

J.R. Huston Enterprises, Inc.

From: J.R. Huston Enterprises, Inc.

POC: Jim Huston

Rev date: 10-23-2003

Format: MS Word

TOPIC: Negotiating with customers (**Junk yard dog school 101**)

Introduction

Negotiating with customers, whether they are commercial or residential ones, is a learned skill which is as much an attitude as it is a skill. However, to become proficient at it, you have to know your facts and know them cold. Why do you need to know them cold? Because if you don't, you won't be ready for the customer from "hell" who will cost you thousands of dollars, lots of sleep and possibly your livelihood.

Knowing your facts (the product, service, cost break-even point, schedule, etc.) produces confidence. And confidence is power in the negotiating process. Confidence based on thorough preparation is a negotiator's best asset.

I have clients that give the farm away when they enter a negotiating situation. I threaten to send them to junk yard dog school where we can toughen them up. They're too easy. They need to visualize what they are doing so I jokingly tell them, "You're taking food right off your family's kitchen table." Or, "There went your kids' college education." And if I want to really make it hurt, I tell him he just blew away getting that new Bobcat 753 or Ford F-250 pickup truck.

Think of it this way. How much money would the extra 2-3% (and that's conservative) that you could add to your jobs through more effective negotiating add up to during your career? If you sell \$300,000 per year for 20 years it is an extra \$150,000. And that is pure profit. That is \$7,500 per year, which would make a nice retirement contribution.

Steps to negotiating better: I assume that you are technically proficient and that you know what you are doing in the field. You aren't trying to pull the wool over anybody's eyes, especially your own. Here are some helpful guidelines that my clients have found helpful.

1. Know your job: Building confidence starts with thoroughly knowing the product or service that you are going to provide to the customer and knowing that you can deliver it on time and on budget. In like manner, know your limits. Don't promise something that you cannot perform. Under promise and over deliver are two principles that you as a contractor should live by. Set the

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tone at your first meeting with the customer. And show up on time and be prepared. Call this professionalism, if you will, but it gives you negotiating leverage.

2. Know your bid: A thorough bid that includes all of your direct costs, administrative overhead costs, general conditions, net profit margins, break-even point, etc. is essential in the negotiating process. If a customer thinks that the price is too high, ask what item or size would they like to reduce. This is called “value-engineering”. Ask the customer, “How can we value-engineer this project? What specifically can we change or phase in?”

Always link a reduction in price to a reduction (value-engineering) in the product or service provided. Never lower your price without value-engineering the scope or size of the project. Present recommendations for down sizing plants, using alternative less expensive materials and/or spreading a project over 2-3 phases. Anticipate price objections and plan your response before you get in front of the customer. Be specific and go over the bid item by item to show the customer where you can make changes without sacrificing the aesthetic quality of the project. Don’t give away the farm like our earlier contractor. And always link a decrease in price to a decrease in the scope of the project.

The break-even point is one of the most important bidding tools for a contractor to understand. It is the sum of the direct costs (materials, labor, labor burden, equipment, subcontractors, sales tax) in a bid plus the G&A overhead cost allocated to the job. Defined another way, it is the price for the job minus the net profit in the bid.

$$\begin{array}{r} \text{Direct costs} \\ + \text{G\&A overhead} \\ \hline \text{Break-even point (BEP)} \\ + \text{Net profit margin} \\ \hline \text{Price for the job} \end{array}$$

Once you know your BEP, you know when to say when. The owner’s salary is usually in G&A overhead. So if you want to take food out of your family’s mouths, bid your work at or below your BEP. In today’s market, you should almost always add 10 to 20% net profit margin on top of your BEP to arrive at your price.

3. Know your client: A client told me this story. He had just sold a \$30-40,000 landscape installation project to an attorney. As he walked out of the attorney’s house with signed contract in hand, he noticed for the first time the license plate on the attorney’s car. It read, “SUE EM”. My client wanted to tear up the contract. Had he noticed the plate before, he probably would have not taken the job. At least he would have put a lot more net profit on the job and a contingency factor.

Smart generals choose their battles wisely. The jobs (battles) that you avoid are often the most

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important. Do your homework. Study and listen to your customers. And don't be afraid to walk away from a job.

Try to obtain the budget for the project that the client has in mind. This is often difficult but if you can find out the price range that the customer has in mind, it will greatly simplify the negotiating process. At your first meeting, ask the client outright what their budget is. If this does not work, suggest a ballpark figure (make sure it is high) for the project, once you understand it. Ask them if your ballpark budget figure is what they had in mind.

Is the customer a referral or a repeat customer? If they are, you should add 5 to 10% more net profit margin on to the bid. This brings us to a discussion of gross profit margin.

4. Know your market: Gross profit margin (GPM) is the best indicator of different market segments. GPM is defined as the price for a job minus all direct costs. Or it is the sum of the G&A overhead allocated to the bid plus the net profit margin. Why is it important?

$$\begin{array}{r} \text{G\&A overhead} \\ + \text{Net profit margin} \\ \hline \text{Gross profit margin (GPM)} \end{array}$$

The GPM normally seen on commercial installation jobs around the country is 25% +/- 5%. Negotiated commercial installation jobs usually have a GPM in the 25 to 30% range. Jobs where four or more other contractors are bidding them, usually have a GPM in the low 20% range. In times of a recession, the GPM will drop 5 to 10%.

The GPM on residential installation jobs around the country is usually 35% +/- 5%. Large projects over \$100,000 usually have GPMs in the low 30% range. Smaller projects usually have a GPM in the high 30% range. I have seen this market drop to the 17 to 23% range in times of recession.

Commercial and residential maintenance jobs usually have a GPM of 32% +/-5%. It can drop to the mid to high 20% range during a recession.

When negotiating work, it is important that you know these GPM ranges and where your bid falls in respect to them. Our Bid Board/Lead Tracker software tracks the GPM, and other crucial information, on all jobs bid. Knowing that your bid is within acceptable norms gives you confidence when negotiating with someone who is trying to manipulate, and nickle and dime you to death. It helps you to confidently stand your ground.

Remember that, as a general rule, repeat business in the residential or commercial market is not only your least risky work, but it is also the most profitable work that you will do. You should make it a goal to do as much repeat work for the same customer as possible. Negotiating this

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work is easier too. Do less work and make more money. Sounds like a smart formula does it not?

5. Know your company: The GPM on jobs bid and installed at the end of the year can and often should be bid differently from that on work bid mid-season. If you are running out of work and need to fill up your production schedule, it's time to sharpen your bidding pencil and negotiating skills. Are your sales on budget or are you ahead or behind in sales? All of these things affect negotiations and how flexible you should be when negotiating.

If work is plentiful and GPMs are high, why fill up your schedule with cheap work? You can afford to be fussy. However, if there is lots of competition, margins are tight and you need work; it is time to get creative at the negotiating table.

Put the job being negotiated in proper perspective by asking, "How does this job add to my bottom line?" If it is work bid and installed at the end of the season and you have no other work to replace it, be aggressive, lower your desired margins and negotiate accordingly. In this scenario, it is better to have 20% of something than 30% of nothing.

Using this logic, winter work can be realistically bid with slim margins. However, do not negotiate away your margins unless you absolutely have to in order to get the work. Normally, I never like to negotiate below the break-even point. However, winter work can be different. Think how a particular job being bid can impact your bottom line.

G&A overhead on a bid pays the rent, owner's salary, light bill, advertising, etc. Direct costs cover costs related to materials, sales tax, field equipment, direct labor and burden, and subcontractors. The net profit margin put on a bid is free and clear money. It is used for capitalization, bonuses, new acquisitions, expansion, etc. In a tight market (i.e., winter work) when there is little or no work, it is the first thing to be lowered. G&A overhead is next. Let me give you an actual example.

A client on Cape Cod had an opportunity to bid on a winter tree pruning contract that would last about two months for a 3-man crew. His price with a 30% GPM normally would have been about \$40,000. He knew the owner of the project and he also knew that if he could lower his price to about \$28,000, he would get the job. He had little or no other work scheduled during the winter period when the pruning would be done. He asked me if he should take the job at around \$28,000, which would only cover his direct costs? There were no material or subcontractor costs associated with the job.

The key was that he could not replace this "cheap" job with more profitable work. However, even this job added to the bottom line. First, it paid for some equipment costs, which were bid into the job. And the payments he would have had whether the equipment sat in the yard or was being used. Second, he kept his crews busy and billable. He also probably eliminated some downtime labor costs because he would have had some of the crew do "busy work" around the

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office. The crew leader was the division manager who was on salary as a G&A overhead expense year round. Putting him in charge of the crew and out in the field for two months would save the company about \$6,500 in G&A expense. The labor burden in the bid would not just cover associated payroll taxes and insurances, it would also help pay for field labor's medical insurance, holidays and vacations. These expenses the company would have had whether it got this job or not.

Perhaps one of the biggest considerations, which was hard to quantify, was the cost of laying off personnel in the winter, possibly losing them to another company and having to start in the spring with new untrained and/or unproven personnel. This job would not only have kept the crews busy most of the winter, it might very well have kept the crew with the company.

Our conclusion was that this contractor should take this job even at a direct cost price. It would add to his bottom line as it would cover expenses that no other job would cover and that he would have with or without the job. It would also be a big motivator for the crew.

Additional tips to put in your negotiating “bag of tricks”

Know when to say “when”. This is crucial. The break-even point and gross profit margin figures will help you know where to draw your “line in the sand” when negotiating.

Giving the customer too much information can kill you. Provide the customer with the price, quality standards, specifications, schedule, etc. but be careful. Do not give them too much non-essential data. One client told his customer, when asked, the number of labor hours in his fixed price bid. Every day this customer was at the job site looking at his watch. At the end of the job, he disputed the number of hours that it took the contractor to do the job and he refused to pay the full contract price. This contractor set himself up for disaster. The number of labor hours to do a project in a fixed price contract is no ones business but the contractor. He should never have shared this information.

Unit prices can cause problems. I like to present and negotiate unit price contracts but with one caveat. I tell the customer that this is not a shopping list to take to Wal-Mart. If they change the quantities +/- 10%, I reserve the option to re-price the job and items. This ain't Wal-Mart.

Phasing: If the customer cannot afford the whole project as priced, offer to spread it out over a couple of years in phases.

Phase discounts: If a customer is thinking about spreading a project over 2-3 phases, offer them a 5% discount if they do it in one phase. Bid the project as if it were going to be done in phases. However, because the extra general conditions, mobilization and start up costs usually comprise 6 to 10% of the phase price, you can legitimately offer a 5% discount because you will probably save that amount if you do the project in one phase.

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Let your price do your talking: Take the high road when it comes to negotiating. Don't argue with customers about your prices. If they think that your price is too high and you do not want to drop it, let your price do your talking. Tell them that is the price that you need to get to cover costs and to make the project worthwhile. Offer names of other contractors that they might want to talk to. I tell my clients, if they need to, to blame me and to tell their customers that they have an idiot consultant in Colorado who says that this is what they need to get for the job. Of course, I tell them not to give out my name, address or telephone number.

The customer from "hell": We have all experienced it. Some customer's, both commercial and residential, main goal in life is to put the screws to you. I know clients who have lost tens and hundreds of thousands of dollars due to one customer from "hell". One client lost \$90,000 and it took him two full seasons to make it up. You cannot guarantee that you won't have a bad experience with a customer. However, thorough preparation and objective reference points that help you to negotiate and know when to say no are a contractor's best defense against the customer from "hell".

Rehearse: Do not be afraid to get in front of a mirror and/or rehearse what you are going to say to the customer. Practice scenarios and responses to objections and questions. Realize that you have a great product or service to offer to the customer. You just have to arrive at a mutually satisfactory price. Make it fun. Practice, practice, practice! You can do it.

After college, I sold fire alarms door to door and had to make lots of "cold" telephone calls. It scared me to death. My sales director gave me a phrase to memorize. "Do the very thing you fear and fear itself will disappear." I got to the point where I would assault a telephone or strange door because I was conquering my fears. Today, I love cold calls.

Conclusion: Attend junk yard dog school

Do your homework. Contractors who know their business and their numbers, exude confidence at the negotiating table, whether it is at the kitchen table or the conference board room table. Contractors who do not know their business and numbers often appear like the village idiot at a carnival when it's time to negotiate. If you know how to bid with confidence, you will have the foundation to negotiate with confidence. Too many contractors throw numbers around during negotiations, which are pulled out of thin air. Their presentations usually reflect it. If you do not have confidence about bidding and the numbers in your business, make plans to learn about them.

Negotiating effectively, or more effectively, will add thousands of dollars to your bottom line throughout your career. It is primarily an attitude based upon objective reference points, which you can learn and understand. I am amazed at how much my clients negotiating skills improve once they are provided with the proper tools to do so. And remember, if you fail to learn how to

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negotiate effectively, the job that you lose might not just be that new potential award-winning design/build residential project that you just heard about. It could very well be the job that you show up for every morning.

This article was adapted from James Huston's new book and audio book, *How to Price Landscape & Irrigation Projects*, released in July 2003 and his previous book, *Estimating for Landscape & Irrigation Contractors*. The author is president of J.R. Huston Enterprises, Inc., which specializes in construction and services management consulting to the Green Industry. Mr. Huston is a member of the American Society of Professional Estimators and he is one of only two Certified Professional Landscape Estimators in the world. For further information on the products and services offered by J.R. Huston Enterprises, call 1-800-451-5588, e-mail JRHEI at jrhei@jrhuston.biz or visit the J.R. Huston Enterprise web site at <http://www.jrhuston.biz>.