



Purchasing professional consulting

Part IV: Pricing related risks

by Steve Bauld and Kevin McGuinness

Be aware of what you are pricing

BREAKING UP A consultancy project into different phases often seems like a good way to keep control over the project and to impose some kind of quality control. In fact, it can undermine both efforts. Changing from one consultant to another after the completion of the initial phase of a project almost always involves incurring significant additional “ramp-up” cost. The probability of even higher costs increases as each successive phase is reached. Thus, when bidding for the subsequent phases, the existing consultant can increase its bid price yet reflect the built-in cost-saving of staying with a consultant who knows the project. The need to avoid ramp-up costs also undermines the practical ability to use a competition for a subsequent phase as a quality control mechanism.

In our last column (*Summit*, June 2009 online, Part III) we discussed the implementation of a roster system as a possible solution to sourcing professional consultants. We described how a roster system could be built and used; however,

they do suffer from some practical problems. The first is the tendency to seek out firms that can be short-listed to perform a broad range of work – so called, full service firms. Most firms of this nature tend to be based in Toronto or other major cities, with the result that they charge the high rates associated with those locales.

Not only does using such a firm have the disadvantage of shutting out local consultants – always a problem in the municipal sector – but very often the high price cannot be justified by higher quality work. An alternative approach is to restructure the roster RFP so that it seeks out firms that are capable of servicing individual areas of expertise, thus creating an expanded roster system. For instance, in an RFP for legal services, instead of retaining a firm that handles litigation, administrative, insurance, environmental, labour, employment, contract, corporate and municipal law, one would look for firms that are active in any one or more of these areas. A separate roster is prepared for each area of expertise.

Another potential problem with the roster approach is that the service rates are quoted in the abstract. For instance, a firm may quote an hourly rate of \$150 for “routine” contract work. However, when assigned a particular file, it will argue that the rate of \$150 does not apply, because the work is not “routine.” The goal of a

roster system is not to fix the price for “soft” supply, but rather to have a general price for all kinds of supply that your organization will require over the period during which the roster is valid.

On the other hand, at least this sort of claim involves some form of disclosure by the supplier. Some organizations believe that some supplier firms simply quote a low rate in order to get placed on the roster, and then pad the number of hours when they prepare their invoice.

This approach seems to be particularly common where there is a substantial disparity between prevailing market rates and the quoted rate for roster work. Problems of this kind are not specifically associated with consultancy work. Rosters for general electrical, carpentry and similar work notoriously attract unrealistically low bids for hourly work. However, when the final bill comes in, the number of hours claimed to have been spent locating wires and switch boxes seems completely unrealistic. We spoke to one purchasing manager who identified a contract for routine clean-up, where not one single job assigned over an 18 month period had come in at the bid price for a “typical” clean-up. This hardly seems possible.

Buyers need to be aware of the manner in which consultants spread their costs among clients. A junior associate who is paid \$75,000 per year, who has a small office and who shares a junior secretary with another junior associate obviously has a much lower cost than a senior partner who has a draw of \$350,000 per year, occupies a much larger office, and who has a senior secretary as well an executive assistant. Surprisingly, however, the profit margin for the hourly rate charged for both consultants is often

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If the agreed hourly rate of \$150 is not sufficient to meet the cost of a junior lawyer, then work can only be done if the consultant firm is prepared to run at a loss. That is unlikely so some padding is probable. However, even when the anticipated profit margin is not being earned, there is a tendency to pad.

Hourly rates have been the traditional method of pricing consultancy services for many more years than most people can remember. Many sophisticated clients have now moved away from paying on this basis. Instead, they are able to draw on their experience involving a wide range of different types of work to estimate an appropriate fixed price for services of a given kind. For instance, on a litigation file relating to a wrongful dismissal claim, a bank may have learned through prior experience that such work should take 20 hours for basic interviews, exchanges of correspondence and the preparation of draft pleadings. Documentary discovery may take another 20 hours. Oral discovery may take another two or three days of time. Therefore, when they retain an outside law firm to handle such work, they agree on a fixed price for each stage of the possible claim.

On an individual basis, most municipalities are too small to have a sufficient scale of operations to engage in this kind of pricing. However, municipalities across Ontario would easily be able to employ a similar approach if they were to exchange information among themselves,

particularly if they also shared information with the broader MUSH sector.

Who makes the call?

The problems associated in dealing with a consultant only worsen when a dispute arises within the municipal corporate bureaucracy as to which department ought to supervise the work of a professional consultant firm. Suppose, for instance, that the municipality is constructing a capital facility and needs to hire an environmental lawyer to assist it in over-coming legal problems associated with that project. The municipality must decide whether the work and billings of the private sector law firm should be subject to the supervision of the public works department (which is responsible for the capital facility) or the legal department.

Although it is probably true that the public works department is more sympathetic to the imperatives of its capital project and the sensitivity of that project to avoid or mitigate environmental law problems, generally it is the legal department that will be better placed to supervise the work that is being done and to control expenditure. Where direct supervision

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by the legal department is not practical, a suitable work-around solution must be found. Standardized retainer letters can address at least some of the problems associated with hiring decisions and internal supervision of external consultant work.

Consultants to consultants

Relative to most consumers, municipalities are generally fairly sophisticated purchasers of professional services; after all, virtually every municipality will require such services from time to time. In contrast, even medium-sized businesses may have only infrequent need of such services. Unfortunately, the changing nature of the specific services required compromises the benefit afforded by prior experience as a customer. Real estate and intellectual property require different types of expertise. A firm that has extensive experience in one may be unable to provide competent representation in the other.

For any number of reasons, it will often be necessary for a consultant from one field of specialization to retain a consultant from some other professional field to assist in the work that is being done for the municipality. Considerable care needs to be exercised in relation to such arrangements otherwise things can quickly get out of hand. A pure cost pass through arrangement is almost certain to present problems over the long term.

Both the client and the first level consultant should agree on the criteria for the consultant's selection of such an advisor. And, there should be some due diligence done by the client as well as the professional consultant to ensure that the second level consultant actually meets the agreed criteria.

There needs to be some method for evaluating both the quality of work done, and the amount of time required to carry out the work. Work done and time spent should be well documented. There needs to be a clear understanding of what is to be done, and there needs to be proper

reports to confirm that work is progressing on a timely basis. Where possible, estimated hours and total cost should be agreed in advance. If this is not possible, there should be some settled method for reviewing on-going need and the potentially ever-escalating cost of obtaining service. There also needs to be some agreed method for dealing with poor performance or unaccountable billings. Imposing proper discipline on a business relationship creates a foundation for trust. It does not undermine it.

Unrealistic pricing

With the steady increase that occurred in the cost of professional services over the 1990s, many governments tried to develop some method of capping the cost of such services, for instance, by setting maximum rates that they

would pay for the services concerned. This approach to service pricing has had a number of unintended and largely undesirable consequences.

In some cases, caps are tied to wholly unrealistic goals. For instance, the hourly rate approved for the retainer of a law firm may be capped at something, which at one time approached the high end of the cost of the most senior lawyers from the in-house legal department. This is almost certain to be far below the cost of any outside law firm. Most private sector law firms occupy Class “A” office space. Government legal departments are more likely to be found in Class “C” space – sometimes in buildings that

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the government has long since paid for. Furniture and secretarial costs are also likely to be much lower in the private sector. Like any other kind of business, the price charged by a private sector consultant must meet his or her overhead – there is no point in being in business, unless one is making a profit. Thus, even when such a cap rate was originally set, it was unrealistic. As time goes by and the disparity between prevailing market rates and the government's cap rate increases, the attractiveness of government work declines accordingly.

Capping service fees at unrealistic (i.e. below market) levels encourages honest, competent professionals to withdraw from any supply competition. Given a choice of work for a private sector client at \$1,000 per day and work for a government client at \$500 a day, few senior consultants are likely to choose the government client. The selection of a firm on the basis of the number of its consultants who are considered to be leaders in the field makes little sense if the

fee arrangement between the municipality and the firm is such that those leading experts are almost certain not to work on the file.

In principle, one way around this problem is to make use of junior consultants, who work under the supervision of senior consultants – although obviously this is not a satisfactory solution where lower cap rates are specified for junior staff. And, even where there is no junior cap to deal with, the use of junior consultants can be problematic. Professional firms often promise that work will be carried out by senior partners who have a national or international reputation, however, when the work is actually done, it is performed by junior associates who are far less experienced, and who are often working with minimal supervision. If the entire point of retaining a private sector consultant was to buy expertise that the municipality cannot supply internally, that goal may well be defeated by having to rely on junior consultants. 

Editors Note:

This is the last of a 4-part series on purchasing professional services that has sought to inform you of some of the perils and solutions in this, at times, challenging area of procurement. Finding the right person, with the right skills at the right time for the right price and, ensuring that the quality of work is exactly what you wanted now and for the future, is a balancing act that requires you as purchasers to be cautious, sometimes skeptical, sometimes open to change and always aware of the risks. There are no silver bullets or ironclad processes that will help you, but it seems to me that the suggestions presented in this series can help. To summarize:

- be precise in your language when describing categories of work;
- understand the different types of expertise you need and what is available and whether it can be found in one firm alone;
- determine the skills the consultant must have to liaise with you, the client, other customers, and other professional consultants or perhaps all three;
- think in terms of outcomes rather than prescriptive methods to get to an outcome;
- seek input from prospective bidders on the prospective work and ask how their expertise can solve your problem;
- pay close attention to your compensation package – that what you offer in remuneration is market comparable and that what you are billed for fairly represents the work done;

- ensure that the supervision and accountability lines are clear within your own organization; and,
- while not addressed in this series of articles, it is important to evaluate your consultants for future reference.

Steve Bauld spent many years as purchasing manager at the City of Hamilton and is now vice president of the Ontario General Contractors Association.

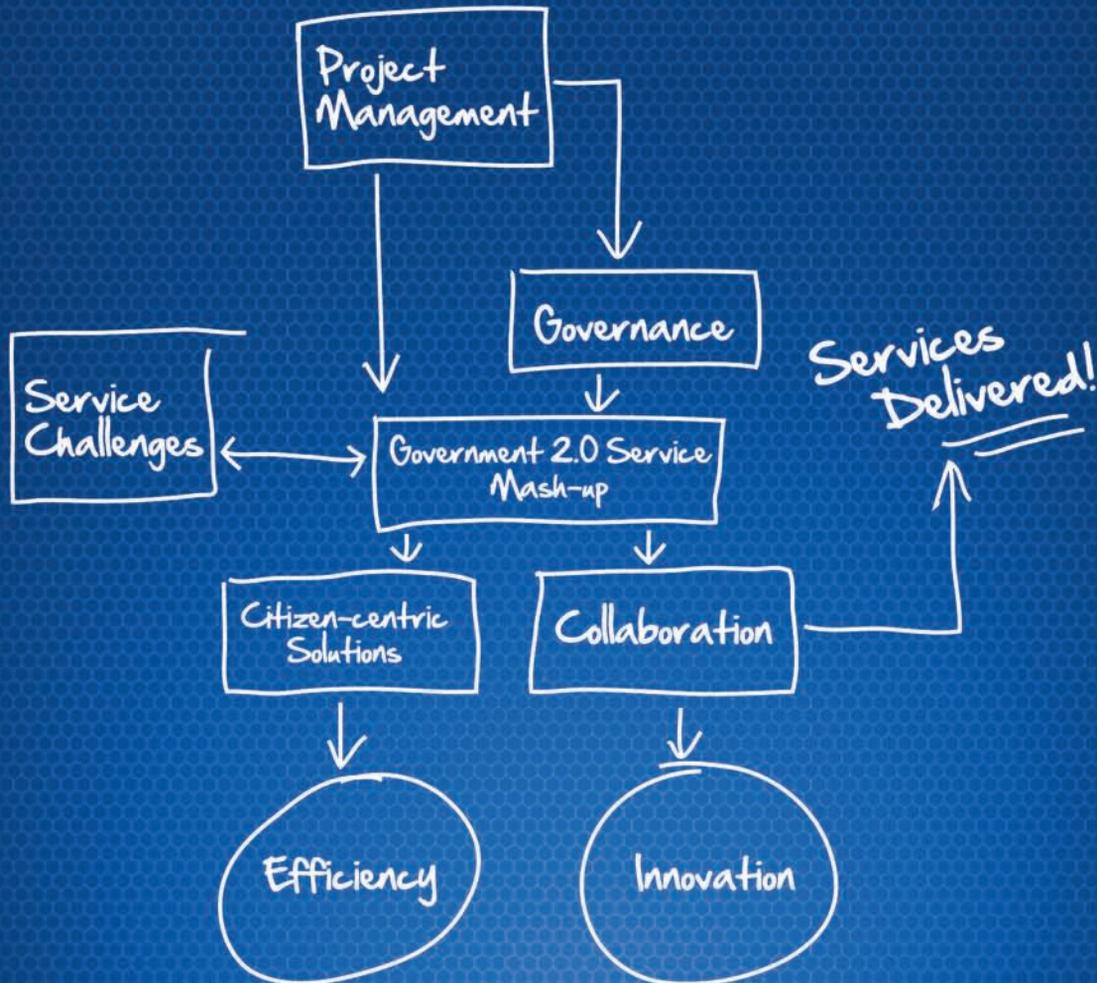
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