how to charge high fees. Rather, it's meant to push you to think about how to increase profitability by being more thoughtful and systematic about your pricing policies. At many large professional firms, there is some central oversight and control over the pricing decision. However, it is often done in a perfunctory manner, with a focus on whether or not certain benchmarks for billing rates, fee scales, or gross margins are being met. More questioning is needed.

First, let's quickly review some of the factors that support robust fee levels, and then we'll examine about nine different dimensions of pricing that you should think about when formulating how much to charge your clients.

What underpins your ability to maintain robust fees, or at least prices that are satisfactory to you? Briefly, and in no particular order, here are some of the most common factors:

Products and services that are highly tailored to each client

Deep client knowledge—having a better understanding of your clients' needs than your competitors

High value-added: Your clients believe that what you do creates significant value for them

Perceived scarcity/few perceived substitutes: you are seen as being “a category of one”—the only person/firm who can really do the job at hand (or at least one of only a few).

A feeling of mutual trust and loyalty between you and your client

Client selection: Choosing to work for those clients who can afford your fees

A client who feels he is a buyer rather than someone who is being sold to

Guarantees or other arrangements (e.g, gain sharing) which reduce risk for the client

Dealing with the economic buyer. Economic buyers can authorize hiring you, and they are typically focused on return on investment rather than simply getting the cheapest deal

Dealing with executives who have P&L responsibility: Again, unlike functional staff who have “cost” budgets, line managers usually have profit budgets and are more likely to appreciate the economic value you create.

Next, let's look at 9 different considerations that may enter into the price-setting process:

### **Standard market scales**

**In some markets, there are accepted fee or commission levels based on a percentage: Financial advisors may get 1% of assets under management per year, for example, and most executive search firms typically charge around 30% of an executive's total annual compensation for completing a search. What I personally don't like about this approach is that it doesn't allow for flexibility to account for the other variables we are going to discuss, such as value or degree of risk. Also, these percentages are usually only negotiated downwards, which then undermines their integrity in the client's mind. Sometimes, you can change the paradigm and adopt a more flexible pricing approach, which is what the Swiss-born Egon Zehnder did when he founded the executive search firm of that name. He felt that charging a fee based on the difficulty of the search would more closely align the interests of the client and the firm, and be fairer to all concerned.**

*Question: If your firm prices this way, how can you avoid price erosion? How closely are you prepared to hew to your pricing scales? What small, additional, but valuable things could you add to the equation to boost your clients sense of value and therefore willingness to not pressure you for discounts?*

### **Internal benchmarks**

**Many professional firms, especially consulting firms, have a target gross margin they want to achieve, and they determine pricing by working back from that goal (usually translated into daily rates, which are calculated to support the desired level of profitability). If you work in a large firm, you may be obligated to work with these profitability standards.**

### **Value to the client**

**Charging on the basis of value-added has been the subject of stormy debate for years. It goes like this: If the work you're doing saves a client ten million dollars, then why shouldn't you be able to charge them \$250,000, even for a week's work! Volumes have been written about value pricing, and I wholeheartedly support it. It is a very client-centered approach to pricing—after all, clients don't care about how many hours you work—they care about getting a particular result. Discussions with prospective clients should always include questions that touch on the issue of value (put most bluntly: “If you were able to accomplish this, what would it be worth to the company?”). Proposals should also have a section on value. As my friend, author Alan Weiss says, you should always negotiate value, not price. If clients want to cut price, then talk about what part of the value you are going to subtract. There is no question that many consultants and lawyers, in particular, leave money on the table with their obsession with billing rates and chargeable time. HOWEVER--there is one big problem with value pricing: Clients are skeptical of it. They look at all your calculations about value, and divide by 20—or 100. They also figure that a lot of the value is achieved, ultimately, through *their* implementation efforts, and therefore you don't deserve more than your fair (or fairly discounted) share!**

*Question: How effective are you at estimating value, measuring value, communicating value, and enhancing your client's understanding and perception of value? Do you negotiate price or value in your discussions?*

## **Time**

**In professional services, pricing is often based on “time and materials”—e.g., how long is it going to take us to do this? Whereas investment bankers work off fee scales, consultants and lawyers are always trying to calculate the person-days that will be required to get the job done. Even if you are a value-pricing fanatic, you must look at this aspect of pricing.**

*Question: Are you over-emphasizing time and materials to your client? If you focus on this, then so will your client. You will end up educating him/her to be concerned about hours or days billed rather than results (who wants to hear, “Hey, you said there would be 3 people here five days a week, but this week we had only 2 on Friday afternoon because one left early!”).*

## **Embedded intellectual capital and/or proprietary data**

**In some cases, you may have proprietary data or information that you have accumulated at great expense. There may be physical products involved in your service delivery (training materials, for example, or software). You do need to think about how and whether this should be reflected in what you are charging.**

*Question: How can you make your client more aware of the embedded investments in your delivery? In highly competitive situations, can you explicitly offer these as extras which then provide support for your fees?*

## **Difficulty, speed, and risk**

**These could all be reasons to raise your price. One client of mine, for example, a large bank, put out an RFP for a consulting firm to do an extensive study of how investment banking services are purchased. They wanted to interview only very top corporate executives, and they wanted it done in a short space of time—a few months. The bids all came in far higher than the bank had anticipated—several million dollars—and they cancelled the project before even starting. The consulting firm perspective, however, was that they were being asked to move heaven and earth—and expend valuable relationship capital to get the top executives to agree to be interviewed—and this had to be compensated. In a different example, a law firm might well charge a large fee for a written opinion (versus a verbal one) because of the future litigation risk that such a document might expose them to.**

*Question: Do you make speed an explicit part of the value equation? Are you charging appropriately when clients demand above-average speed or ask you to take risks with your reputation or draw down your relationship capital?*

## **Quality**

**In many fields, to talk about reducing the quality of your work is heresy. You’d be hard pressed to hear a corporate client for legal services, for example, say, “We’re happy to pay less for low-quality work on this matter...” But in fact, in many cases clients are willing to trade off quality for speed (number 6). They may want something done in a week or a month, and they know they are not going to get the same level of detail and polish that they would if they gave you more time.**

*Question: Are you delivering too much quality? In other words, are you doing a 120% job when 95% is going to result in a highly satisfied client (or 98% when 90% is OK)? Your own perfectionism and risk aversion may be eroding your profitability!*

## **Competitive offerings**

**It’s great to talk about value pricing, or raising fees for very difficult work, but you have to consider what your competition is offering to charge. Now, I’m not saying you have to match your competition to win business. What you need to do is demonstrate that your approach and way of working together are superior. Research has shown, in fact, that high prices themselves often give an impression of high value and scarcity. So if you think you’re better and you have a distinct market**

niche, then by all means charge more. But you always have to look at this aspect. Maybe clients feel that paying 30% more for a better service is completely acceptable. What about 50% more? What about 200% more? There is a point where, regardless of the extra, perceived value, clients will balk. Question: What do you know about your competitors' pricing? Have you ever ASKED your client? Most clients, I find, are happy to share this sort of information if you have a good relationship with them and if you ask it in a professional manner.

### Value to you

Finally, how badly do you want the work? How valuable will it be to you and your career? There are many intangible factors that might induce you to invest in building a relationship—for example:

It's a well-known, marquee client that will greatly enhance your reputation and provide valuable referrals and references

Your own stock of intellectual capital will be unusually augmented

It will give you highly transferable experience

It will be really fun (e.g., working for the board of tourism on a beautiful Caribbean island...)

Now, just because an engagement has especially high value to you doesn't mean you cannot and should not charge a fair and full price. But again, it's just another factor that you should consider in both how you price the work and in terms of how hard you push to win it.

Question: Is every client who can fog a mirror and write a check a good client? On the other hand, are there some clients you'd just love to work for, even if the check they cut is slimmer than usual?

Finally, a pet peeve—the one phrase I HATE to hear from a prospective client who is trying to reduce my fee (not common, but it happens): “We’re looking for a long-term relationship.” Why? Because I watch clients’ feet, not their mouths. When they say this they are stating the obvious at best, and at worst (and most commonly) offering a flimsy justification for win-lose behavior. Also, the opposite of this assertion is pretty nonsensical! In my business, few people are looking for a one-off transaction—they are usually searching for smart, experienced professionals who can help them grow their business over time. So justifying a discount with the elusive promise of a “long term relationship” is really bogus. My advice: Hold the line unless the circumstances are very special and you know the client quite well.

So look carefully at your pricing strategy. If your main guide is what your competitors are charging, you're really missing out on significant profit-improvement opportunities. Most organizations could use better pricing strategies to improve profits by 2-3 percent without much work at all. Try it, and reap the benefits (or prove me wrong!).

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