Strategically pricing accounting services: Should you use value-based pricing or fixed fees?

WHITE PAPER

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Thanks to greater automation and integration in technology, today's firms are working faster and more efficiently. That's great for your staff and clients, but not so great for revenues if you are practicing hourly billing. For firms billing by the hour, this means fewer billable hours and, ultimately, erosion of your firm's profitability.

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When was the last time you took a good, hard look at how you're pricing accounting services? Many clients are now demanding upfront pricing, using that information to shop for the lowest fees, identify which firms offer more for the dollar, and weed out the compliance-focused providers from the value-added advisors.

Changing client demands, advancements in technology, and increased competition are giving rise to a new normal in pricing methods within the profession. Firms looking to remain competitive and relevant must rethink how to price accounting services.

Accounting firms have long embraced hourly billing. A growing number of firms, however, are bidding adieu to the status quo, as evidenced in the AICPA PCPS/CPA.com National MAP Survey, which reflects declining use of hourly pricing across firms of all sizes.

There are several factors driving this shift. For starters, client demands are evolving. To remain competitive, a growing number of firms are moving away from compliance-based services in favor of more value-added advisory and consulting services. To be accurately compensated for the added value they are providing clients, many firms are re-examining their pricing models.

Then there are advancements in technology. Thanks to greater automation and integration in technology, today's firms are working faster and more efficiently. That's great for your staff and clients, but not so great for revenues if you are practicing hourly billing. For firms billing by the hour, this means fewer billable hours and, ultimately, erosion of your firm's profitability.

Then there's staff recruitment and retention. Staffing is a top issue among many firms, but embracing a new pricing model, such as value pricing, can help firms attract and retain top talent. Freeing staff from tracking time — and the stress associated with it — enables them to work more constructively and focus on delivering higher value work. That is an attractive recruitment and retention tool in a competitive job market.

Clearly, new ways of thinking, revamped business practices, and innovations in technology are fueling changes in pricing protocols. For many firms, the question then becomes how do we bill and how much do we charge for accounting services? Change isn't easy, and breaking from the norm (in this case, hourly billing) can be unnerving.

To help you better understand the pricing model that's best for your firm, this white paper explores value pricing and other accounting firm pricing models.

Pricing accounting services: getting started

Value pricing and fixed pricing are starting to become the norm for many accounting firms, but not all firms have recognized the benefits of these kinds of pricing structures. Creating a strategy for pricing accounting services starts with a philosophy of value that must be absorbed throughout your firm. Before you sit down with your partners to determine how much to charge for accounting services — and when to bill them — think through the basics of invoicing and billing and how you want your firm to operationalize the financial aspect of engagements. Let's review the fundamentals as a starting point.

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What is pricing?

Pricing is always defined before any work begins. Structured pricing is still a shift in progress within the profession. Most firms continue to start the work first, then figure out the price and send a bill later. Pricing accounting services involves identifying your firm's costs, analyzing market value, and setting a price for each type of service. Often, pricing is based on time spent. Accurate and consistent pricing is pivotal in establishing value-based pricing fees, fixed-fee pricing rates, and CPA hourly rates.

What is billing?

Billing is done after work has been completed and is usually based on an hourly rate by service and/or role. Billing invoices show the fees and rates charged for all services performed during a specific time period (often a month) or for a specifically contracted project. It's important to note that "billing" and "pricing" are not interchangeable terms — they are completely different things.

What is scope?

For many firms, not having a defined scope of work is the biggest problem when it comes to pricing accounting services — as well as managing client relationships. The first thing you need to do with a client is educate them on what's included and what's not included in their engagement, before you begin the work. Without a defined scope, you may end up doing more work than the client is willing to pay for. You have to scope the work out in advance and make sure your client agrees with what will be included and what will cost extra. Scope is important regardless of which pricing structure you employ: value-based pricing, fixed-fee pricing, or hourly billing.

How does value pricing work?

With value pricing, you assign a value (price) based on the client, not the package of services. Value pricing varies from client to client because it is based on what the client values most (and what they are willing to pay for that value). Value is subjective. Some clients may value a consultative brainstorm every month more than bookkeeping services. They would therefore pay more for your accounting advisory consulting on a recurring, monthly or quarterly basis. Scope has to be well defined for value pricing to be well received, but value pricing can result in higher margins and happier clients. We go into more detail about value pricing below.

How does fixed-fee pricing work?

Fixed-fee pricing is a set price that occurs before work begins (it is a form of pricing, as defined above) and applies to all clients across the board. The fixed fees can serve as a menu of sorts — your clients review your service offerings and each of their fixed fees, and choose which services they want. Fixed-fee structures can simplify pricing and billing, but don't offer the same margins that value-based pricing does. Frequently, accounting firms start with cost-based pricing to calculate fixed-fee pricing. We discuss more about fixed-fee pricing below.

How does hourly billing work?

Because it is a form of "billing" as defined above, hourly billing occurs after the work has been done. The bill, or invoice, is determined by totaling hours for certain services performed and multiplying them by the hourly rates assigned to them. Hourly billing is the traditional model used to calculate accounting firm fees, but is beginning to phase out in favor of fixed-fee billing and value-based pricing.

Now that we've defined the fundamentals, let's take a closer look at value-based pricing versus fixed-fee pricing to help you determine how you want to structure fees for accounting services.

What is value-based pricing?

A far cry from just a buzzword, value-based pricing has become the pricing model of choice for a growing number of firms. And for good reason.

What is value pricing? Under this pricing model, the price is established before the works begins and firms charge for the client's perceived value of a service. In other words, it's the value that determines your price.

This enables your firm to drive profitability because you can demand a higher price for your expertise. And once clients fully understand the value of your knowledge and business offerings, most will agree to pay a premium price.

"To me, the idea of value pricing is that someone is buying a relationship, not a transaction," said Paul Miller, president of Business by Design in Edina, Minnesota.

For firms providing value-added advisory and consulting services, as well as firms specializing in a specific vertical or niche, value-based pricing is an ideal fit. Value-based pricing enables firms to achieve attractive profit margins and to be appropriately compensated for the knowledge and expertise they are delivering.

"Value pricing allows you to use your own body of work and experience to predict the future for your clients. You come to me with a problem and I can predict the path you're currently on, and I can also predict a different path, a different outcome," said Miller. "To me, value pricing enables you to have the time to anticipate not just the next question, but also the next two or three questions coming up."

Figuring out your value-pricing strategy

When it comes to setting your fees, value your knowledge at different price depths or tiers. Consider: What type of advisory services are you delivering? What type of value does it bring to the client? Here's how these tiers and your value pricing strategy might look:

TIER 1: If the service being delivered brings a direct bottom-line benefit, you can charge the greatest percentage of value for your fee. For example, if it takes you 15 minutes to identify $200,000 in tax savings for a client, are you going to charge the client for those 15 minutes? No, you will price based on the value you delivered. That's a valuable direct benefit for the client.

TIER 2: Services that have an indirect movement to the bottom line will have a lesser percentage of price to value. For example, your firm helps a client to gain business efficiencies, which means they have more time to spend on generating sales. However, if that business client doesn't do their part and actually dedicate that extra time to make more sales, then your service has had less of an impact.

TIER 3: Services that deliver a protective benefit of sorts may have the smallest percentage of value to price. For example, your firm delivers a service to a client that makes them less susceptible to fraud or negative audit findings.

"When it comes to value pricing, you have to charge an amount for what you're worth, separate from doing the task, separate from completing the transaction," Miller said.

"The biggest benefit that we've realized with Practice Forward is that, as a CPA or as a professional, you always feel like you're giving — you have way more experience and knowledge, and it's worth more than what you're charging your client. You don't want to be a commodity; you want to be the answer, you want to be their partner. By having the Practice Forward module, it validates that you're finally getting paid for your experience because you're creating value for your client."

– Glenn Harper, CPA, Owner/Partner, Harper & Company CPAs LLC

Value-based pricing pros

- Brings clarity and certainty
- Establishes a consistent cash flow
- Makes staff happy

Value pricing brings clarity and certainty. Value-pricing arrangements allow you to discuss the full, detailed scope of the engagement, as well as the price and value of the services your firm is providing, with clients in advance, before work begins. This means that clients have a clear understanding of your value and know the costs upfront. Therefore, there are no surprises when the bill is issued.

Value pricing establishes a consistent cash flow. Firms that opt to set up monthly billing with clients reap benefits that are two-fold. For starters, clients will appreciate knowing exactly how much they will be billed each month. This helps them budget accordingly.

Monthly billing can also help firms better manage their cash flow, as well as enjoy a consistent revenue stream, and reinforced client interaction. This can prove to be especially beneficial during times of economic downturn and uncertainty.

Value pricing makes staff happy. Employees are usually happier when they feel as though they are making a difference and bringing value to their clients. Implementing value pricing, which highlights one's expertise and knowledge, can help your staff achieve that. Plus, associates are incentivized to work more constructively and efficiently (profits are no longer directly tied to number of hours) and there's less angst about how an engagement will play out. This can be a strong recruitment and retention tool.

Cons of value-based pricing

- Requires a change in mindset
- Takes practice
- Instills fear of rejection
- Requires more upfront strategic planning

Value pricing requires a change in mindset: With value pricing, firms are no longer pricing based on the effort they put in, but rather on the outcomes. Valuing your knowledge is more ambiguous and requires a change in mindset.

Value pricing takes practice: Because valuing your knowledge is more ambiguous, it can be more challenging. Once you establish your value-based pricing model, there's a good chance you'll need to make adjustments as you grow and become more accustomed to this new way of billing.

Value pricing may instill fear of rejection: Some firms may be reluctant to change pricing models and/or raise fees out of fear of rejection. What's important to realize, however, is that under a value-based pricing model, not everyone will be the ideal client. You have to be selective and intentional in establishing the right client base. And if you're winning every single new client, there's a good chance you are under-valuing your knowledge and pricing too low.

Value pricing requires more upfront strategic planning. When you need to develop a specific price based on each prospect's unique needs and perceived value of your services, you need a lot more time to truly understand what it is that they need so that you can bake it into the agreement. The strategic planning in advance of the work to map out the scope can slow down the onboarding process (though, it typically pays off in the long run). You may also want to implement client minimums when switching to a value-pricing model.

What is cost-based, fixed-fee pricing?

Cost-based pricing is more often associated with compliance-based services and is usually determined based on the costs to complete the work (i.e., labor costs, software costs, overhead costs, etc., within the firm). It is often used as a baseline to develop fixed fees for accounting services. Start with the cost basis and add your firm's markup to create a fixed fee for each of your service offerings.

Using tax preparation as an example, Miller said, "If it's a Schedule C, E or F on a personal tax return, I think we can add value. If a taxpayer has a Schedule A, B or D, we probably can't add a lot of value, realistically. If I have clients with Schedule C, E or F, those are the clients that I want to target for advisory services and will therefore present value pricing rather than fixed fees."

How you decide to price your accounting services may depend on what kind of clientele you have or which services you offer. Firms that are focused primarily on providing compliance-based services rather than advisory or consultative services may opt for fixed-fee pricing structures instead of value pricing.

Across the industry, fixed-fee pricing is used more for compliance services than advisory, but it's always balanced out against the tendencies of the regional market. So, firms need to be sensitive to what their local market will bear and what it will not.

Despite the differences in pricing models, however, there can be a lot of gray area and hybrid-fee-structure approaches used for pricing accounting services. For instance, cost-based fixed fees and value-based pricing are not always mutually exclusive.

"What my costs are have to be a factor as I calculate my value billing model. When I'm building my value-bill price, it isn't just about the client; it is also about what the firm needs to be profitable at an acceptable rate for the owner. I need to identify my cost basis regardless of which pricing model I ultimately choose to use. I don't think they are mutually exclusive," Miller said.

And when looking to leverage a cost-based, fixed-fee pricing model, you should assess your firm's skill sets and then look at how to create different service and price packages. What does your firm do well? What are your resources and firm capacity? What are the types of clients you work with?

Cost-based, fixed-fee pricing pros

- It's simple
- It's easier to justify

Cost-based, fixed-fee pricing is simple: Fixed-fee pricing based on a cost basis isn't subjective. You just need to calculate your costs (i.e., software costs, overhead, labor costs, time, etc.), and determine a markup fee.

Cost-based, fixed-fee pricing is easier to justify: If your firm needs to increase pricing due to a rise in costs, fixed-fee pricing can be easier to explain and justify to clients.

Cost-based, fixed-fee pricing cons

- Ignores value
- Creates tunnel vision

Cost-based, fixed-fee pricing ignores value: When adopting a cost-based, fixed-fee pricing model, you are not factoring in the value you are providing your clients. And that's what really matters most to the client. They aren't interested in your costs. They are interested in the value you provide.

Cost-based, fixed-fee pricing creates tunnel vision: If you are pricing your firm's services based on cost (plus a percentage markup for profit), you may be viewing pricing through too narrow of a lens. Not only does cost-based pricing ignore value (which is significant), but it also ignores other factors like market trends and competitor pricing.

"The most significant change that Practice Forward offered was the way I think about my practice: How I approach new client meetings. How I approach the pricing. Really thinking outside of the box and delivering more value. It's really forced me to sit down and decide: What's the solution for this client? What does that mean in dollars and cents? And what is a good ROI to price this at? I've kind of approached every new meeting that way."

– John Sanchez, CPA, Partner, John A. Sanchez & Company

Hourly-based billing

As noted earlier, billing by the hour is a long-standing tradition within the accounting industry. In fact, the concept of hourly billing, in general, dates back more than 100 years to attorney Reginald Heber Smith. Smith invented the billable hour and hailed it as a simple, fair, and transparent pricing method. Some may argue that Smith was correct in his assessment, but times have changed. A lot.

One obvious change is advancements in technology. Thanks to greater software automation and integration, today's practitioners can work much more efficiently. That means fewer billable hours spent on an engagement.

Another distinguishing factor is that hourly billing usually means that prices are not discussed up front with the client. A lot of times, firms won't tell their clients exactly what the bill is going to be in advance — it's more job by job. The invoice amounts go up and down based on what work was done, what it cost them to get it done, plus their markup.

The use of hourly billing among accounting firms is declining. A move that many industry sources believe is a step in the right direction.

Furthermore, sweeping regulatory changes throughout the industry, and shifts in client demand, have created greater business opportunities for firms.

As noted in the National MAP Survey, "Changes in both the tax and accounting landscapes provide an opportunity for firms to showcase their status as trusted advisers. Firms that leverage that status to deepen their relationships with clients and move beyond compliance and into advisory will be well-positioned to value their services at their worth, not at simply the number of hours incurred."

Hourly billing may still have its place — say, in instances like litigation support services, when you may not be in control of how long a project will take — but, in general, the use of hourly billing among accounting firms is declining. A move that many industry sources believe is a step in the right direction.

This is not to suggest that firms abandon tracking hours altogether. The time of your staff is one of the resources you have to allocate across the business and make sure that the resource compensation is where you need it to be. So, don't get rid of the time tracking, just be cautious if you're looking at it as a foundation for your billing strategy.

Miller agrees and said, "I try to ballpark about what I think how much time I have to put in ... and come up with kind of a fixed-fee arrangement for that. What do I think is going to be involved? And that's using my background and experience to anticipate problems and issues, and how I'm going to get the job done. So, it's not mutually exclusive in any way."

Hourly billing pros

- It's familiar
- It's easy to justify

Hourly billing is familiar: Change isn't easy. Hourly-based billing is deeply engrained within the accounting profession and shifting to a new way of pricing can seem daunting.

Hourly billing is easy to justify: Billing by the hour is not subjective or ambiguous like value-based pricing, which makes it easier to explain to clients.

Hourly billing cons

- Increases fee pressure
- Ignores value
- Lacks certainty
- Discourages collaboration
- Punishes efficiencies

Hourly billing increases fee pressure: When firms operate in a transactional business model, it makes it easy for clients to comparison shop. This makes it difficult for firms to develop a sufficient profit margin, especially as costs continue to rise.

Hourly billing ignores value: Hourly-based pricing does not factor in the value you are providing your clients. And, again, that's what really matters most to the client.

Hourly billing lacks certainty: Clients value transparency and certainty. Under this pricing model, clients don't know how much they will be paying for your services until the work is complete and the hours are calculated.

Hourly billing discourages collaboration: If a client has a question or runs into an issue, they could be hesitant to reach out to you for guidance knowing that as soon as you pick up the phone, the clock starts running. This could lead to a weakened client relationship.

Hourly billing punishes efficiencies: Today's firms are looking to drive greater efficiencies and automate workflows. This enables firms to better serve clients and eases the strain on staff. However, under an hourly billing model, this also means fewer billable hours and, ultimately, less profitability for the firm.

Fees for accounting services: Making the switch to value-based pricing

Making the transition to value-based pricing won't happen overnight. Understanding how to make the move and navigating change management both within the firm and among clients are among the factors that need to be considered.

This isn't a light switch. Think of it more as a dimmer switch. Part of the reason firms are hesitant to make this change is a fear of the process. It's okay for the process to take a little while. It certainly takes planning and time to implement.

While every firm is different, the AICPA suggests that 12 to 24 months is a good guideline for implementing value-based pricing.

Knowing where and how to start can be daunting. To help get you started on your journey to value-based pricing, consider the following recommendations:

1. Implement your new pricing model beginning with your next new client.

2. Identify a group of consistent or stable clients to help set your foundation and practice your message.

   What does this mean? If you have a group of consistent clients (meaning, you provide them the same level of services year-over-year or month-over-month with little to no variation), these could be good clients to start with in a cyclical fashion, say at the end of the year or after delivering their tax return.

   Communicate to these clients the same message. For example: "We'd like to even out your cash flow. So, we're going to take what you paid us last year and divide it by 12. That's your new fee going forward, and here are the services that the new fee encompasses …"

*You're providing the foundation. You're getting used to delivering the message.
These clients are least impacted — for them, it's a positive change. By starting with
them, you're also setting yourself up to where if one of them does have any kind of
transitional item come up (like selling their business, acquiring a new business, etc.),
now you have established a scope with them so that you're ready for them to have a
change.*

3. The next time a client approaches you with a change they'd like to make (for example, form a new business entity), view that as an opportunity to implement your new value-pricing model. In other words, if you can find an advisory service that results in a change to the compliance services, you now have an opportunity to bring all of those services together under one bill, communicate the scope of services with the client, and even out their cash flow through monthly billing.

4. Start small. Pick 10 clients to transition to the new pricing model and clearly communicate with them the reason for the change. Then learn from those 10 clients to further fine-tune and perfect your new way of pricing.

5. Offer tiered pricing with varying degrees of service and assistance in each level (i.e., Gold, Silver, and Bronze levels or Tier 1, 2, and 3).

How does value-based pricing affect client relationships?

If it takes so much effort, and so much time, to switch to value-based pricing, why would anyone want to do it? The benefits of value-based pricing are manifold, but perhaps the most significant result is how your clients respond to it. They become more deeply aligned with you, more committed and loyal to your firm. They become part of the process, with a deeper understanding of your partnership and the value they will receive, before work even begins. This not only eliminates confusion later, but it also creates a lasting bond, establishing longevity for the professional relationship, above and beyond traditional annual compliance services. This partnership allows you to take more time to challenge them, guide them, and help them grow their businesses.

Winning strategies for pricing accounting services

Accounting firms have long embraced hourly billing, but new ways of thinking, new ways to conduct business, and advancements in technology are fueling changes in pricing protocols.

For a growing number of firms, especially those looking to deliver value-added advisory services, value-based pricing has become the pricing model of choice. And for good reason. It enables you to drive greater profitability, strengthen client relationships, and incentivize staff to work more constructively and efficiently.

The time for change is now. Many firms today must rethink how to price accounting services to remain competitive and relevant in a dynamic market.

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