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A METHODOLOGICAL
APPROACH FOR
INTELLECTUAL
PROPERTY PRACTICES**

by Michael Roch



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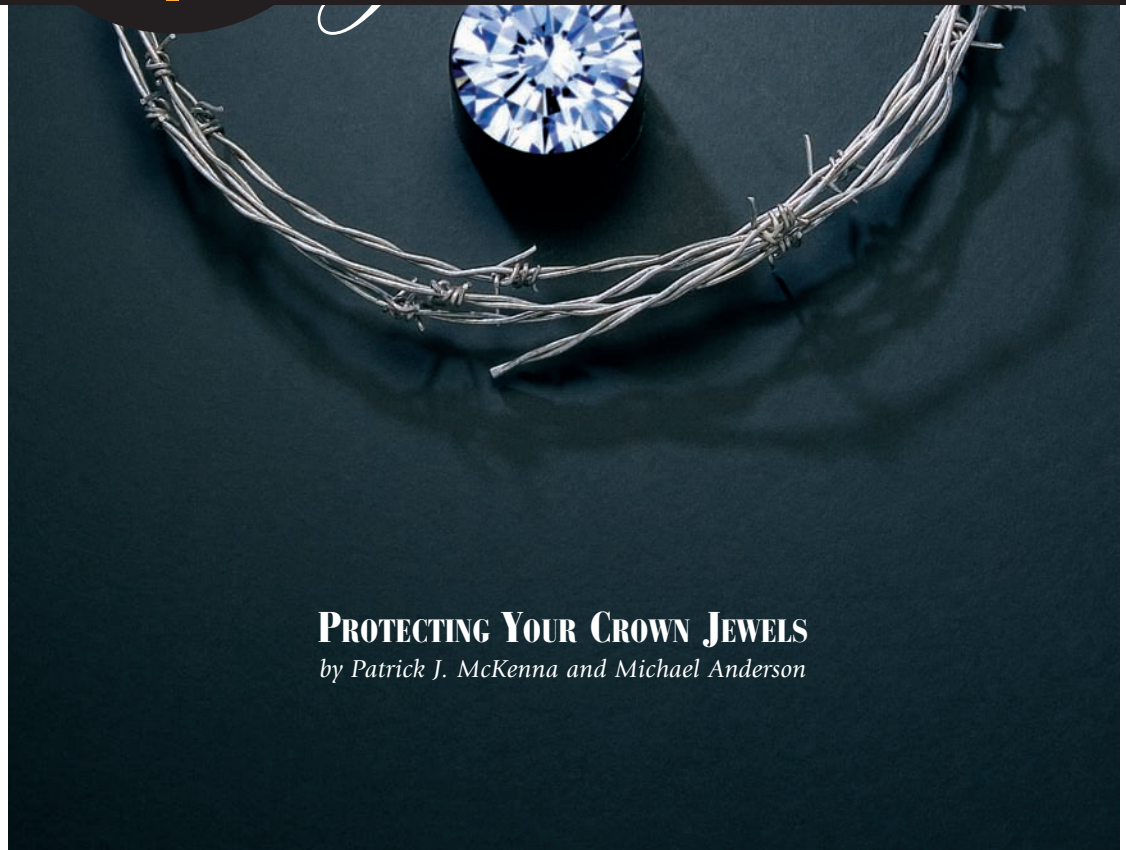
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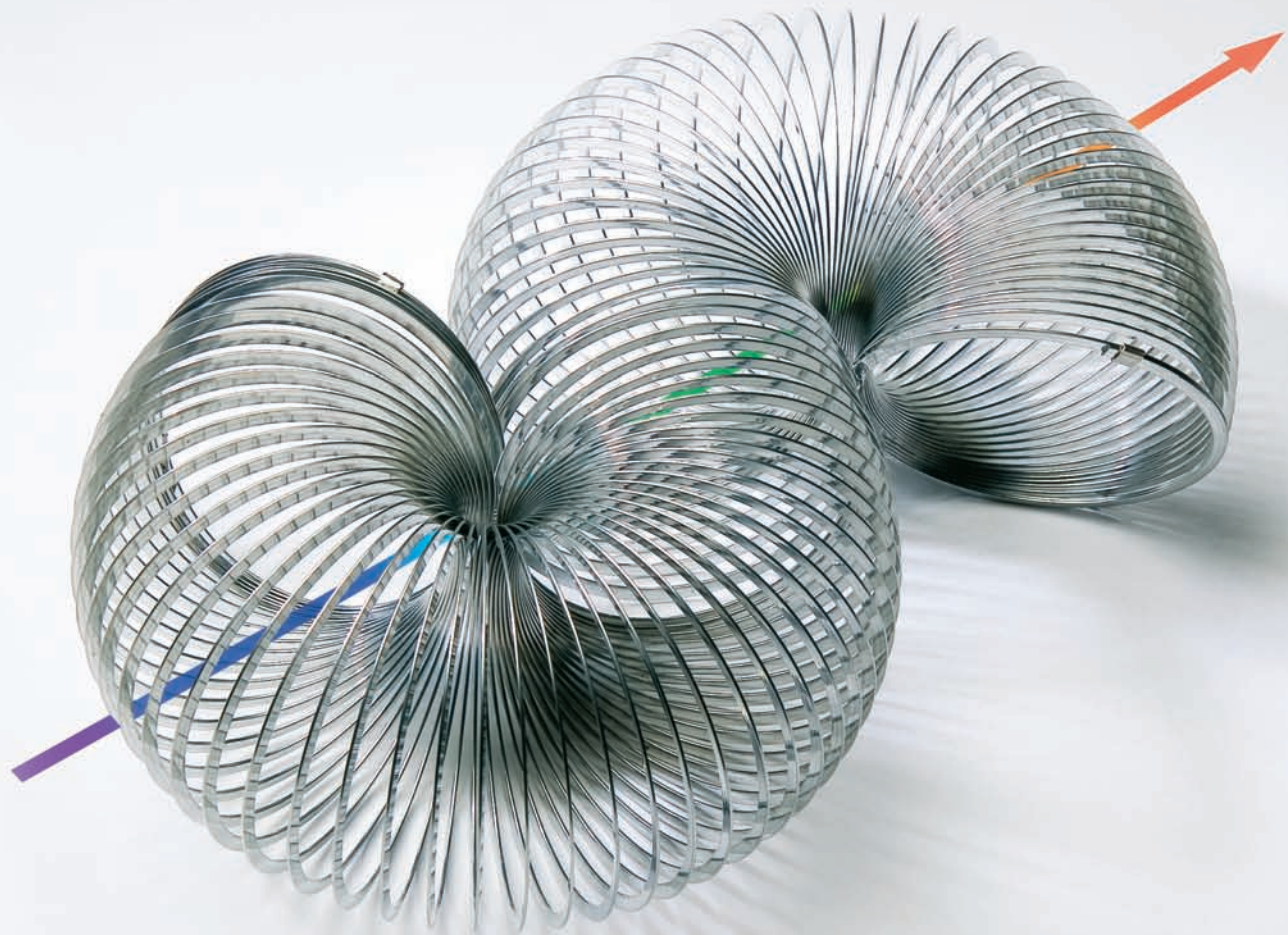
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PRICING OF SERVICES

A Methodological Approach for Intellectual Property Practices

“Many professional services firms put more creativity, mind power and time into a brochure or an advertisement than thinking about pricing policies. This is a serious mistake, [as] pricing is how the firm captures the value it provides to the market place.” Ronald Baker, *Professional’s Guide to Value Pricing*, 2001



The price, together with the client’s service experience with the firm, is one of the most important statements that an IP practice can make about its brand to its market and about its value proposition to its clients. It is therefore important that IP practices approach pricing from a strategic perspective. This article provides

a structured roadmap for IP practices to develop their pricing approaches.

DUAL BUSINESS MODEL IN IP PRACTICES

Intellectual property practices typically house two separate businesses: IP

prosecution and maintenance of IP rights

To provide true value to the client, an IP prosecution practice requires extensive technical, industry and legal expertise to effect, for instance, a valid patent application that is sufficiently specific to render an idea patentable while maintaining

sufficient breadth to cover as many potential competing ideas as possible so as to protect the client's business. The heavy intellectual lifting is done in this part of the business, and traditionally this work is charged on an hourly basis.

The IP maintenance practice is usually the opposite. Heavily leveraged and staffed primarily by paralegals (in the United States) or patent secretaries (in Europe), the maintenance practice monitors infringing uses of the client's trademark


or ensures that the client's patent registrations are maintained. Traditionally, this work is charged on a per transaction or fixed fee basis. However, the IP maintenance practice tends to generate the higher profit for the IP practice, and often the prosecution work is heavily discounted to obtain the more profitable IP maintenance work. In recent years, service providers have entered the market of processing patent maintenance, trademark renewals and the like, thus squeezing IP practices out of the profitable maintenance business unless they can compete with these service providers either on value or on price.


While intellectual property lawyers have long recognized that both practices operate as distinctly separate business models, all too often opportunities for revenue maximization are lost because the pricing of each business, and how one complements the other, is not approached in a strategically structured manner or in a manner that is sufficiently flexible to maximize the value proposition to the client.


PRICING FOR IP PRACTICES IN FIVE STEPS

The following approach begins at the firm level and descends down to the level of the client and each individual engagement, as follows:


Price, together with the client's service experience with the firm, is one of the most important statements that an IP practice can make about its brand and about the value proposition to its clients.

 **Step 1: Determine the value proposition associated with the brand of the IP practice**

 **Step 2: Determine a pricing objective for each client segment served**

 **Step 3: Determine the pricing method and presentation method for each client segment**

 **Step 4: Determine the clients' price sensitivity**

 **Step 5: Determine service packages to deliver value for each engagement**

Step 1: DETERMINE THE VALUE PROPOSITION ASSOCIATED WITH THE FIRM'S BRAND

The starting point for any discussion on price is the IP practice's value proposition for its clients. "Are you trying to compete based on (1) price, (2) quality or (3) by serving a niche?"

Price Proposition. The cheap IP practice competes on price. Its profitability lever is quantity and a low service cost, achieved

through people leverage, highly efficient systems and a high degree of standardization.

Quality Proposition. The best IP practice competes through quality. It has superb client relationships, and its superior client focus delivers a first class service. This value proposition allows only a limited degree of leverage, relying more on the experience and expertise of its senior attorneys to charge a relatively high price.

Niche Specialist. The niche IP practice has specialized in one narrow area of IP or industry. It is at the cutting edge of that area and delivers value based on superior know-how and a high degree of fee earner specialization.

Knowing your value proposition is critical – it is very difficult, if not impossible, to be a price leader, quality leader and niche specialist at the same time to all clients. Firm management should ensure that every fee earner understands, is able to and frequently does communicate the answer to this question to existing and potential clients.

Step 2: DETERMINE A PRICING OBJECTIVE FOR EACH CLIENT SEGMENT SERVED

Once the IP practice firm understands its value proposition, it will typically follow one of three pricing objectives for any given market:

1. **Maximize current profits**
2. **Increase market share**
3. **"Skim" the top end of the market**

An IP practice that seeks to maximize its current profits will approach the question of pricing differently from one that seeks to increase its market share. In order to know

which pricing objective to set for a given market, the IP practice should segment its clients according to the value proposition offered to each segment and set the price objective accordingly. For any practice, pricing by client segmentation – in particular for the prosecution business – is critical to ensure that each client segment understands the firm’s value-add proposition. There are several ways in which to effect segmentation. For a technology IP practice, segmentation by industry or product life-cycle appears to be the best fit.

For instance, an IP practice known in the market as a high quality electronics patent litigation practice that desires to enter the field of GPS patent litigation may set its price below the perceived value received by that market. On the other hand, an IP practice that serves only one particular market segment may want to give its attention and resources only to that work which provides the largest amount of revenue and profit, thus “skimming” the crème at the top level of the price range and refer to another firm all other work that does not bring in the most revenue.

Step 3: DETERMINE THE PRICING AND PRESENTATION METHOD FOR EACH CLIENT SEGMENT

Once the IP practice understands its pricing objective with respect to each client segment, it can begin to determine what pricing method it will pursue. It essentially has three choices:

1. **Cost plus pricing**
2. **Competition pricing**
3. **Value pricing**

Cost plus pricing. Firms that charge by the hour typically engage in cost plus pricing; even fixed fees are usually based on the cost to the firm of providing the service plus an assumed level of profit. The focus is internal, based solely on the cost structure and capacity of the firm as well as on the amount

of time and effort it takes for the firm to meet the client’s objectives. IP practices in particular have long experimented with fees that are based on something other than hourly rates, but many IP practices still maintain an hourly rate structure for their prosecution work based on the cost of providing the service.

Competition pricing. To see whether their standard hourly rates or fixed fee schedules are roughly in line with what the market will pay, many practices will merely have a brief look to their peers for a reality check, ensuring that their rates are neither the most expensive nor the cheapest. While a competitive check is valuable, setting a fee below the highest rate of a competitor just because one does not want to be the most expensive potentially dilutes the image of the brand of the IP practice (and, indeed, the firm), unless this approach is consistent with the pricing objective. For instance, an IP practice that competes based on high quality in a given segment should not price its services below those of the other quality leaders in the market unless it has a well-considered penetration strategy in mind.

Value pricing. Neither cost plus nor competition pricing takes into consideration the value of the IP practice’s services to the client. The basic premise behind value pricing is that the revenues for a given engagement should be based on the value that this particular work represents to the client instead of on the effort the IP practice incurs in completing the engagement. The difference between cost plus pricing and value pricing is one of focus: cost plus pricing focuses on the bottom line of the IP practice, whereas value pricing focuses the IP practice on the client’s bottom line.

Ronald Baker has pointed out the various benefits of value pricing which needn’t be repeated here. May it suffice to say that value pricing usually affords an increased ability of an IP practice to pursue its pricing objectives and

facilitates pricing based on segmentation. As the examples below illustrate, the client might be willing to pay a lot more than just an hourly rate times time spent on a given IP prosecution matter. The key to understanding what value the client wants from the IP lawyer – and to communicating to the clients that the IP practice will deliver that value – is to focus on the client’s needs and to ask the right questions.

Irrespective of whether they charge by the hour or on a fixed fee basis, many IP practices employ only cost plus pricing. However, IP practices should consider using a combination of all three methods to achieve the highest revenue. How each method is presented to the client – hourly fees, fixed fees, caps, blended rates, etc. – merely becomes a mechanical exercise that nonetheless should be grounded in what the client values most.

Step 4: DETERMINE THE CLIENTS’ PRICE SENSITIVITY WITH RESPECT TO THE ENGAGEMENT

While cost plus pricing is static, a value pricing approach can react to favorable and unfavorable market conditions as well as accommodate a client’s price sensitivity in a much better way. My partner Ed Wesemann has previously published a series of questions to determine price sensitivity. Below, these are examined for an entrepreneur bringing his single idea to market, compared with the large corporation that applies for hundreds of patents per year and with an established mid-sized company that applies for only a few patents per year.

For instance, the large corporation has knowledge about the fees of the firm’s competitors, likely has a panel of IP practices and probably will be more price sensitive than an entrepreneur who is using an IP practice for the first time. All other things being equal, a client who has an existing relationship typically has higher switching costs than does a new client, because usually there is value to

understanding the client's organization and key individuals. A client who cares about prestige tends to be less price sensitive – imagine Wal-Mart v Neiman Marcus and compare both with your practice's value proposition. Taking that example further, clients such as the large corporation where the cost of one patent application requires a fairly small amount of the annual legal budget tend to be more price sensitive, in particular because of the many patent applications that are filed, only a small percentage of which are likely to become cash cows. The entrepreneur, on the other hand, views the initial patent as a "must succeed" and is, therefore, less price sensitive – but may have difficulties financing a large fee up front.

Step 5: DETERMINE SERVICE PACKAGES TO DELIVER VALUE FOR EACH ENGAGEMENT

The last step puts it all together. Understanding the value proposition that an IP practice brings to each of its client segments, its pricing objective and the client's price sensitivity allows the IP practice to put together a service package with a pricing method that delivers the best value to the particular client at the highest price a particular client or client segment is willing to pay.

Following the above examples, the large corporation likely is highly price sensitive because of the small percentage of patents that turn out successfully. In this instance, one might think about a volume discount in exchange for assurance that all prosecution and/or all maintenance work is done for that client for particular types of patents, plus a success fee for those patents that go to market. If the IP practice is getting squeezed on price already because the prosecution work is a loss leader for the maintenance work, there is less to be lost in proposing such an

arrangement; if done anywhere above the break-even point, this work will contribute to the fixed costs which will not change if the work increases. Of course, if the prosecution work is done at a loss and the patent maintenance work does not follow from this client, the firm bears all the risk and has no upside. All IP practices should have systems in place to enable them to manage to their break-even point on a per engagement basis (irrespective of whether fixed fee or hourly).

An IP practice should price its services thoughtfully and conscientiously, keeping in mind its strategic objectives and focusing on the delivery of value to the client on each engagement.

For the entrepreneur, the IP practice might propose a similar risk-sharing arrangement with a higher reward if the business succeeds. The entrepreneur will be much happier to pay a kick-back to the firm that helped him make lots of money than pay, begrudgingly, some firm a high fee as a "hoop he has to jump through" to protect his work.

The IP practice's value proposition for the mid-sized client with a small legal staff could involve taking as much off the plate of the overworked in-house counsel as possible, thereby increasing the client's switching cost. For instance, once the patent is registered, the IP practice could handle the licensing work as part of the package or the trademark work around the patented product; the intellectual property boutique firm, of course, needs to be careful that doing so

does not conflict with the efforts of the full service firm that referred the client to it in the first instance.

THE BOTTOM LINE

Price is one of the most important aspects of the brand owned by an IP practice – and, indeed, of the entire firm. Pricing should be done conscientiously and thoughtfully, keeping in mind the IP practice's strategic objectives and delivering value to the client on a per engagement basis. The structured, five-step approach to an IP practice's pricing strategy as it relates to its desired brand image, careful segmentation of its client base and their product life-cycles, as well as pricing based on value, not on the cost of providing the service, will help maximize revenues.

This article is based on my presentation to the International Federation of Intellectual Property Attorneys (FICPI) in Lisbon,

*Portugal, in November 2005. I appreciate and have borrowed from Paul Dunn and Ron Baker, *The Firm of the Future* (2003), Philip Kotler et al., *Marketing Professional Services* (2002) and Robert G. Docters, et al., *Pricing und Branding, Strategien für mehr Profit* (2005). I am also grateful to the thoughts of my partners, Ed Wesemann and Friedrich Blase, in the preparation of this article.*



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