8 ESSENTIAL FEATURES OF LAW FIRM PRICING MODELS

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IMPORTANT FEATURES OF A PRICING MODEL

1. **An estimated hours distribution** (by timekeeper type for a typical case);
2. **A frequency component** that allows the testing of several assumptions;
3. **Historical data** (for comparison to assumptions);
4. **Volume assumptions**;
5. **Capacity analysis**;
6. **Payroll and overhead cost per hour**;
7. **Contributions to overhead and profit**; and
8. **Before and after rate comparisons** including a rate uplift feature.

BUILDING A NON HOURLY BILLING PROPOSAL

1. ESTIMATED HOURS DISTRIBUTION

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	TASKS, HOURS ASSUMPTIONS AND FREQUENCY								
	Partner	Associate	LA PL	Total	Occurrence %	Partner	Associate	LA PL	Total
Tasks	Hours					Hours			
				-	100%	-	-	-	-
				-	75%	-	-	-	-
				-	70%	-	-	-	-
				-	60%	-	-	-	-
				-	75%	-	-	-	-
				-	100%	-	-	-	-
				-	80%	-	-	-	-
				-	35%	-	-	-	-
				-	30%	-	-	-	-
				-	25%	-	-	-	-
				-	25%	-	-	-	-

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2. FREQUENCY COMPONENT

Factoring risk into the pricing model

- Estimate of how often an event is likely to occur
- Attempts to factor risk into the pricing model
- Setting prices to maximum exposure will typically result in a non competitive offer
- Setting prices to the minimum will typically result in profit losses
- Goal is assess an appropriate level of risk and price in that range

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3. HISTORICAL DATA

Using real case data to test assumptions

- Experienced firms have an advantage
- Clients can provide data (is typically limited)
- Non competitor peers and colleagues can provide data
- Simulated or assumed data is the least reliable

4. VOLUME ASSUMPTIONS

- **Developing a profitable pricing strategy requires a true comprehension of the impact of volume at an indicated price point.**
  - Volume can temporarily reduce cost per hour
  - Continued volume increases can lead to rising costs and declining profits
  - Too little volume can lead to increased costs per hour and decreased profits.

5. CAPACITY ANALYSIS

Available capacity and pricing

- Excess capacity and pricing
  - May trigger more aggressive higher risk pricing
- Limited capacity and pricing
  - May trigger less aggressive lower risk pricing

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5. SAMPLE CAPACITY ANALYSIS

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SIMPLE CAPACITY ANALYSIS				
			AVAILABLE CAPACITY	
Partners	**Planned**	**Committed**	**Available**	**Monthly**
Partner 1	1,600	1,500	100	8
Partner 2	1,750	1,400	350	29
Sub-total	**3,350**	**2,900**	**450**	**38**
Associates				
Associate 1	2,000	1,800	200	17
Associate 2	2,000	1,900	100	8
Associate 3	2,000	1,700	300	25
Associate 4	2,000	1,600	400	33
Sub-total	**8,000**	**5,400**	**600**	**50**
Legal Assistant PL				
LA 1	1,600	1,600	-	-
LA 2	1,600	750	850	71
Sub-total	**3,200**	**2,350**	**850**	**71**
Report Total	**14,550**	**10,650**	**1,900**	**158**

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6. PAYROLL AND OVERHEAD COST PER HOUR

Payroll and cost per hour considerations

- Test the impact of assumed volumes on payroll and overhead CPH
- Recognize the burden of efficiency falls on the firm
- Smart clients will compare the ultimate cost of hourly and non hourly pricing
- Bid too high and you may still win initially and lose it all later
- Firms with efficient cost structures are better suited to non hourly pricing

7. CONTRIBUTIONS TO OVERHEAD AND PROFIT

Identify the direct costs separately

- Calculate the threshold contribution to overhead and profit
- Only covering direct costs leads to disaster
- Overhead allocation is essential and not optional
- Tying available capacity with unprofitable work can transform a practice for the worse

8. BEFORE AND AFTER RATE COMPARISON AND RATE UPLIFT

- Pricing models should include a rate uplift feature
- Helps reverse engineer a process to achieve targeted revenue
    - For example, setting a target rate or using a market rate to determine profitability at certain levels
- Using revenue constraints to find cost efficiencies

SAMPLE PRICING MODEL – BASIC

- Capacity Analysis
- Frequency Analysis
- Cost and Profit

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TAKEAWAYS

1. Important to pricing process: Accounting, Finance, Economics, Marketing, and Seasoned Judgment
2. A well-built pricing model can provide opportunities to secure work.
3. Create a pricing template for your firm. Hire help if needed.
4. ***Close enough* may work in a game of horseshoes. Missing the mark by 5% – 10% in a pricing decision can cause your firm to lose out on bids. Or worse, it can win the bid, along with a big loss for your firm.**