



Why 20 plus 20 equals 50

By Colin Dunn

Average hourly rate recovered is a key measure of profitability in a professional services firm. Irrespective of whether you price in arrears based on time x rate, or you price every job up front based on value, your scarce resource is available client hours. Traditionally much focus has been placed on maximising productivity. Naturally, it's important to keep volume up but there is only so much blood you can squeeze out of a stone. So it makes sense to implement strategies to lift yield, measured by average hourly rate recovered.

I speak with partners in accounting firms every day and I often ask the question "what would happen if you increased your prices by 20%?" The answer is invariably "not much" – as in, there would be little in the way of client attrition. Those firms who then go ahead and implement a 20% price rise find that in the majority of cases, their initial answer was right on the money. If any clients are lost, they tend to be the lower end, price conscious ones and such an outcome is usually viewed as positive rather than negative.

Another question I challenge accountants to answer is "how can you increase your average hourly rate by 50%?" Interestingly, this question causes more consternation than the previous one and I have concluded that this is because the question they are HEARING is "why don't you put your prices up by 50%?" Re-read the original question – there is a real difference between hiking prices by 50% and raising average hourly rate by 50%.

Pricing is only half the story. An effective pricing strategy combined with a focus on efficiencies is where you will find the dramatic increases in average hourly rate. And it is through pricing jobs up front that you will find the key to gaining that focus in both areas. Let me give you a simple example.

Let's assume that you have a client for whom you do the tax compliance work. And let's say that this year, you billed that client in arrears based on time charged to WIP, and that the bill was \$4,200. Your WIP records show that 35 hours were taken in total to complete the job. This gives an average hourly rate recovered of \$120 on this particular job.

How do we move to pricing this job up front for next year's compliance work? Here's a script that has worked well with some firms we have worked with:

"John and Mary, we have been thinking about the relationship you have with our firm and it occurred to me that as a valued client, you might be interested in a new way of pricing our services that we have offered to several new clients of our firm in the past few months. The reason I am raising this with you is that the new clients have loved this new process and I thought it my duty to run it by you.

"What we've been doing with our new clients is providing them with a fixed fee up front for every project they ask us to work on during the course of the year. So, for example, we give a fixed fee for the compliance work before we start that work. Then, if we are asked to do a cash flow forecast later in the year, we give another fixed fee in advance. Then the same for tax planning if we're asked to do that work. It's a simple process where we provide you with a fee and ask you to sign off on that fee then we'll start the work. The reason our new clients like it so much is that it reverses the risk so that you always know how much to plan for in respect of our fees. Under this new arrangement,

we're motivated to finish your work as quickly as possible. We've come to realise that under the time based billing in arrears model, we make more money the more inefficient we are – and that can't be right.

“Another benefit to you as the client is that when you move to the new pricing arrangement, you have access to us at any time if you have any questions or want to bounce any ideas off us. The reason we're doing that is that we want to encourage you to call us; time based billing actually DISCOURAGES you from calling us. And that's crazy. Our goal is to strengthen the relationship we have with you, not put barriers between it.

“Now, of course, you can choose to keep things as they are if you're happy with the existing arrangements, or if you'd like to transition to the pricing up front model, we can organise that for you right away. Which option would work best for you?”

This simple dialogue, which will take you less than a minute to deliver, does three things:

1. It focuses the client on the value you deliver on a project by project basis and sends a subliminal message that if they want more, they pay more
2. It lets the client know you are serious about building a trusting relationship
3. It negates the risk of disenfranchising the client – if they are concerned about the change in any way they have an 'out clause'.

If the client agrees to move to up front pricing, you must increase the fee over and above what it was last year. There are two compelling reasons to do that: firstly, you have assumed the risk from the client and as such, you can justify an increase in your price; and secondly, you're offering a hugely valuable service (on call and open access to you) as part of the arrangement. This differentiates the new offering from the previous one and lifts the value to the client significantly. (Incidentally, if you're worried you'll be flooded with phone calls from clients taking advantage of this new arrangement, the reality is that this does not happen. Some clients call weekly, others not at all. But why would we worry about our clients calling us anyway?)

The title of this article is “Why 20 plus 20 equals 50”. We have covered the first 20 (the price increase). The second 20 concerns efficiency gains that come from being really focused on an internal hourly budget once we have set the price in advance. So in the example cited earlier of the \$4,200 compliance job that took 35 hours this year, we should be aiming for the following scenario for next year:

- Minimum price agreed up front with client: \$5,040 (20% increase)
- Maximum hours taken to do the job: 28 (20% decrease)
- Average hourly rate: \$180 (50% increase)

If you're thinking it's impossible to do a job that took 35 hours last year in 28 hours, experience suggests otherwise. In fact, we find in real life that efficiency gains in the order of 25 – 30% are not uncommon when focus is placed on workflow management and standardised systems to complete the job within the hourly budget.

Mathematically, it is a fact that with a 20% price increase and 20% efficiency gains in terms of hours taken, your average hourly rate on the job will increase by 50% in every case.

What is happening here is a subtle, yet important shift. You have moved from cost driving price to price driving cost. I see this as an interim step to true value pricing and it is a huge improvement on

pricing in arrears based on time taken because at least you have gained agreement from the client as to the PRICE of the job before you start. It's important to acknowledge, however, that this price will not, in many cases, represent the true value of the project – but that is for a later article.

Action required: pick five friendly clients, use the script provided and test out the theory for yourself. With every client you move to pricing up front, you're slowly pulling yourself out of the mire of time based billing AND forcing yourself to focus more on delivering value and operating efficiently – and when you consistently do both of those things, your average hourly rate will increase, along with your revenue and profit.

End note: Colin Dunn is a director of ReNew Group Pty Ltd, based in Queensland. ReNew Group helps professional service firms market and promote their services. We do that by helping you to identify what your clients need, develop a range of services to address those needs and then build strong relationships with clients to help clients acknowledge their needs and engage the firm to assist.

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