

WILEY ADVISOR



IMPLEMENTING VALUE PRICING

A Radical Business Model
for Professional Firms



with **WEBSITE**

RONALD J. BAKER

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**More Praise for *Implementing Value Pricing:*
*A Radical Business Model for Professional Firms***

"This is THE book I have been hoping Baker would write for the last 10 years. Value pricing as a concept is quite well known but not very well understood. Despite pricing being the most important determinant of enterprise profit it is given relatively little attention in the literature compared to other elements of the so-called marketing mix. At last we have a book that nicely blends elegant theory with a robust practical solution for implementing VP. I consider this book to be required reading for anyone interested in developing a business model that is based on the simple, but time-honored, idea that we should be paid what we're worth. For that to happen we need to focus on creating more value AND then implementing a system for capturing our fair share of that value. This book answers both these issues."

—Ric Payne, Chairman of the Principa Group
of Companies, www.principa.net

"*Implementing Value Pricing* not only produces more evidence that the historical cost-based system of pricing professional services is wrong-headed, Ron Baker shows the way to execute win/win pricing that both customers and professional firms will value."

—David G. Littlefield, President and CEO,
Littlefield Brand Development, www.littlefield.us

"As a reader of all of Ron Baker's previous works, I can state unequivocally that this is by far his most thorough and enjoyable read to date. He not only builds upon the ideas about which he has previously written, he integrates them into a new and fully fleshed-out business model. If his *Professional's Guide to Value Pricing* was the Old Testament, *Implementing Value Pricing* would be the New."

—Ed Kless, Senior Director, Partner Development
and Strategy, Sage

"Once again, Ron's work turned an endless flight into an intense reading experience. Unease about the task of moving beyond the billable hour was mixed with excitement about the tools, experiences, and intellectual ammunition that Ron provides to make it happen. It is far from certain that effort-based pricing will disappear, but it is more likely because of this book. Ron has not just shown the way; he has paved the path. Now, we shall walk or we will fail—our profession, our purpose, and, ultimately, our place in society."

—Friedrich Blase, Director of Strategic Initiatives,
Holland & Knight

"I wish I had been able to access this book five years ago when I started moving my business from the 'old model' to pricing up front. For those accountants and lawyers out there seeking a 'how-to' on design and implementation of value pricing, this is the bible. This book should be required reading for any person who owns, runs, manages, or works in a professional knowledge business. What they do with it then comes down to courage. Be courageous and learn from Ron's experience. A brilliant read and seminal text."

—Matthew Tol, FCA, Principal, mta optima,
www.mtaoptima.com.au

"Every professional must read this book. Be brave and trust that Ron Baker knows what he's talking about. You'll find comfort in reading the amazing real-life examples of the innovators that took the leap. You'll want to slap yourself for not believing in change sooner!"

—Brandy Amidon, CPA, Brains On Fire,
Greenville, South Carolina

"Ron Baker is already regarded by most professionals who understand the impending implosion of a time billing business model as the pricing guru. In *Implementing Value Pricing*, Baker manages to further cement his reputation by comprehensively answering the 'elephant in the room' question of every professional firm looking to price on value—that is, how it is *actually* done. The book is a truly compelling read for any professional wishing to implement or improve a value pricing business model based on selling intellectual capital rather than time."

—Matthew Burgess, Partner, McCullough Robertson—
Lawyers, Brisbane, Australia

"Ron Baker does it again. Just when you think you have heard all there is about value pricing, Baker produces yet more challenges as well as solutions in this informative, well-researched, and at times humorous book on the practical implementation of pricing by value. How any leader of a professional firm could lead their business in the future without both reading this book and adopting many of Ron's practical concepts is beyond me."

—John Chisholm, former Managing Partner and CEO of law firms,
and now Principal John Chisholm Consulting,
www.chisconsult.com

To my mother and father, for genetically encoding me to challenge the conventional wisdom, and providing the most immeasurable of all blessings: their love and unwavering support in everything I do.

"At every crossway on the road that leads to the future each progressive spirit is opposed by a thousand men appointed to guard the past."

—Maurice Maeterlinck (1862–1949),
Belgian Nobel Laureate in literature, 1911

"It does not take a majority to prevail, but rather an irate, tireless minority keen on setting brushfires of freedom in the minds of men."

—Samuel Adams

Foreword

This book should come with a warning label: Reading this book may cause a Ron Baker Headache.

Now, before you put the book down, let me explain: I'm not talking about a headache in a bad, migraine-y kind of way. Think of it more like what you get when you have an ice cream on a hot day, or drink a milkshake too fast. When you read Ron Baker, and even more so when you talk with him about value pricing, you get a feeling that your head is going to explode because you suddenly have too many thoughts and ideas in it. In other words, it's a good kind of headache. A Ron Baker Headache.

I run a Boston law firm called Shepherd Law Group (shepherdlawgroup.com), which helps companies make easier workplaces. When employers get into situations where they need a lawyer, they often feel like they're losing control. My job as a lawyer is to help them get some of that control back. But the problem is that most of the time, dealing with lawyers makes the employers feel like they're losing even more control. This is because lawyers never tell them how much it's all going to cost, so the employers don't know what they're getting into.

The main cause of this problem is, of course, hourly billing. So when I founded my firm a dozen years ago, I started looking into how I could kill the billable hour and get rid of timesheets. I read everything I could find on the topic, which was of little use. There was no one I could consult to learn how to fix prices in an employment-litigation law firm.

And then I found Ron.

The first Ron Baker book I came across was *The Firm of the Future*, which he coauthored with Paul Dunn. And I promptly got my first Ron Baker Headache. In a good way. My head filled up with thoughts and ideas and questions. I was no longer alone in my quest to make a better law firm. I found someone who shared the ideas I had stumbled upon, but who then took them much further than I ever could.

I tore through Ron's other books (more headaches!), and then a few years ago, I had the opportunity to meet Ron. From that first conversation over dinner, through our many chats over the past couple of years, I've always felt, "Here is someone who just plain thinks differently." I've said it many times: Ron Baker is the smartest person I've ever spoken with, in any industry or walk of life.

How fortunate we are then that Ron has chosen to use that powerful intellect to make the world of professional firms a better place, both for professionals and for customers. And as you will see in this book, his intellect is completely accessible. Ron is equally comfortable quoting F. A. Hayek and Homer Simpson.

Thanks in no small part to Ron's wisdom, my law firm successfully abandoned hourly billing and the tyranny of timesheets. Our profit has risen dramatically as a direct result. But so too has our customers' value. As you will learn, hourly billing creates great waste and inefficiency. With value pricing, both professionals and customers win. This isn't just a theory; firms like mine are actually doing it. And trust me: it is better than the old business model that relegates professionals to merely "selling time."

When Ron asked me to write this foreword, he warned me that as a reader of his other works, I might not learn anything new in this book. As if. For example, I was reviewing Chapter 16 and got to the part where Ron reveals how hourly billing got its start in the legal profession almost a hundred years ago—in 1919. Suddenly I had a new weapon to use in my fight against the billable hour: that it was an antiquated, Industrial Age concept.

Ron and I have talked about the need for a business—a law firm, a CPA firm, a consultancy—to have a central purpose or belief to guide it: a reason why it exists. Ron's wisdom and insight helped me come up with my firm's "why," which is "to fix the practice of law through innovation." And what I learned in this book gave me the argument that a business model developed in 1919 is the opposite of innovation. I've already started using this concept in talking with clients.

As you will find in the pages that follow, Ron is a true thought leader. These days, so many lawyers are paying vague lip service to the concept of "alternative billing," it's refreshing to find someone who has actually thought through all this and proposed a better business model. But unlike so many thought leaders, Ron doesn't mind if you don't agree with him. All he cares is that you bring an open mind and be prepared to question your own assumptions. As he wrote in his seminal book *Pricing on Purpose*, "My goal is to have you think with me, not like me. ... Do not accept anything at face value, not even from an expert."

Ron Baker is the expert when it comes to pricing professional services. But don't just accept his wisdom from the pages that follow. Think about it. Of course, you'll get that Ron Baker Headache, but in a good way.

Jay Shepherd
clientrevolution.com
May 22, 2010
Boston, MA

Preface

People of the same trade seldom meet together, even for merriments and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.

—Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, 1776

One of my mentors is the late Peter Drucker, who always insisted on asking himself before writing any book, “Why this book, now?” It is a good question to ask oneself before setting out to write a book.

This book is a Declaration of Independence to my colleagues in all of the professions—to once and for all free ourselves from the tyranny of time. The “We sell time” business model I was taught as a young CPA is outdated, suboptimal, and driving the best and brightest out of the professions. We simply must find a better path to take us into the future.

Since 1995, I have been speaking to leaders in the professions around the world on the shift from “hourly billing” to value pricing, and if an observer from outside the profession were to attend, Adam Smith’s charge above would certainly seem true. In a sense, this book is about how to raise your prices. But it is emphatically not a conspiracy against the public. Indeed, the main message of this book is that the customer is the sole and ultimate arbiter of the value that we, as professionals, provide. Further, the customer, too, must earn a profit from the relationship with our firm. If we do not provide something of value to the customer from which they will profit, we have no business being in business.

This book is the culmination of a personal odyssey for me. In June 1989, I attended a four-day seminar titled “Increasing CPA Firm Profitability.” In the tranquil setting of Lake Tahoe, Nevada, I learned three major strategies on how to increase my CPA firm’s profitability:

1. Raise my hourly billing rate by at least \$10.
2. Grade my customers “A,” “B,” and “C,” and fire all the “Cs.”
3. Offer my customers “fixed fee agreements” on all services, with an appropriate “weasel clause” to cover any scope changes.

Inspired, I immediately shared all of these ideas, and more, with my new partner, Justin H. Barnett. We talked about becoming a “winning firm,” the term the instructor used throughout the seminar, which meant, by today’s vernacular, going from good to great. The course provided me with the tools I needed to put some of these ideas into practice immediately. In other words, it taught me *how* to do it.

What it did not teach me is *why* I should do it. It was all case studies and examples, but had absolutely no theory. So when I returned to my firm I had a hammer—the tool I needed to implement some of these new concepts—and I started furiously hitting things. I raised my hourly rate but did not simultaneously convince my customers that my value rose commensurately with that increase. I began grading my customers, and ridding the firm of the “Cs,” but it was not until I began researching the ideas behind Total Quality Service that I learned that *my customers were not going to get better until I did*. Without a solid theoretical foundation of *why* I was doing these things, I failed miserably.

This is one of the most glaring weaknesses in most business books and management ideas: They are all practice with no theory. Most do little else than propound platitudes and compose common sense into endless checklists and seven-step programs. Yet, all learning begins with theory. There is nothing as sterile as a fact not illuminated by a theory; we may as well read the telephone book.

Theories are powerful because they seek to do at least one of three things: explain, predict, or prescribe. Yet when one reads a typical business book today, the author will usually begin by saying something to the effect that “this book is not based on some ‘ivory tower,’ theoretical model, but based on practical, real-world experience and examples.”

Beware when you read such a qualifier, because as Dr. W. Edwards Deming used to say, “Without theory, experience has no meaning. No one has questions to ask. Hence without theory, there is no learning. Theory leads to prediction. Without prediction, experience and examples teach nothing” (Deming 1994: 103). In a business environment, whether we admit it or not, we are guided to a large degree by theoretical constructs that have evolved to simplify—and thus explain, predict, or control—our various behaviors. Theories build buildings and bridges, fly airplanes, and put men on the moon. There is nothing more practical than a good theory.

I have tried to avoid this defect by having the theories presented herein drive the ideas, not the other way around. Therefore, the book you are

about to read contains more theory than you may be used to if you are a regular reader of business books, or attend business seminars. I make no apologies for this, because there is nothing more practical than a good theory. I wish I had one back in 1989.

About This Book

As Herman Melville wrote in *Moby Dick*, “To produce a mighty book, you must choose a mighty theme.” There are three mighty themes that run throughout this book:

1. Changing the predominant business model of the professional firm from “We sell time” to the radical “We sell intellectual capital,” transforming them from *professional service firms* to *professional knowledge firms*. This is described as “radical” because *radical* is Latin for “getting back to the root.” The root in this case is customers buy *value*, not time, a truth the professions appear to have lost sight of since the adoption of the billable hour and timesheet regime.
2. Strategies to enable your firm to *create* more value by offering Total Quality Service, and developing a value proposition for which customers will gladly pay premium prices.
3. A specific eight-step model for implementing value pricing so your firm can *capture* a fair share of the value it creates from selling intellectual capital, not hours.

There are two types of readers this book addresses:

1. *Readers not at all familiar with any of my prior books.* This book offers a one-stop, comprehensive read to help you make the transition to becoming a firm of the future. As the three themes above are getting much publicity within the professions, new readers are being exposed to these ideas, some for the first time. My objective is not just to illustrate *how* to implement a business model change, create more value, and price to capture a fair share of it, but to persuade you on the importance of *why* to do it, because if you want to make incremental changes, work on practices and techniques. But if you want to make significant advancement, you must work on your theories and paradigms—the way you see the world.
2. *Readers who have read one or more of my prior books.* If you have previously read *Professional's Guide to Value Pricing* (editions 1 through 6), or *The Firm of the Future*, you will find much new “how to” implement material here. I would suggest jumping directly to

Part V, “Eight Steps to Implementing Value Pricing,” along with the Appendixes, for the specific tools and strategies that will assist you in making pricing on purpose a core competency in your firm. I would also encourage you to read the Appendixes outside of your profession since much pricing skill can be learned and applied from other sectors.

In addition, here is new material you will find throughout the book:

A discussion of business model innovation, which is what the firm of the future is all about (Chapters 2 and 36).

New research on the history of the billable hour and timesheets, introduced in 1919—earlier than originally believed—in law firms, inspired by Frederick Winslow Taylor’s Scientific Management religion (Chapter 16).

The foundations of creating value, Part II (Chapters 3–15) are somewhat duplicative if you have read *The Firm of the Future*, *Pricing on Purpose*, or *Professional’s Guide to Value Pricing*; though the astute reader will notice much new material. Though this added to the length of the book, I felt it necessary to include these chapters for new readers, because the only way to *capture* more value through value pricing is to *create* value in the first place through excellent customer service, and other principles of exceptional value creation.

Part IV (Chapters 18–26) deals with what, specifically, replaces hourly billing and timesheets—including a case study from a firm that has made the transition—and a chapter is included to discuss each replacement in either Part IV or Part V.

Part V contains a new eight-step model to assist firms in implementing value pricing. One major addition is the inclusion of project management written by VeraSage Institute Senior Fellow, and project management expert, Ed Kless. A new chapter also contains two frameworks for scoping complex engagements, such as litigation, IT installations, and other engagements where the scope is very difficult to define upfront. Developing different options to offer the customer is also presented.

Throughout the book there are several case studies from firms that have implemented the specific ideas and the consequences of doing so.

As with all of my prior books, an extensive bibliography is included to make it easier for those who wish to find the original source discussed in the book, and further their knowledge.

About the Web Site

There are seven Appendixes available for download as a companion to the book, available at www.wiley.com/go/valuepricing (password: baker).

The Appendixes include a summary checklist containing strategies firm leaders need to discuss and implement; strategies with respect to Request for Proposals (RFPs); an Appendix for each of the professional sectors—advertising agencies, CPA, IT, and law firms—containing specific issues, case studies, and checklists for each.

I would encourage you to read the Appendixes outside of your profession, since much pricing skill can be learned and applied from other professional sectors.

An extensive Suggested Reading list, sorted by topic and alphabetized by author, is also included.

About the Words Used in This Book

Words have meaning, and as Werner Erhard wrote, “All transformation is linguistic. If we want to change our culture, we need to change our conversation.”

Throughout this book, I use the word *customer*, *price*, *invoice*, and *team member* in lieu of, respectively, *client*, *fee*, *bill*, and *staff* (except when quoting from other sources). I do this because I believe these words convey better images and evoke more positive emotions of what they are attempting to describe. According to my dictionary, “among the ancient Romans a *client* was a citizen who placed himself under the protection of a patrician, who was called his patron; a master who had freed his slave, and retained some rights over him after his emancipation; a dependent; one under the protection or patronage of another.” Are these the type of images we want to invoke? The welfare state has *clients*, while businesses have *customers*. A *fee* is negatively associated with a tax or some other charge, while *price* is a benign term most customers easily comprehend, eliciting no positive or negative emotions.

Value billing is not used because billing takes place in arrears, after the work has been done, whereas pricing takes place up front, before the work is begun.

It is not my objective to change your vocabulary, though I hope you will seriously consider your choice of words. I am simply far more comfortable using words that elicit superior images in other's minds. Action is released by emotion, and emotion is stirred largely based on the words we use.

The professions are a noble calling and the predominant method of pricing for the services they provide is not worthy of professionals. There is a better way.

My odyssey has been an incredibly circuitous route, proving that sometimes you have to go a long way out of the way to come a short way

correctly. Author and educator William Arthur Ward wrote, “The great teacher tells. The good teacher explains. The superior teacher demonstrates. The great teacher inspires.”

If I can shorten your path by sharing my learning—and that of many others who have traveled to a new destination—while inspiring you to life-long learning, this book will have accomplished its purpose.

Ronald J. Baker
Petaluma, California
October 12, 2010

Acknowledgments

Someone once wrote that acknowledgments are the equivalent of tipping, but with Monopoly money. I hope those mentioned herein forgive my frugality—but I give my deepest and profound thanks to the following individuals.

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George Gilder is the most profound thinker I have ever encountered, and his insights of how an economy creates wealth permeate this book. Every century needs an Adam Smith, and Gilder is ours for the twentieth and twenty-first.

The late Peter Drucker deserves special thanks for always focusing on doing the right things, why an organization exists, and knowledge workers, all the while teaching me that business is really a branch of the humanities because you have to deal with real people, not efficient machines.

My mentor Reed Holden continues to teach me pricing skills, and much else. Thank you, Reed, for always supporting my work.

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Sarah Armstrong of Coca-Cola was kind enough to give me an individual tutorial on the Coca-Cola Value-Based Compensation model, which is an outstanding step in the direction of focusing both agency and advertiser on the right things.

Richard DelCore of Procter & Gamble has also innovated an agency compensation model that deserves to be replicated. Rich's constant challenges and penetrating questions have helped us refine our ideas to better serve agencies and advertisers.

William Cobb, father of the beloved Value Curve, has been kind enough to grant me permission to use his curve for over a decade. He is one of the few consultants to the legal profession who truly "gets it." Thanks Bill.

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VeraSage Institute has created quite an active—and vocal—community of mavericks and trailblazers. Their comments, support, and even disagreements over the years have helped me present these ideas—hopefully—more effectively.

I would especially like to thank all of those knowledge workers who were kind enough to provide case studies and unselfishly share their experiences in these pages. In order of appearance: Karen Smart, David Littlefield, Brandy Amidon and Robbin Phillips, Matthew Tol, Kurt Siemers, Brent Uken, John Shaver, Brett Kreykes, Mark Chinn, and Jay Shepherd.

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John Chisholm has been courageously carrying on the crusade in Australia ever since he met our late friend Paul O'Byrne. Any progress in killing the billable hour Down Under is due to this fearless attorney. Better yet, *in vino veritas*—"after a bit of the grape, people tend to reveal themselves," and the revelations have been wonderful. Thanks for everything John.

Self-taught philosopher Eric Hoffer wrote, "There are no chaste minds. Minds copulate whenever they meet." Nowhere is this more true than with my friends and colleagues at VeraSage Institute, who are often accused with being part of a religion. But "veracity"—the first word that makes up VeraSage, the second being "sagacity"—differs from the word "truth."