

Hourly versus Fixed Fee

The most common method of calculating compensation for the service of an attorney, an accountant, a consultant, a web designer, or any professional who sells increments of their time is hourly billing. Hourly billing, as the term suggests, simply compensates the person or firm providing services to a client multiplied by an hourly rate. An hourly rate is typically set based on experience level, seniority, and reputation.

Advantages of Hourly Billing

The advantages most frequently cited for billing hourly versus a fixed fee are:

- *Clarity* – Hourly bills clearly detail the dates and times of service.
- *Conformity* – There are strict rules for lawyers against adding a mark-up fee to third party pass through costs such as court reporters, expert witnesses and travel costs. Hourly billing is a good option to comply with these rules.
- *Simplicity* – The hardest thing to measure is talent. The easiest thing to measure is time. Detailed itemized statements based on contemporaneous time entries provide a chronology of work performed. They can be used as tangible evidence and facilitate communication between the service provider and the client.
- *Standard* – According to the December 2012 National Law Journal in an annual survey report titled *The 2012 Law Firm Billing Survey*, hourly billing is the standard or industry norm in many service businesses including legal practices. In fact, in situations requiring court approval of fees, some courts only recognize hourly billing.
- *Subjectivity* – Subjective judgment is not required or at the very least minimized by hourly billing.

- *Predictability* – The most common complaint for hourly billing is not knowing the total cost in advance. This can be handled by providing an estimate of hours at the outset of the job and communicating any change. Your clients know each month how much your bill will be so they can budget for it.
- *Trackability* – There are 1,440 minutes each day. How many did you make matter? Hourly billing can be somewhat automated, particularly with computerized billing systems. Such programs compute the amount based on time increments and specified hourly rate to produce automated invoices.
- *Variability* – In most fixed fee situations variability cannot be foreseen with a reasonable degree of accuracy notes Jeremy Holmes in a *Guide to Hourly Billing* for University of Iowa College of Law Students.

Advantages of Fixed Fee Billing

On the other hand, the advantages cited for fixed fee billing over hourly billing are:

- *Efficiency* – Fixed fee billing forces the professional to be more efficient and work fewer hours states Richard Reed, a well-known authority on the subject in *Beyond the Billable Hour*.
- *Productivity* – Clients are billed fixed fee regardless of the productivity of the service provider.
- *Eliminates Padding* – Fixed Fee billing eliminates the incentive that exists in hourly billing to bill for unnecessary time and services. This practice includes billing for frivolous services such as an inordinate amount of research or discovery. The added hours charged may have diminishing value of the benefits received by the client.
- *Underpaid*- The lawyer is not adequately compensated in high-value and high-responsibility matters or for highly successful outcomes when the only form of payment is an hourly rate.

Conclusion

On the client side, flat fee billing eliminates any billing surprises and enables the customer to know the total cost from the onset. However, while fixed fee billing may force the service provider to manage their time more efficiently, it does not eliminate the potential for a service provider from bidding high and providing the fewer hours of service.

From a service provider's standpoint, work paid by the hour will be the fair compensation. Such a payment structure is less risky because all the hours a provider works for a client are billable and the chance of underbidding a project with a fixed fee is eliminated entirely. The hourly billing method is favored by most because it is the norm for many types of services and it provides the simplest alternative for documentation and track ability.

In the end, there's no right or wrong method when it comes to billing clients. Fixed fee billing has higher risk for both the client and the service provider. Depending upon the circumstances, in most cases the risk is assumed by the service provider because they have to deal with the unknowns.

To reduce any risk and potential reward or loss, hourly billing wins for both clients and service providers. All the reasons provided support why hourly billing is the most prevalent billing method used by professional service providers.