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Avoiding the Profit Squeeze

The following material is provided for informational purposes only. Before taking any action that could have legal or other important consequences, speak with a qualified professional who can provide guidance that considers your own unique circumstances.

You are nearing project completion. Overall, it's been a pretty successful and trouble-free venture -- but it hasn't been perfect. Your client hit you with a few surprise project add-ons that resulted in a bit of scope creep. You've had to put in a few extra hours and pay overtime to both your staff and your subconsultants. Plus, your costs for fuel, equipment and supplies are sure a lot more than you anticipated.

Suddenly it hits you. The extra time and money you've put into this project is taken a sizable bite out of your projected profits. Any more surprises and you may not be making a profit at all. You went into the work with a pretty tight margin in the first place because you really wanted to work with this new client, hoping for more lucrative work in the future. But now your rather low bid isn't looking like such a smart idea. There's a possibility you may be losing money on this deal.

So what do you do? Do you start taking shortcuts to squeeze as much profit out the project as possible? If you avoid any glaring errors or omissions the client will probably not notice that a little quality control is being sacrificed.

Do you, instead, ask your client for an increase in fees due to the scope creep that occurred during the project? The client may understand, or it may consider such a move highly unprofessional.

Or, do you simply bite the bullet? Do you continue to perform all services asked for and sacrifice rightfully earned profit to keep your client happy?

None of these three options is ideal. The best option is to avoid this predicament in the first place. Here are a few tips to help you ensure that you end up with a satisfied client and an adequate profit at project completion.

Develop a Full Scope of Services

Developing a comprehensive scope of services is an essential first step to basic project and budget management. The scope should identify exactly what you are being paid to do as a design consultant and, equally important, what you are *not* being paid to do. A comprehensive scope allows you to budget time for your services more effectively and, as a consequence, quote a more accurate and adequate fee.

Discuss your scope of services with your client. Explain clearly the full scope of services you feel is necessary for a successful project. If the client chooses to forgo recommended services, document your client's decision in writing, explaining that those services were recommended and offered. If the client asks for extended services, this gives you ammunition for establishing an adequate and itemized budget.

Do not let your client forego services that you feel are critical to a successful project. In the event of a future claim, a judge or jury is likely to believe a plaintiff's argument that you, as an experienced professional, were in a far better position to know what was and was not needed for successful project completion. Accordingly, you could be found negligent because you did not insist upon performing a critical service whose omission feasibly allowed a problem to occur. Never mind that you told the client that the service was needed. Never mind that the client expressly said the service would be unnecessary or performed by others. You will likely be held liable.

Charge an Adequate Fee

Don't undersell your services. Sure, there is always the temptation to shave a few dollars off of your bid in order to increase your chances of getting the job. But do you really want a client who is looking for the lowest bid?

Keep abreast of prevailing fees in your industry and locale. Is your fee structure in line considering your areas of expertise and years in service? When was the last time you increased your fees? Have your costs increased for subconsultants, overhead and other expenses? Balance these factors with what you think the market will bear.

Similarly, if you are asked to provide cost estimates in your bid, be as realistic and thorough as possible. Make sure you are using up-to-date figures for materials, systems, etc. Present these figures as "opinions of probable costs." Let your client know these are not guarantees and that actual costs may differ.

Document All Changes in Scope

Consider this scenario: The project's design phase is complete and you present the client with an unanticipated, several-thousand-dollar bill for a wide array of changes you did not bother to document at the time each was performed. Some of these changes are the result of add-on requests from the client once the design work began. Others are the result of your own oversights that didn't become apparent until your design work commenced.

How do you suppose the client reacts to these added charges? Does he say, "No problem!" and merrily sign the invoice to authorize payment? Or does he say, "What's this? Had I known this work involved an extra fee, I never would have authorized it!"

Too often, the latter attitude prevails, creating the seed from which claims and lawsuits emerge. The client can refuse to pay, and you very well could wind up having to sue the client for payment of additional services. The client's likely response would be to sue you for negligence. Alternately, to keep the client happy, you could simply eat the extras and hope for a break-even project when all of your unbudgeted bills are paid.

To avoid this problem, it is critical to document every change in scope, including its cost. When the client authorizes you to go beyond the original scope, prepare a written change order or memo of acknowledgement indicating what the extra comprises and how much it will cost to perform. Be sure that your form or memo references the basic contract, so all its terms and conditions apply.

Whenever possible, obtain the client's acceptance of the change order in writing. By presenting your overall change budget buttressed by individual, signed change orders, your client will be far more willing to pay the extra cost and far less likely to sue you for negligence. Better yet, submit your

change-order bills on a regular basis, so you can avoid the presentation of a mountain of additional charges created from multiple changes over the life of the project.

Ask For a Contingency Fund

Relatively few projects evolve exactly as originally planned. Educate your client about the possibility that he or she will be required to pay for a certain threshold percentage of project omissions or errors, and encourage the client to plan for the resultant extra costs by setting up a contingency fund.

A contingency fund establishes a certain percentage of the project budget to cover the normal “extra” costs that pop up in almost every project despite your best efforts to provide an accurate budget and perform to the prevailing standard of care. The percentage set aside in the fund should take into account the size, complexity and duration of the project. A 5%-10% contingency fund is not unusual for a standard project while a larger fund may be necessary for a highly innovative project with many unknowns. Also, try to negotiate a clause in your contract which states that your client will not sue you for extra costs that are within reasonable range of the contingency amount.

All changes paid for by the contingency fund need to be documented. To an extent, these added fees will fall into the category of “known unknowns,” and, because they will have been budgeted, they should create little cause for concern.

When Necessary, Bite the Bullet

Biting the bullet means providing everything the client expects or has been led to expect (via the scope of services) at the agreed-to fee. The logic for biting the bullet is basic: It is better to keep the client happy than to make the client unhappy, thereby risking loss of the client -- and client referrals. More to the point, the dollar loss associated with performing professionally -- i.e., applying the appropriate amount of quality control -- is a prudent investment in risk management, especially given the dispute costs associated with litigation.

But biting the bullet should not be your first choice. Many clients have been in similar financial situations themselves and will be sympathetic for pragmatic reasons: They understand that firms performing services at a loss are probably not going to perform those services as well as they otherwise could, to the client’s ultimate detriment.

In short, your first choice should be speaking with your client to obtain the amount to which you believe you are entitled. In many cases, clients are willing to pay the additional amount, in full or at least in part. In some cases, they pay nothing at all, but --even then -- quality control should not be sacrificed. Professional performance is your top priority. By taking this approach, you should avoid problems, retain a client for the future, and learn an important lesson.

Can We Be of Assistance?

We may be able to help you by providing referrals to consultants, and by providing guidance relative to insurance issues, and even to certain preventives, from construction observation through the development and application of sound human resources management policies and procedures. Please call on us for assistance. We’re a member of the Professional Liability Agents Network (PLAN). We’re here to help.