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Slippery Scope: Common errors made by professional service firms in managing scope

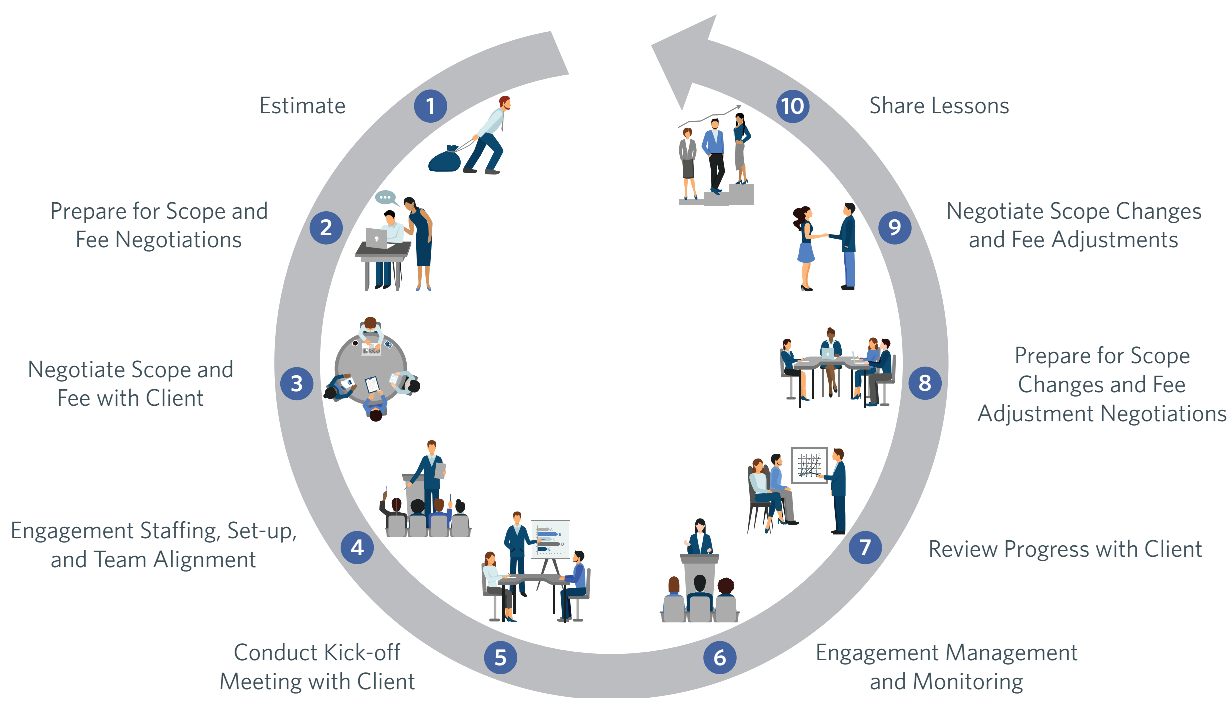
By Mark Gordon and Andrew Lewis

Professional service firms, regardless of the fee arrangements by which they charge for their services, are for all intents and purposes selling their time and expertise. Managing scope is one of the keys to driving profitability and recovering a fair fee for their services. All professional service firms face challenges managing scope, as there is often tension between the conflicting goals of delivering superb client service and keeping costs down.

While we expect our clients in the professional services sector to prize client service, we are surprised that many do not focus more energy on effective scope management (managing the scope of effort and deliverables to be consistent with the initial engagement letter, or managing the fees to be commensurate with the actual work required). Failure to focus on scope management can lead firms to consistently over-deliver and under-recover. In the long-term, this is neither in professional service firms', nor their clients', interests. Professional service firms that consistently under-recover for their services not only risk being less profitable, but also they will have trouble over time recruiting and retaining top professionals, investing in new technology and methodologies, and maintaining the capacity for the superb client service delivery to which they rightly aspire.

At Vantage Partners, our Sales and Account Management practice works with professional service firms to improve outcomes in fee and scope negotiations throughout the engagement lifecycle to help them recover fair fees for the services they provide. In this piece, we will provide a brief overview of the biggest mistakes we see professional service firms making at each stage of a typical engagement lifecycle, and suggest ways that they can ensure both superb client service **and** reasonable margins from their high-value work.

Vantage Model for Fee and Scope Management: Fee Negotiation Along the Engagement Life Cycle



At each node along the engagement lifecycle, professional service providers can set the stage for reasonable fee recovery, or make mistakes that will create challengesfor recovering a fair fee while meeting or exceeding clients' expectations. Here are some of the most common mistakes we see professional service firms making along the engagement lifecycle:

Mistake 1

Under-estimating time in initial scoping: If the initial estimate of the scope required to perform an engagement understates the actual time it will take to deliver the services to the client, it will be very difficult to ever recoup and get to reasonably profitable service delivery. Initial under-scoping is likely to lead to any of three possible bad outcomes: significant under-recovery by the service provider; unhappy clients due to under-delivery if the service provider holds to the inadequate scoping; or unhappy clients due to supplemental fees if the service provider seeks to negotiate change orders to recover a fair fee for the actual time required.

Many of the challenges in managing scope stem from an overly optimistic initial assessment by the service provider. Often, the client service team will list the tasks in a project plan, and assign each the minimum required time for completion. The intention is good: they want to create an impression of efficiency and don't want to have to defend spending time that may appear to be unnecessary on certain tasks. However, simply because an audit could theoretically take as little as 7,000 hours to complete does not mean it will actually be done in the barest minimum time if the sun and planets all align (by one calculation, the last such alignment was 561 BC, and the next will be in 2854, and the perfectly efficient engagement is only slightly less rare).

In our work with accounting firms, we have often worked with audit teams that are consistently surprised when the audit they thought might take as little as 7,000 hours actually takes 10,000 hours (again). Many audit firms have solid data about how long it takes to get certain projects over the finish line in the real world. One would think this would lead to more robust estimates that include both the necessary contingencies and a more realistic assessment of the time it would actually take to deliver. Yet we often see professionals consistently underestimating time, perhaps in a bid to "remain competitive."

Mistake 2

Under-preparing for scope and fee negotiations: Many senior practitioners become engagement leaders or partners thanks to their substantive expertise and skill in client service delivery. For them, doing the work for clients is their passion. Negotiating commercial arrangements for the work is often viewed on a spectrum from petty annoyance to the most distasteful part of their job. We see incredibly smart professionals systematically underpreparing for fee conversations — after all, this is unbillable time, and many seem to assume something like: "The client is only going to pay what they are willing to pay at the end of the day, so investing more time to get ready for the fee conversation is just a waste of time." For some, preparation for the fee conversation may simply boil down to answering three questions: What is the fee we will propose? What is our fallback position? What is our bottom line or "reservation price"?

While this is clearly grossly inadequate for preparing for an important fee conversation, many firms do not have a robust, systematic and widely shared business process that enables their senior professionals to prepare for fee negotiations. Moreover, given the incentives in many firms to "win the business" or "please the client", we often see professionals negotiating with themselves before they ever talk to the client. Instead of starting with the highest justifiable price for the engagement, they scale back their initial fee quote to make it both more palatable to the client and more competitive. Once they start talking with the client, they have less room for flexibility than they otherwise would and face pressure to offer further concessions from their starting quote.

Mistake 3

Caving in to tough tactics: One of the most insidious mistakes we see service providers making when negotiating fees is to cave in to aggressive tactics used by their clients (or procurement professionals in the client organization). We often see professionals giving the best fees to clients who threaten incumbents with putting the work out to bid, threaten to pull future business, or use other aggressive "hard bargainer" tactics.

Simply lowering the fee in response to such aggressive tactics rewards exactly the kind of behavior that most service providers dread. It actually *trains* clients to behave more aggressively and to devalue the relationship. Moreover, since it sets precedents in the marketplace for lower pricing and degrades the integrity of "standard" pricing, it leads to more pervasive discounting over time and leaves "good clients" wondering whether they need to be tougher on their service providers in order to get better fees.

Mistake 4

Failure to equip the internal team adequately to manage scope: As an engagement commences, many professional service firms kick off the project internally by detailing the project plan; finding and onboarding team members; clarifying milestones, deliverables, and timelines; and assigning roles and responsibilities. All that is, of course, necessary and elementary project management. On the other hand, many firms fail to do three things: 1) clarify norms for flagging out-of-scope work (such as requiring early notice to the engagement managers for requests from clients that might not be completely in scope); 2) specify how to quickly identify when assumptions built into the initial scope and the engagement letter seem to be questionable or wrong; and 3) clarify dependencies so that when the client fails to deliver something in a timely fashion or in the agreed form, there is a swift feedback loop to the client on the potential scope consequences of their actions (or inaction).

In many cases, it is actually the service provider's own client service ethic that becomes a barrier to success. Many firms have trained young professionals on the team to be immediately responsive to client requests, to go "above and beyond" in delivering what the client wants, to jump in and do things for the client even if the client had agreed to do it themselves, and to do anything required to make the client happy. While exceeding client expectations is a wonderful aspiration for a professional service culture, this needs to be coupled with an equal dedication to effective scope management from the very outset of the engagement.

Mistake 5

Failure to discuss shared accountability for scope: Many firms have some kind of kick-off session with the client at the start of an engagement to get aligned on issues such as resources, timelines, communication, deliverables acceptance, and decision-making rules. Yet very few firms have an explicit part of the kick-off session dedicated specifically to making scope management a **shared problem**. Too often it seems that scope management is viewed as the service provider's problem, but in reality, there is much the client can and should do to help the project stay on time and on budget. An explicit discussion of where project responsibilities lie and, in particular, what the client is expected to do are critical elements of a truly effective kick-off meeting.

This includes creating appropriate client accountability for timely delivery of materials in suitable form, responsiveness to communication and requests for information or feedback, along with some clarity on the fee or timing consequences if the client fails to deliver as anticipated. If service providers treat managing scope as solely their problem and do not hold clients accountable for helping to manage scope, they should not be surprised when clients either fail to deliver what they have to contribute or keep on making requests for additional services that they get "for free".

Mistake 6

Ineffective scope monitoring: Although one would think that regular scope management would be part of the routine "blocking and tackling" of project management at leading professional service firms, it is surprising how often even great firms fail to establish mechanisms to monitor scope compliance. This includes provision by the client service team of regular and accurate "estimates to completion" so that management can understand how the actual time inputs stack up against completed deliverables as well as the original estimate. A regular, accessible dashboard on "actual to estimate" and "estimate to completion" enables engagement leaders and others to manage scope effectively and take any corrective action necessary. Many engagement leaders lack these rudimentary tools, and it is not surprising that they often learn about scope challenges far too late in the engagement to have a timely discussion with the client about how to remediate the overrun situation.

Mistake 7

Failure to conduct regular scope reviews with the client: Over the course of an engagement progress meetings are naturally taking place. However, many service providers do not incorporate into those discussions early warnings to their clients about scope changes, or requests to the client to help ensure that the service provider can stay in scope. Progress meetings should review where the project is, negotiate any potentially out-of-scope requests made by the client, and detail actions that the client needs to take to keep the project on track. The earlier the service provider and the client can engage in discussion of how to deal with actual or impending scope changes, the better for both of them.

Mistake 8

Inadequate anticipation of likely scope and fee adjustment negotiations: A huge scope management mistake most firms make is to engage far too late in conversations about a fee adjustment or change order. In many cases, partners don't find out about overruns until after a great deal of out-of-scope work has already been performed and deliverables tendered. By that point, many feel that all they can do is go back to a client with a message that risks being heard as: "We have just performed a whole bunch of work for you that was out of scope. We were delinquent in not telling you sooner. It would be nice if you gave us more money for that work." The challenge is that it is too easy for the client to refuse, and there is little that the service provider can do. Anticipating this, the partner often lowers the initial "ask" to a much smaller amount than is justifiable in order to avoid upsetting the client and in the hope of recovering at least some of the time spent on the overrun. Once again, we see this as a classic mistake of negotiating with yourself before even going to speak with the client.

Two simple rules of thumb apply here:

A. *The conversation about a fee adjustment or scope change is much more likely to be successful* ***before*** *you perform the work.* Before the provider performs any out-of-scope work is the right time to discuss whether the client can do anything to help the provider to stay in scope (e.g., give the provider more support from client personnel; take on some tasks that the provider was going to perform; or cut back on other deliverables to enable the service provider to stay on budget) or whether the client prefers to pay a fair fee for additional work.

B. *Regardless of when you have the conversation,* ***if you don't ask for it, you won't get it.*** While the service provider may not recover the full fees for incremental work even if they ask for it, they certainly will not get any fees that they do not ask for. If you can assert fair standards of legitimacy both for why there should be a fee adjustment and what that fee should be, it is appropriate to put this information on the table. If you choose to write off some of the fees, you also need to make that clear. If you do a "secret favor" for a client by asking for $100,000 in additional fees instead of the $200,000 you actually deserve, you cannot expect them to be grateful for the write-off you took without even telling them!

Mistake 9

Not projecting confidence in asking for incremental fees: In the conversation with a client about a fee adjustment or change order, we often see service providers coming in apologetically and tentatively. It should not be surprising that if you seem to lack confidence when seeking incremental fees, clients will sense this and will not be enthusiastic about paying more money. Most clients will assume that if you don't sound like you deserve the additional fee, then you probably don't.

A professional can be confident and assertive without being aggressive or risking the relationship. By bringing arguments to the table that the additional fees are consistent with standard practice and indeed with agreements made between the two parties, you can be firm on the need to recover a fair fee while still being soft on the relationship.

Mistake 10

Not discussing lessons learned and creating a coaching culture on scope issues: Too few professional service firms conduct after-action learning reviews and share lessons to enable all professionals within their organization to improve their ability to manage scope and improve recovery rates. In many firms, partners may be embarrassed by low recovery rates and reticent to discuss what they could have done differently to better manage scope. Sometimes they blame the manager or staff for not running the engagement efficiently; sometimes they blame the client or changed circumstances (e.g., new regulations, marketplace changes, or staff turnover); and sometimes they justify their low recovery rates based on competitive market dynamics (e.g., "We had to set a low fee to win the business"). In many firms, partners are measured mostly by the top line revenue they bring in, and they may receive praise, status, or additional compensation for big engagements even if profitability is low. This means there may be insufficient incentive for them to invest time in trying to get a bit more margin out of every engagement.

At each node along the engagement management lifecycle, professional service firms have an opportunity to either enhance the likelihood that they will capture fair fees or make it virtually certain that they will hemorrhage margins. Deliberately discounting fees because of the competitive environment or to gain a foothold in a potentially strategic account may be good business decision. However, mismanaging scope in a way that forfeits fees they ought to recover is not a business decision; it is simply a failure to apply good business practices to managing professional service engagements.

Vantage Partners advises professional service firms on building organization capability and the design of tools and processes, to support effective fee and scope management. Please contact Mark Gordon, mgordon@vantagepartners.com, +1-617-904-7804, for more information about our Sales and Account Management practice and our work with professional service firms.