

Closing the Deal without Discounting: Value-Pricing Strategies for Professional Services Solutions

Abstract

In a difficult market, sales of professional services slow down like anything else. There are some techniques to generate sales and even increase margins. Now, more than ever, clients need professional services to ensure that their initiatives deliver the expected value. This White Paper examines some alternative strategies in pricing and structuring deals for professional services.



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Introduction

Ever hear this from a client?

"I love your solution, but I can't get the capital approved right now"

Or "I love your solution, but my budget was just cut and I can't afford to move forward right now"

Does your sales rep ever tell you?

"If we could just cut the price by 10% I could close this deal"

Or "I need to give them some consulting to help them justify moving forward"

In today's economic environment, it is increasingly difficult to convince clients to move forward with a solution and yet maintain acceptable margins. Traditional pricing structures such as cost plus time and expense, cost plus fixed price, services as a percent of product price, or price to match competitive pricing are in many cases not enabling you to get the order and when you do get the order causing you to leave money on the table. But alas, there's hope. There are alternative pricing strategies that not only make it easier for your client to give you an order but they can also improve your gross margins.

Current Client Environment

There are many factors influencing your client's desire and ability to place an order with you. Many clients either have been burned personally or have at least heard the horror stories about large IT initiatives that were late, over budget, and failed to deliver the promised value. Add to this the overall sluggishness of the economy, and you end up with a challenging sale for professional services. There are five major trends impacting IT spending today. Most of your client's will be experiencing some if not all of these issues:

- ❖ Shrinking capital budgets
- ❖ Shrinking expense budgets
- ❖ Need to forecast ROI to receive funding
- ❖ Increasing accountability for results (delivered ROI)
- ❖ Shorter expectations on project payback (from 1-3 years to 9-12 months)
- ❖ Aversion to or even mandate against large initiatives

In this environment, you may need to be more creative on pricing and deal. Value-Pricing can play an important role in gaining the order.

What is Value-Pricing?

To sell on value is to price your product or service based on the value it brings to the customer. Your price is no longer determined based on your cost plus a margin. In *Competing on Value*, Mac Hanan wrote, "a customer who knows your value will have no trouble affording it because he knows that it represents a good investment. He will always get more back than he pays out. As a matter of fact, he will not think in terms of affording your value. He will not be able to afford doing without it."

When we formally present our value to our clients, we call that a value proposition or business case.

Environment to Achieve Value-Pricing

In order to achieve Value-Pricing, a few environmental and cultural criteria should exist within your company. Ideally your sales force will be selling to or have the ability to get to the economic buyer at your client. It is difficult if not impossible to sell value to a technical buyer or purchasing agent. Your company would have a tolerance for taking risk, since not all deals will deliver acceptable margins. Value-Pricing is predicated on having a sales force trained and capable of identifying and selling value and consultants involved in the selling process. You need to have a level of mutual trust with your client whenever you enter into any results

based contract. You also need to have strong project/program management skills within your Professional Services organization to manage the risk.

Value-Sharing

Value sharing is sometimes called gain sharing. Value pricing shares in the reward of a project. Value sharing also shares in the risk of the project. Managed correctly, there is opportunity for far greater margins with value sharing.

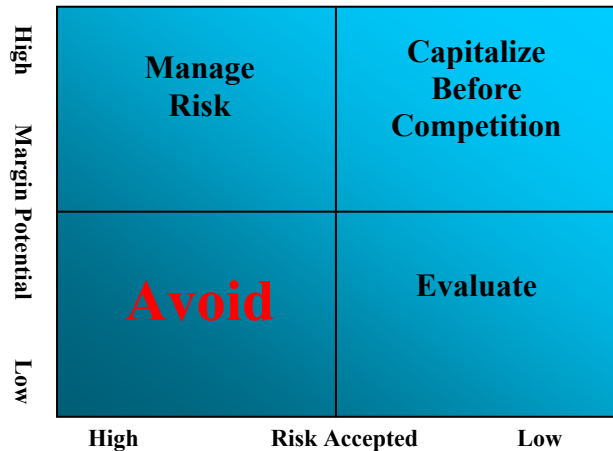
A common trap that people fall into when moving towards Value-Pricing, is accepting more risk without tying that risk to higher return. Whenever you believe that there is potential to enter into any type of a gain sharing or results-based contract, you shouldn't discuss price until after determining the metrics and business value.

Value-Pricing should give you the opportunity to improve your margins by sharing in the value you are delivering to your client. Keep in mind that lowering your price with the hopes of only getting back to your original price by delivering value is NOT Value-Pricing. It's discounting!

Figure 1 - Risk and Margin

The Relationship between Risk and Margin

High Risk – Low Margin: Obviously, you should always avoid situations where you are accepting more risk with low margin potential. A common pricing scenario that falls into this quadrant is Time and Expense not-to-exceed. Even though in theory the client is paying purely time with no expectation of deliverables, in reality the client typically expects a deliverable within the allotted time. If that expectation isn't met within the not-to-exceed limit, you have three choices: negotiate for more money – which can work sometimes if you have a good relationship with the client, walk away – which will leave an upset past client, or finish the job at your cost – which means you lose money. There is rarely a win-win in this type of contract.



Low Risk – Low Margin: If you find an engagement or a set of offerings in this quadrant, you need to evaluate if you should continue or exit this business. There may be a very good reason to take the order or continue with the offerings, but it typically isn't the margin you're making. True time and expense contracts quite often fall in this quadrant since typically hourly rates will eventually be turned into a commodity by competition.

Low Risk – High Margin: Whenever you find yourself here, you will want to capitalize on the opportunity as quickly as possible. Unless there are high barriers to entry in your market, competitors will soon see the potential return and enter your market thus your margins will likely erode over time.

High Risk – High Margin: The most likely scenario to maintain high margins is to accept more risk. In order to achieve those higher margins though, you need to manage your risk. This requires strong project/program management. If project/program management is not currently a core competency, you need to invest in it before going down the path of accepting more risk.

How can you Structure Deals to Leverage both Value-Pricing and Value-Sharing?

In order to close a deal, you need to structure the deal in a way that your client can buy. This sometimes requires a non-traditional deal structure and/or alternative pricing.

There are a few simple principles to keep in mind when pricing and setting up the deal structure of your Solution.

Premium: avoid using hourly and/or daily pricing which will eventually commoditize your service

Align: define your success criteria based on your client's business goals

Value: tie your price as closely as possible to the value delivered to your client

Enable: structure the deal based on how your client wants to (or can) buy

. . . PAVE Your Way to Better Margins

Keeping PAVE in mind, outlined below are some possible deal structures. A table at the end of this document that summarizes some of the pros and cons of each alternative and when it might be appropriate to use it based on the situation.

Bundling

One way to increase your operating earnings, but not necessarily your gross margin, is to bundle some services with product sales. This strategy can improve earnings by increasing your company's average sale price (ASP) without significantly changing the selling cost. This is one of the easiest pricing strategies to implement with a product based sales force and gets your foot in the door to sell other services. The downside is that you typically need to discount the bundle and there are no fixed deliverables. You need to manage the customer's expectations to understand that they bought a finite quantity of consulting to support their implementation, nothing more.

Pilot with Contracted Rollout

You can offer this when you encounter a client that is either concerned about a large-scale solution or isn't convinced of the value of your solution. You sell the client on a pilot of your solution with some conditions. Ideally, the client pays for the pilot, but you may choose to reduce the price or even deliver the pilot at no charge. The contract for the pilot outlines a set of performance metrics. When your solution delivers at or above the performance metrics, the pilot conditions commit the client to either begin a rollout of the solution or pay a higher price for the pilot.

Managed Services

Managed Services is sometimes called a subscription. It allows your client to use the system that you are delivering, typically without a capital acquisition. In essence, you deliver the solution to your client and charge a monthly fee based on delivering a guaranteed service level on the solution. The contract is typically based on a guaranteed service level (a Service Level Agreement or SLA) that you will provide. These are typically longer-term contracts (three to five years) and the system could reside either on the client's site or on your site depending on the application and requirements. In order to achieve economies of scale in these types of arrangements you will need to have multiple contracts. There are significant advantages to both sides in this type of arrangement. A couple of primary advantages for you are a guaranteed annuity stream and the ability to sell-up by basically being embedded in the client's operation.

Pay-by-the-Drink

This is a derivative of a Managed Services contract. Rather than the client paying a flat monthly fee for a guaranteed service level, the client pays a fee based on either a usage metric, such as transactions or users, or a business performance metric, such as number of widgets produced using the system.

Base Price plus Performance Incentives

This is quite often the most attractive deal structure and easiest to implement for both sides. Your initial price for the system is lower than you would typically charge (balanced with upside potential). Once the system is delivered, there are incentive payments. Ideally, the incentive payments should be based on business performance metrics, but they could be based on deliverables or system performance metrics. The total price, including all of the incentive payments should be significantly higher than your typical fixed price for a similar solution since you assumed the risk of accepting the lower price if the performance metrics were not met. One strong advantage to this structure is that both organizations are in perfect alignment and pulling for

the same performance improvement. Another advantage from the client's perspective is that there is a cap to the amount that they will pay for the system if it significantly outperforms their expectations.

Pure Results Based

Rarely will a client sign up for a Pure Results Based deal structure. These deals typically have very high or even unlimited upside potential for the vendor, and the deal will typically need to be approved at a very high level (even the board in some cases). Even though it is unlikely that you will close a deal that is purely results based, it is an excellent way to demonstrate to the client how firmly you believe in your solution and its ability to deliver value. Quite often, a deal that starts down the path of being pure results based, will end up in one of the other structures (Base Price plus Performance Incentives for example). Even if it ends up as a fixed price, typically the price is no longer an issue, and you can end up with a better margin than initially going in with a fixed price.

Structure	Pro's	Con's	Obstacles/Objections Overcome
Bundling	Ensure selling service with product Easy to sell Easy to buy Foot in door to sell other offerings	Typically need to discount Not selling a solution No defined deliverables	Don't buy services from vendor
Pilot with contracted roll-out	Easier to buy Guaranteed margin if performance metrics met	Low/no margin on pilot Must trust that client will move forward with roll-out	Concern over value of solution Concern over big bang
Managed Services	Higher potential value Aligns priorities Embedded in client's operation Guaranteed annuity	Higher risk Dependent on client's market conditions	Shrinking capital budget Move towards outsourcing No competency to manage the system
Pay by the Drink	Higher potential value Aligns priorities Guaranteed annuity	Higher risk Dependent on client's market conditions Dependent on client's institutionalized use of the system	Shrinking capital budget Shrinking expense budget Move towards outsourcing
Base price plus performance incentives	Easier to close deal Puts skin in the game Aligns your goals with client's goals Gives upside to normal margin	Higher risk	Shrinking expense budget Concern over value delivered
Pure Results based	Highest potential value Easier to convince client of commitment Aligns your goals with client's goals Enables selling another value pricing scenario	Difficult to close deal Highest risk	Shrinking expense budget Concern over value delivered

Conclusion

In order to close the deal, you must first understand your client's environment. You can then PAVE your way to higher margins through Premium pricing, Alignment of goals, Value-Pricing, and Enabling your client to buy through an appropriate deal structure.

It is possible to close deals and maintain or even grow margins in today's economic environment. All it takes is knowledge of how your client can buy and some creativity in how you structure the deal. It is best to evaluate your offerings and determine the best deal structures to use for each one and then pilot one at some target accounts.

About the Author

Darrin W. Fleming is a Principal of FutureSight Consulting leading the Professional Services consulting practice. His years of managing consulting and professional services organizations allow him to bring a wide range of experiences and insights to organizations, particularly where complicated software products require a comprehensive turnkey solution, including the related professional services. Mr. Fleming has developed proven approaches for analyzing the environment, developing professional services strategies, developing offerings, developing an appropriate Go-To-Market strategy for the offerings, and enabling an effective execution of the strategy.

Prior to joining FutureSight Consulting, Mr. Fleming was Principal Practice Leader at a Fortune 500 leading global industrial automation company, where he created a global manufacturing consulting and systems implementation practice. He established the strategy, methodologies and service offerings, recruited and developed the consulting team, and managed the global consulting practice. In this role, he led the business to achieve over \$10M of sales and 20% quarterly linear growth in its second year. His team's consulting engagements created additional orders for other services and products at a 5:1 ratio.

Mr. Fleming attended the MBA program at the University of Oregon where he focused on Marketing and Organizational Development. He is currently based in Cleveland, Ohio with his wife Nikki, daughter Amanda, sons Connor and Spencer.

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Let FutureSight Help You Improve your Selling Price

FutureSight Consulting has the following range of services to help your organization price your solutions to get the maximum value:

<i>Solution Pricing Workshop</i>	Bring key stakeholders in the pricing decision (such as sales, marketing, finance, legal, product management) together to identify opportunities for improvement in current pricing practices
<i>Current Pricing Assessment</i>	Assess your current pricing practices and identify opportunities to improve your gross margins by modifying and/or changing your practices
<i>ROI Scenario Modeling / Calculator Tools</i>	Enable your consultants and sales reps to have an intelligent business conversation with economic buyers, and develop pricing scenarios that are based on the potential financial returns of the solution being proposed.
<i>ROI Case Studies & Benchmarking Data Research</i>	Discover the specific, tangible and intangible benefits your solution brings a customer organization, and validate this data with industry standard benchmarks in order to more effectively price your solutions.
<i>Professional Services Value Sales Training</i>	Train the sales team(s) selling your solutions to identify opportunities to leverage alternative pricing scenarios and sell the value.
<i>Audit Solution Results</i>	Independent third-party validation of the financial results delivered by your solution that can be used as proof for a case study and/or payment if tied to value delivered.

About FutureSight Consulting

FutureSight Consulting is a boutique consulting firm specializing in marketing and professional services consulting for high-tech clients desiring break-through revenue growth. We apply our industry expertise, research, facilitation and execution capabilities to corporate-wide, sales and marketing and solution delivery initiatives. Clients value our proven abilities to quickly turn strategies into action for greater revenue growth.

For more information regarding FutureSight Consulting's Professional Services Strategy practice, or any of FutureSight Consulting's services, please email PS@FutureSightConsulting.com, visit us at <http://www.FutureSightConsulting.com> or call us at 206-686-5800.



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