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“A perfection of means, and confusion of aims, seems to be our main problem”
Albert Einstein

Introduction

Chapter 9 looked at the pros and cons of pricing strategies such as hourly billing or fixed fees. Whichever strategy is deployed, understanding the costs of delivery is essential. This method for calculating prices proposed in this chapter assumes measurement of delivery costs as a pre-cursor.

The “calculator” tables used to illustrate examples are snapshots from a system we use to ensure fees are based on the degree of expertise required to address different levels of client complexity.

The Basis Used in This Chapter

The pricing process examined in this chapter is based upon:

- measuring time spent on client-related tasks undertaken by client-facing roles
- calculating the hours per annum available for each role to spend on client work
- establishing the direct costs and share of indirect costs applicable to each role
- determining a chargeable hourly rate to each role
- remembering to build in profitability to the rates used
- applying the hourly rates to the time taken for tasks carried out

N.B. THE REFERENCE TO HOURLY RATES IS NOT BASED ON USING HOURLY BILLING AS A CHARGING METHOD – IT IS BASED ON ESTABLISHING THE UNDERLYING COSTS OF DELIVERING ELEMENTS OF ADVICE AND SERVICE

Measuring the Cost of Client Work

The cost to your business of delivering a service has to be understood before prices can be set. Chapter 10 emphasised the importance of documenting, and wherever possible automating, repeatable, routine processes as this is a factor in minimising costs.

In any event, it is a simple starting point to list all the tasks and activities the business has to undertake in order to

- move a prospective new client from discovery to the end of implementation
- deliver on-going service to existing clients

Mapping Your Activities

The key thing here is to map out only the tasks relating to work which could be legitimately be charged against a specific client. So, you will not be looking to measure the costs of the

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administration team opening up the post each morning (although you may as part of a general efficiency drive wish to streamline that general activity of course).

So, the mapping process needs to capture:

- Tasks which deal with client advice, implementation, communication and service
- Which role in the business carries out the task
- The hourly chargeable rate for the role (see below for method of arriving at this)
- Time taken each time the task is carried out
(some tasks may be carried out multiple times for more complex clients)

In reality, businesses tend to deal with varying degrees of complexity in terms of client work and offer different “levels” of service according to their servicing strategy. This means a business can tailor its processes accordingly. In measuring activity, you might assume different activity profiles for:

- Simple
- Moderate
- Complex

cases in terms of initial engagement and on-going service delivery

Work undertaken during several client engagements should be analysed to gain a true idea of the time taken per task. It is important to employ systems which automate as much routine work as possible

Measuring work in this way will evaluate the cost of delivering discreet pieces of work. It also provides the basis for establishing the business’s capacity for delivering work.

(However, setting a price doesn’t solve the challenge of acquiring enough of the right clients to ensure the expertise available is used to its full capacity.)

Establishing the hourly rate

Four factors which contribute to the calculation of a chargeable hourly rate for each role which carries out chargeable activities:

- available days per year after holidays, training etc. to work on client facing tasks
- the number of hours per available day realistically spent on client-facing tasks
- the direct (i.e. salary, NI, benefits etc.) costs of each role
- the share of indirect costs allocated to each role

Available Days

It is important to be realistic about how many days will be available from the 260 working days in a 52 week year. So, take care to deduct sufficient allowance for Bank Holidays, staff holidays, sickness, training, company meetings, industry seminars etc. This might produce a net number of days of say 195.

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Number of hours per working day

If you assume a standard 8 hour working day, it is unlikely that 100% of the time will be spent on client work, so allow a reduction to reflect the reality of office life, maybe assume 80% of time is spent on client work. That would mean 6.4 hours per day for client work.

Combining net available days with hours per day spent on client work, the chargeable hours per annum comes to $195 \times 6.4 = 1248$ (the total is likely to vary from role to role, but should not vary in respect of individuals conducting the same role)

Dividing this total into the costs of the role will establish a notional chargeable hourly rate.

Direct Costs

These are the costs directly attributable to the employment of an individual in a role.

If one individual has 2 roles, say as adviser and managing director (MD), their direct cost in respect of their MD role should be added to the indirect costs of the business.

Allocating Indirect costs

You need to decide how indirect costs are allocated across different client-facing roles.

There are 3 options:

- only RIs absorb the indirect costs – thereby weighting the effective hourly cost of the business on the adviser's time.
- all client-facing individuals across all roles bear an equal share and this share is added to the direct costs
- indirect costs are allocated according to relative proportions of direct costs
For example in the business illustrated in the table below, total indirect costs are £150,000. The share per individual in each group (G) can be calculated as follows:

A	B	C	D	E	F	G
Role	No. in role	Direct Costs p/person	Direct Costs for group	Proportion of overall direct costs	Proportionate share of indirect costs	Indirect costs per member
Adviser	3	£50,000	£150,000	0.64%	£96,000	£32,000
P'planner	1	£35,000	£35,000	0.15%	£22,500	£22,500
Admin	2	£25,000	£50,000	0.21%	£31,500	£15,750
			£235,000		£150,000	

In this business, if the paraplanner has 1248 hours available per annum for chargeable client work, the hourly rate for their tasks would be

$$(\text{£}35,000 + \text{£}22,500) / 1248 = \text{£}46 \text{ per hour}$$

Applying a Profit Margin

To ensure on-going viability of, and to enable investment into, a business, prices need to incorporate a profit margin. Profitability targets are usually expressed as a percentage of gross turnover. So, using the example above, if a business with a cost base of $(\text{£}235,000 + \text{£}150,000) = \text{£}385,000$ wants profitability of 20% it needs to turnover:

$$(\text{£}385,000/80) \times 100 = \text{£}481,250$$

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If we apply that principle to the hourly rate basis, then the rate for the paraplanner in our example above would need to be:

$$(\pounds 46/80) \times 100 = \pounds 57.50 \text{ (profit per hour of } \pounds 11.50 \times 1248 \text{ hours} = \pounds 14,352 \text{ p/annum)}$$

A minimum profitability ratio of 20% is advisable, but where high levels of value are being added, there is every reason for a ratio of 50% to be considered.

Value premium

The difference between a 20% and 50% margin can be referred to as the “value” premium.

A value premium is especially appropriate in situations where the:

- expertise being deployed for a client’s benefit is scarce
- complexity of the client’s situation demands technical knowledge validated by qualifications and a fair degree of experience
- risk associated with advising on highly complex issues may require greater PI cover
- impact on a client’s situation, such as tax benefits, time saving, feeling of peace of mind, security etc. is of extremely high and quantitative value

Illustration of task measurement for initial and on-going services

Below is an example of a breakdown of time spent by a Consultant, Paraplanner, P.A and an Administrator to address a client’s needs at outset then on an on-going service basis.

TIME (Hours)				
	Consultant	ParaPlanner	P.A.	Admin
Average New Prospect time pa				
Initial Meeting	2			
Presentation Meeting	2			
Initial Report	1	1	1	
Quotations			0.5	
Servicing Transfer				0.5
Valuation				1
Travel	2			
New Business processing			0.5	0.5
Fact Find Input				0.75
Provider Liaison			0.5	
Sub Total	7	1	2.5	2.75
Existing Client time pa				
Annual review	0.25	1	0.5	
Annual visit	1.5			
Bi-annual valuation				2
Bi-annual phone contact	0.25			
Enquiry support	0.5	0.5	0.25	
Application processing	0.25		0.5	1
Quotations			0.25	
Travel	1			
Staff Liaison	0.75		0.5	
Account Management	0.25		1.25	
Sub Total	4.75	1.5	3.25	3

In this example:

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- a new prospect utilises a total of 13.25 hours of staff time
- an existing client utilises a total of 12.5 hours.

Of total time spent on new clients, 53% is accounted for by the consultant

Of total time spent on existing clients, 38% is accounted for by the consultant

Differential Levels of Activity for Different Client Types

As mentioned above, it is possible to analyse tasks in relation to different scenarios

The top half of the table below illustrates Simple, Moderate and Complex scenarios presented by new clients.

The lower half illustrates how time and tasks might be allocated in respect of 4 different types of existing client to reflect the complexity of the work they bring to the business.

Type of Client/Service	Consultant	Para-planner	PA	Admin	Grand Total
Simple Prospect	5	1.5	3.25	2.5	12.25
Moderate Prospect	5.75	2.25	4.5	4.75	17.25
Complex Prospect	8	4.5	6.75	8.75	28
Existing - A* Clients	21.75	2.5	7.5	10	41.75
Existing - A Clients	10.5	2.5	6	8	27
Existing - B Clients	4.75	1.5	3	4	13.25
Existing - C Clients	3	1.5	2.25	2	8.75

It is now possible to analysed prospect work for different client types across the advice process i.e. the fact-find & “gap analysis” report, the “strategy & recommendations” report and implementation.

Simple Prospect	Consultant	Para-planner	PA	Admin	Grand Total
Fact Find	3	0.5	1.25	1	5.75
Strategy	1.5	1	1.25	0	3.75
Implementation	0.5	0	0.75	1.5	2.75
Moderate Prospect	Consultant	Para-planner	PA	Admin	Grand Total
Fact Find	3.5	0.5	1.75	1.75	7.5
Strategy	1.5	1.75	1.75	0	5
Implementation	0.75	0	1	3	4.75
Complex Prospect	Consultant	Para-planner	PA	Admin	Grand Total
Fact Find	4.25	1	2.5	2.75	10.5
Strategy	2.25	3.5	3	0	8.75
Implementation	1.5	0	1.25	6	8.75

This can help when a firm wants to set a price for individual elements of work.

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Applying Hourly Rates

Taking into account the factors referred to earlier which affect the chargeable hours available in a working year, assume the hourly rates for roles are as follows, (incorporating a 20% profitability margin):

Consultant	£89.33
Administration	£11.05
PA Sales Support	£19.01
Paraplanner Sales Support	£34.01

In this business, the hourly rate for the Consultants absorbs all the indirect costs of the business.

The table below shows prices when hourly rates are applied to time taken to deliver advice.

Simple Prospect	Consultant	Para-planner	PA	Admin	Grand Total
Fact Find	£269.80	17.00	23.76	11.05	£321.61
Strategy	£134.90	34.01	23.76		£192.66
Implementation	£44.97		14.253925	16.57	£75.79
Moderate Prospect	Consultant	Para-planner	PA	Admin	£590.06
Fact Find	£314.76	17.00	33.26	19.33	£384.36
Strategy	£134.90	59.52	33.26		£227.67
Implementation	£67.45		19.01	33.14	£119.60
Complex Prospect	Consultant	Para-planner	PA	Admin	£731.63
Fact Find	£382.21	34.01	47.51	30.38	£494.12
Strategy	£202.35	119.03	57.02		£378.40
Implementation	£134.90		23.76	66.29	£224.94
					£1,097.45

So the fees range as a minimum from £590 to £1,097 to ensure the costs are covered and a desired margin achieved.

We can then do a similar thing to establish the price for the on-going services which gives in our example the following figures:

Client	Average annual income
A*	2,313
A	1,241
B	584
C	388

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Other considerations in setting prices

Target Market

The size and shape of the existing and desired client bank can impact on prices. If you have a desire to develop 50 high value clients with a comprehensive service they may take as long to look after as 200 clients that want a standard service.

How would you structure your business to cater for such a niche client bank and will they see sufficient value to pay fees equivalent in total terms to the turnover generated by looking after 200 clients?

Competition

If your minimum prices may look expensive compared with your competitors and there is no real difference in the value you deliver, consider whether you can deliver a better service or reduce the cost of what you already deliver.

What elements of the process look unnecessarily time consuming?

Are there elements that can be delegated to lower cost resources?

Are there elements of the service that add limited value compared to the cost, which wouldn't be missed if left out?

Goals

Does the pricing enable the key stakeholders to meet their Personal and Business objectives?

Plans

Is there sufficient margin built in to create the means to meet capital adequacy requirements and invest in new systems, people, premises etc. in order to meet desired business goals?

Restricted or Independent?

What is the impact on the time, cost and prices if the firm opts for Independent status in preference to Restricted or vice versa?

Summary

Pricing is a process to which too few businesses give enough consideration. Whether you express charges as a percentage of funds under management, a time-costed bill or a fixed fee, you must understand your cost of and capacity for delivery in order to earn profitable fees.

Following market "norms", which are rarely based on a meaningful calculation can leave a business struggling to justify their fees or make a profit - or both!

Pricing influences whether staff are constantly under undue pressure to just break even or have the time to stay fresh, think ahead and be proactive, and focus on quality of delivery.

It determines whether shareholders get a fair return for the risk they take or would be better off investing time and capital elsewhere.

Therefore, pricing is a critical business discipline and requires a great degree of analysis and monitoring in order to capture valuable revenues in return for client value delivered.

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